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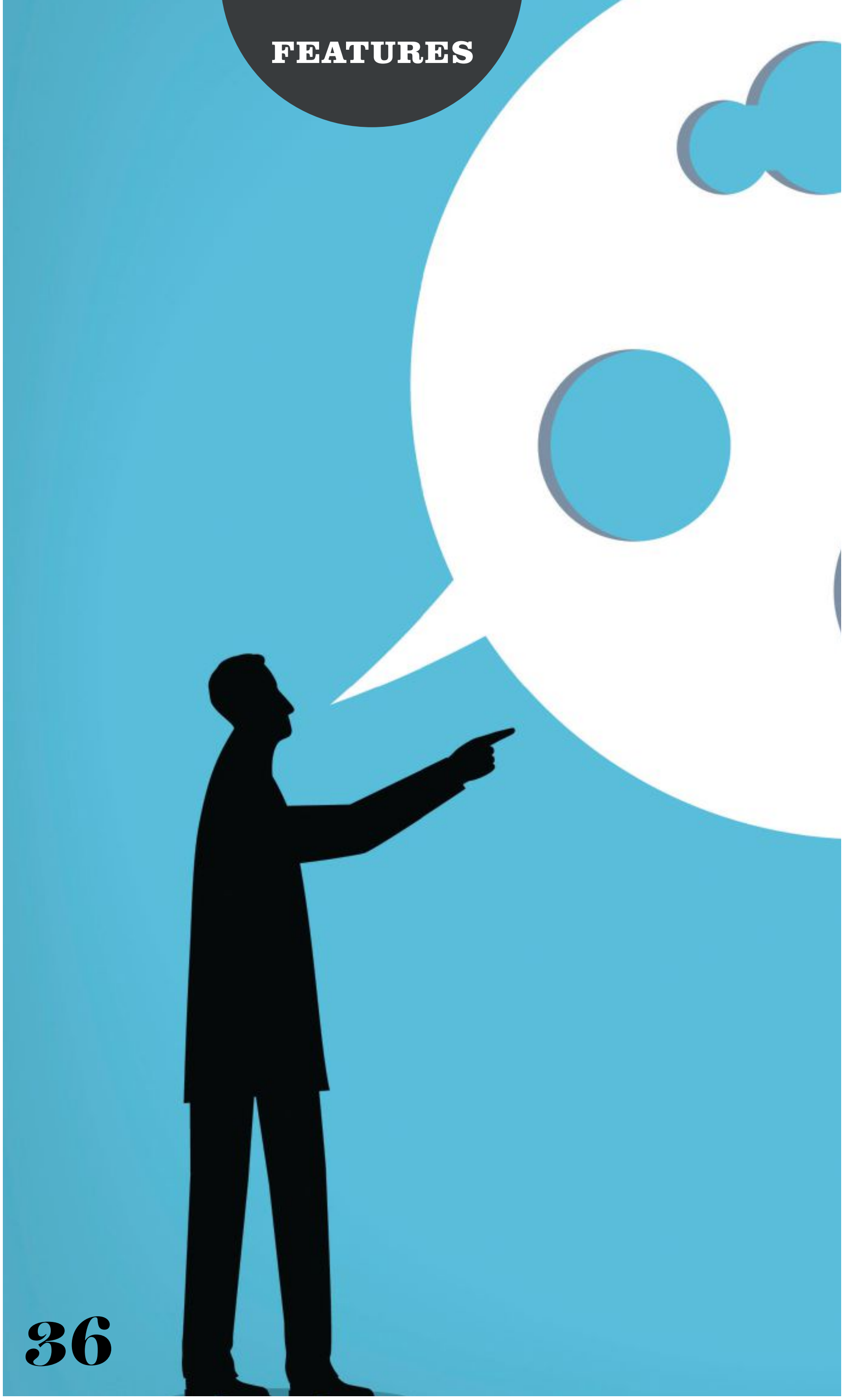
CLINTON v. TRUMP

WHO'S BETTER FOR BUSINESS?

FEATURES

October 2016
Volume 32, No. 8



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CONTENTS

October 2016
Volume 32, No. 8

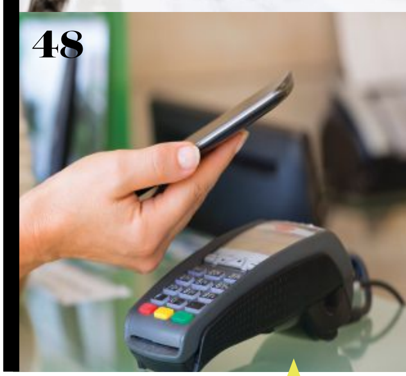
Up Front

12

12

22

48



By the Numbers

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FROM THE EDITOR

Vote for Growth

›› I'm writing this column on the eve of the first U.S. presidential debates, and the race appears to be tightening. Among CFO readers in an unscientific survey in September, however, the race wasn't close at all. The survey respondents clearly favored Republican candidate Donald Trump over Democratic candidate Hillary Clinton.

The choice is hard to fathom, unless (a) Trump supporters, given their stridency, were much more motivated to fill out our survey or (b) chief financial officers are disgusted with U.S. politics and want an outsider, any outsider, to be the next president. There are many other unsavory possibilities, but we shudder to think that a person as intelligent as the average CFO would not vote for Clinton (a) because she is a woman or (b) because she is not calling for deportation of immigrants.

The fact is that Hillary Clinton is far from the ideal candidate for U.S. president. I'm sure CFOs can easily see the contrast between their own highly accountable roles as finance chiefs of public companies and Clinton's lack of accountability as U.S. secretary of state for a rogue email server.

But a Trump presidency, I think, will set U.S. multinational businesses back 40 years or more. Do U.S. companies really want to be penalized by the federal government for opening manufacturing sites in Mexico? Or face a global market in which tariffs are slapped on their goods because foreign companies are forced to retaliate against isolationist U.S. trade policies? Or find themselves in an economy deprived of the stimulus young immigrants bring when they emigrate here and start consuming U.S. goods and services?

The country can do better than the candidate either major party has nominated. But given a choice between the two in November, I hope CFOs vote for a forward-thinking, highly qualified candidate whose policies will keep the economic engine steaming ahead, and not one trumpeting protectionist policies that would assuredly constrict the growth of U.S. businesses inside and outside our nation's borders. A clearer choice for president has rarely existed.

Vincent Ryan
Editor-in-Chief

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EDITOR'S PICKS

PERFORMANCE

CFO's Corporate Performance Management Summit takes place in Miami on January 25-26. This year's theme is "Accelerating CPM." Speakers include the CFO of Firehouse Subs, the head of finance at Swarovski, and the vice president of global procurement for the NBA. For more information, go to https://theinnovationenterprise.com/summits/corporate-performance-management-summit-miami-2017.

DECISION MAKING

When should you trust your gut? Almost never, at least when making business decisions, according to Nobel laureate Daniel Kahneman and psychologist Gary Klein. Read a McKinsey Quarterly interview with them at http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/strategic-decisions-when-can-you-trust-your-gut.

Mark Bennington

LETTERS

Big buyers may hold most of the cards over smaller suppliers when it comes to extending payment terms, but there are ways to mitigate the fallout to the latter, argued postdoctoral research fellow Spyros Lekkakos in **"How Delaying Payments Can Help Suppliers"** (CFO.com, Aug. 12).

Lekkakos characterized two arrangements as workable solutions to cash-hungry suppliers increasingly getting stuck with extended payment terms by their big customers: (1) buyers, based on the cash efficiencies gained from the extended terms, reward suppliers with larger volume deals (Unilever's experience was given as an example); and (2) "reverse factoring," where the buyer pays its invoices to a bank at the extended terms, but the bank pays the supplier early, charging a fee for the service.

A number of suppliers who read the article were not impressed, to say the least. "B.S.!" cried one. **"Big fleas have little fleas on their backs to bite 'em, and little fleas have smaller fleas and so on ad infinitum.** Just pay up and on time."

Getting more specific, another reader commented that "the suggestion that efficiencies captured by Unilever were passed on to suppliers in the form of higher order volumes [and that this] was, in effect, a win-win ... is laughable. Anyone with an ounce of experience [who] is getting the best value out of key supplier relationships knows that **extending payment terms through coercion is counterproductive, erodes trust, and promotes cheating or guile from suppliers."**

Another commenter suggested that, "maybe the author can tell his employer he can wait 90 to 120 days for his paycheck."

THE BUZZ

Perhaps these readers were incited by the article's headline, which may have overstated the author's case. He posted a comment that defended the article in several respects. For example, he wrote, "The article does not claim that extending payment terms to SME suppliers is something good. On the contrary, it clearly states that [the] supply chain is always better off when there is no terms extension."

Correction:

The first paragraph of our September story on robotic process automation ("Robots, Robots Everywhere") unwittingly transposed a pair of words. It defined the "singularity" as the prophesied moment when "humans become smarter than machines." Actually, the singularity would occur when machines became smarter than humans.

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Topline

STATS OF THE MONTH

HOMEFRONT

31%
Non-retired persons in the U.S. who have no retirement savings or pension

42%
Households with an annual income of below $40,000 in the last 12 months

$12,000
Median higher education debt for adults with an outstanding student loan

46%
Adults who had a major medical expense in the past year and owe debt from that expense

Source: Federal Reserve Report on the Economic Well-Being of U.S. Households, May 2016, based on a survey of 5,695 U.S. adults

ACCOUNTING

SEC Wages War On Non-GAAP Metrics

The commission is leaving no doubt that misuse of non-GAAP financial measures is in its crosshairs.

Companies haven't wasted any time in reacting to a series of compliance and disclosure interpretations (C&DI) on the use of non-GAAP metrics that the Securities and Exchange Commission issued on May 17.

Law firm Debevoise & Plimpton analyzed 100 earnings releases issued since then by *Fortune* 500 companies that included presentations of two or more non-GAAP financial measures plus guidance on at least one such measure. Among these earnings releases, 79 contained modified disclosures compared with those made in previous earnings releases.

The use of non-GAAP metrics has proliferated in recent years. The C&DI's reflected the SEC's concern that the way companies are using such metrics may be misleading to investors.

Companies are allowed to use non-GAAP metrics. When they do use them, however, SEC regulations require them to also provide, "with equal or greater prominence," a presentation

Non-GAAP Presentation Changes
% of earnings releases with change

Presentation of GAAP and non-GAAP metric reordered to present GAAP metric first	36%
Non-GAAP metric replaced with comparable GAAP metric in same location	29%
Augmented/modified non-GAAP reconciliation disclosure	29%
Supplemented non-GAAP discussion with GAAP metrics	18%
Non-GAAP metric no longer discussed or highlighted in CEO quote	15%
Non-GAAP metric omitted from entire earnings release and/or replaced with a comparable GAAP metric	10%
Added disclosure indicated that an omitted non-GAAP reconciliation was not available without "unreasonable efforts"	10%

Source: Debevoise & Plimpton analysis of 100 earnings releases issued by *Fortune* 500 companies since May 17, 2016 of the most directly comparable financial measures calculated in accordance with GAAP. They also must provide reconciliation between the non-GAAP measure (adjusted EBITDA or free cash flow, for example) and the most comparable GAAP measure (net income or operating cash flow).

"The members of the commission have been focused on this for more than a year," says Matthew Kaplan, co-head of the capital markets group at Debevoise & Plimpton. "They're not saying you can't highlight non-GAAP metrics. They're saying you can't give them undue prominence."

In response to the CD&I's, companies have made many different reporting changes (see table, page 8).

Since issuing the interpretations in May, the SEC has continued to turn up the heat, sending more than 30 comment letters to companies about their use of non-GAAP metrics. The commission also reportedly conducted a sweep of earnings releases that resulted in letters to many other companies.

In addition, on Sept. 8 the SEC charged the former CFO and former chief accounting officer of American Realty Capital Properties (now called VEREIT) with misuse of a non-GAAP measure.

The case is notable because of its extreme rarity. Kaplan conducted a search and could find only one prior such action. That was a 2009 case against SafeNet, a provider of identity and data-protection solutions.

In both cases, the misuse of non-GAAP metrics was "egregious," according to Kaplan, involving much more than simply the way the metrics were presented.

But, says Kaplan, companies shouldn't rest easy just because they are merely falling short of presenting non-GAAP metrics appropriately and not acting with nefarious intent.

"Whether a number is inflated or the disclosure just fails to comply with SEC guidance, the SEC views either as problematic." says Kaplan.

A July blog post by Audit Analytics suggested that if non-GAAP reporting "isn't topic number one among regulators, it must be close." **DAVID McCANN**

CAREERS

The Optimal CFO? It Depends

Finance chiefs with accounting backgrounds aren't well suited for high-growth industries, on average, new research shows.

A paper in the Journal of Accounting and Economics documented the results of a study of 2,524 and 2,546 "firm years"—one year for one company—in low-growth and high-growth industries, respectively, between 2000 and 2010. "Accountant CFOs" were identified as those with CPAs or experience working as an external or internal auditor or controller at some point before their appointment as CFO of a publicly held company.

During the study period, "high-growth industries" included business services (which incorporates software), electronic equipment, and pharmaceuticals, while transportation, oil/petroleum, and heavy machinery were low-growth industries.

The results were stark. Accountant CFOs in high-growth industries were associated with 7.4% lower investment expenditure and a 14.6% lower likelihood of engaging in external financing. "Lower investment in risky projects and limited exposure to capital markets are both consistent with greater risk aversion on the part of accountant CFOs," wrote the authors, Rani Hoitash of Bentley University, Udi Hoitash of Northeastern University, and Ahmet Kurt of Suffolk University.

On the other hand, for companies in low-growth industries whose revenue was increasing, accountant CFOs were associated with 19% greater cost efficiencies.

"Because low-growth industries offer limited expansion opportunities and require greater cost efficiency to maintain a competitive advantage, firms in those industries may benefit from greater risk aversion," the authors wrote. "In high-growth industries, however, a more conservative corporate investment strategy may hinder value creation."

Another research result bore out that last statement. Company value—as measured by Tobin's Q, or the ratio of the market value of a company's assets to the replacement cost of those assets—was 3.7% higher among low-growth-industry firms with accountant CFOs. But at high-growth-industry firms with accountant CFOs, company value was 4.4% lower.

The study's results could have been somewhat different if data from recent years were included, Kurt acknowledges.

"After Sarbanes-Oxley, companies wanted CFOs with stronger accounting backgrounds," he notes. "Many companies may be realizing that's not working out for them, because they're hiring fewer and fewer accountant CFOs." **D.M.**

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COMPENSATION

Top CFOs' Pay Rises 18.7%

The compensation for finance chiefs at America's top companies has grown 18.7% over the past five years, with performance-based equity significantly increasing its share of the pay package, according to a new survey by Equilar.

The research firm reported that median CFO total compensation in the S&P 500 rose from $2.9 million in 2011 to $3.4 million in 2015. That growth outpaced pay for CEOs, which increased 16.9% to $10.4 million during the same period. Total CFO compensation at the 25th percentile saw the most growth, increasing 26.3% from $2.0 million to $2.5 million.

According to Equilar, finance chiefs in a wide variety of sectors have benefited from the pay growth, with median compensation increasing more than 9.5% in consumer goods, financial, technology, and utilities from 2014 to 2015. On the other hand, health care, industrial goods, and services companies reduced pay by more than 4.5% at the median.

As far as pay components, the most notable trend identified in the survey is the growing prominence of equity pay contingent on performance.

"In the wake of Dodd-Frank and the passing of 'say on pay,' equity compensation contingent on performance goals has become the primary vehicle in executive pay packages because it philosophically aligns executive incentives with company growth and shareholder value," Equilar said.

Highest-Paid CFOs, 2015*

Company	CFO	Total Compensation† (in $mil)
CBS	Joseph Ianniello	$26.4
Apple	Luca Maestri	$25.3
Goldman Sachs	Harvey Schwartz	$20.5
Facebook	David Weiner	$16.8
Yahoo	Ken Goldman	$15.0

* S&P 500 companies

† Includes salary, bonus, grant-date fair value of stock and options awards, and other compensation, but excludes pension and deferred compensation

Source: Equilar

Over the past three years, in fact, performance-based equity has pulled away as the most prevalent equity vehicle, with 78.7% of S&P 500 CFOs receiving these awards as part of their equity package in 2015, compared with 64.1% in 2011.

MATTHEW HELLER

TECHNOLOGY

Smartwatch Sales Sink

Worldwide sales of smartwatches plummeted in the second quarter of 2016, according to preliminary data from International Data Corporation's quarterly Wearable Device Tracker report. Vendors shipped 3.5 million units that quarter, down from 5.1 million one year ago.

Apple took the biggest hit, with sales of the Apple Watch down 55% with 1.6 million units shipped. Apple's market share also slipped, to 47% from 72% one year ago. No other vendor in the top five saw an annual decline in sales. Samsung, the market's distant number two player, saw a 51% increase in units shipped, and Lenovo, in third place, increased smartwatch shipments 75%.

"Consumers have held off on smartwatch purchases since early 2016 in anticipation of a hardware refresh, and improvements in WatchOS are not expected until later this year, effectively stalling existing Apple Watch sales," stated Jitesh Ubrani, senior research analyst for IDC Mobile Device Trackers.

IDC does expect the overall smartwatch market to begin growing again, but it will take some product innovation. "Continued platform development, cellular connectivity, and an increasing number of applications all point to a smartwatch market that will be constantly changing," said Ramon T. Llamas, research manager for IDC's Wearables team.

Vendors must also develop a better use case, says the report. In addition, participation by traditional watchmaker brands "is imperative to deliver some of the most important qualities of a smartwatch sought after by end-users, namely design, fit, and functionality." **VINCENT RYAN**

HEALTH CARE

Specialty Drugs Driving Costs

According to reports released in August by the National Business Group on Health (NBGH) and Willis Towers Watson, overall health benefits costs (the cumulative total borne by employers and passed to workers) for large companies are projected to increase by 5% in 2017.

That figure incorporates changes to health plan design that employers are expected to make to keep health care cost hikes at bay. Without those changes, such costs would rise by 6%, the two organizations say.

According to NBGH's annual surveys of large employers, the expected increase for 2017 is about the same as that experienced in the past few years. Willis Towers Watson data, on the other hand, shows health cost hikes as having hit a nadir since the turn of the century of about 4% from 2013 to 2015, so the forecasted 5% rise represents an uptick.

In this year's NBGH survey, for the first time, specialty pharmaceuticals were identified as the biggest driver of health costs. Among 133 respondents, 80% placed such drugs as one of the top three cost drivers, followed by high-cost claimants (73%) and specific diseases and conditions (61%). In addition, 31% of the NBGH survey participants specifically identified specialty drugs as the top culprit in rising costs. As recently as 2014, only 6% of those surveyed did so.

Pharmaceutical costs, which on average account for 15% to 20% of employers' medical spending, are rising twice as fast (about 10%) as overall health costs, according to multiple published reports. But a majority of that rise is attributable to the specialty drug category. Many drugs for treating cancer and other severe conditions now cost $10,000 a month or more. **D.M.**

CASH MANAGEMENT

Deeper Disclosure Needed?

From current financial reports, it's impossible to tell whether companies are parking cash in prime or government money market funds. So, in light of money market fund reform, corporations that heavily rely on money funds for cash management may need to enhance disclosures and risk management, according to a report from Fitch Ratings.

Regulatory changes to money funds coming into effect on October 14 are expected to cause some U.S. companies to re-examine their comfort level with prime money market funds. That's because the reforms allow institutional prime money funds, in particular, to restrict an investor's liquidity during times of stress.

The rules, created in response to disruption in money fund markets during the financial crisis, allow a fund's board of directors to impose liquidity fees on shareholders looking to redeem cash, or to restrict fund redemptions altogether, if the fund's liquidity level falls below the required regulatory threshold.

The restrictions are going to cause some treasurers to shift excess cash into government money market funds, which typically hold low-risk government and municipal debt securities. They are not subject to the new regulations.

Nonfinancial corporates historically have been big investors in money funds in absolute terms, holding $573 billion in money fund investments as of the end of the first quarter of 2016, according to Federal Reserve data.

Fitch's analysis of the nonfinancial firms in the Fortune 100 showed that 33 noted investments in money funds and 22 disclosed the amount invested in money funds. For the 22 firms that disclosed investments, money funds accounted for 26% of their cash and cash equivalents on average. Walgreens, for example, held $2.4 billion in money funds in the first quarter, which accounted for as much as 72% of its cash and cash equivalents.

According to Fitch, however, "it is unclear whether [companies] invest in prime funds, government funds, or both. For corporations that continue to rely on money funds, enhanced disclosures and risk management will be important to appropriately monitor key weekly liquidity measures in prime funds." **V.R.**

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Will Insurers Embrace Innovation?

Technology can change the relationship between the insurer and the insured. **By Vincent Ryan**

At an Advisen insurance industry conference in September, a speaker asked the rhetorical question, "Is insurance industry innovation an oxymoron?" Certainly few would argue that insurance never innovates. But few would also characterize the industry as a hotbed of creativity and inventiveness. ¶ One problem, according to a new study, could be the risk-averse culture. The study surveyed 500 retail financial services and insurance industry executives across 56 countries to examine the challenges they face in a time of rapid technological change. The survey was conducted on behalf of Pegasystems and Cognizant.

Nearly every respondent (98%) said that insurers, in order to innovate, need to "think beyond traditional boundaries" and "identify new ways of meeting customer needs." But 61% also said their governing boards would tolerate a maximum failure rate for innovation pilots of only 30% or less. To cultivate a culture of innovation, "a 50% failure rate should be the absolute minimum," says Graham Lloyd, director and industry principal of financial services, Pegasystems.

The "safety-first" culture seems deeply rooted. But innovation is coming, driven from two directions. The first is digitally savvy new entrants into financial services, the so-called fintech players. More than one-third of survey respondents said these competitors would be "massively" or "significantly" disruptive to the industry.

And why will they be able to disrupt insurance? The reason is the second driver, the customer base. Banks and insurance companies will have to change their operations significantly over the next five years to keep pace with young customers. By 2020, the report says, U.S. millennials will have annual spending power of $1.4 trillion. One study found that millennials would be more excited by new financial services offerings from Google, Amazon, Apple, PayPal, or Square than from their own banks.

Beyond the 'Grudge' Renewal

In insurance, innovation (as far as it is visible) will be about strengthening the connection with the customer, whether a business or a person. Insurance buyers tend to have very low expectations for the relationships currently. As one corporate risk manager said at the Advisen conference, "Everything that makes you select a carrier depends on the payment of claims. Everything before the claim is the pre-season. If the claim isn't fairly managed, nothing else matters."

To get the insurer–insured relationship to something more than an annual renewal—a "grudge" purchase dominated by price—or the stress point of a claim, the Internet of Things (IoT) is going to play, and is currently playing, an important role. Of the potential for the IoT to change insurance, the Pegasystems report says the following: "For the under-pressure insurance industry, the IoT will undoubtedly be a data shot in the arm. A sector that has seen margins shredded by a fire-storm of price-driven competition and spiraling claims costs is being presented with a one-time-only opportunity to reinvent itself."

That reinvention will be about having the capability to capitalize on data flows from sensors embedded in vehicles, household appliances, buildings, personal fitness trackers, and other connected devices. These data inflows will provide data-driven insights to better manage risk, identify the insured's unmet needs, offer "dynamic pricing based on actual customer behavior," and allow insurers "to finely calibrate their risk exposure."

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"By sharing the insights gleaned from a customer's day-to-day behaviors," according to the Pegasystems report, "insurers will be able to 'nudge' customers toward behaviors that reduce their daily risks." For example, an insurer could inform a driver that "their favored route to work has black ice and recommend safer alternatives, inform a driver when it is time for an oil change, or use data from a fitness tracker to advise a diabetic to test their blood sugar."

Beyond IoT, technologies such as smart contracts (computer protocols that facilitate, verify, or enforce the negotiation or performance of a contract) and blockchain (the technology underpinning bitcoin) have the potential to transform the costly claims process. In the survey, 47% of respondents expected that the settlement of insurance claims using IoT, the blockchain, and smart contracts would be mainstream within five years. "Drawing on data from IoT to validate a claim—evidence of rain damage to a crop—could then auto-trigger the filing of a claim, which is then promptly settled via a smart contract on the blockchain," the Pegasystems report explains.

Can technology end the eternal "soft" insurance market that carriers find themselves in? Maybe, maybe not. But insurers won't know unless they find the will to experiment with and embrace new technologies. CFO

Risk Factors Vex Tech

Cybersecurity, customer loss, and heightened regulation are among the top risks facing tech firms.

Five years is a long time in the technology industry, so perhaps it's not surprising that the risk profiles of major tech firms have changed markedly in that time.

In fact, some risk factors have become significantly greater concerns rather suddenly. For example, among the fiscal-year 2015 10-K filings of the 100 largest U.S. tech firms, 61 reported loss of a major customer as a risk factor, according to an analysis by BDO. Just a year earlier, only 44 did so.

A leading cause of that shift is accelerating merger-and-acquisition activity in several technology subsectors—like the semiconductor business, with Intel, Singapore-based Avago, and NXP all having completed big deals in 2015.

For many tech firms, the sale of components or solutions to other tech firms is a primary source of revenue, notes Aftab Jamil, leader of the technology and life sciences practice for BDO. When a major customer is acquired, that account may be in jeopardy. "If there is consolidation in your target sector, maybe instead of selling to five big customers you now have only three left," Jamil says.

The growing presence of M&A in the tech industry can also be seen in the steep rise of goodwill impairment as a risk factor in recent years.

Another risk factor that became more prominent in 2015 annual reports was loss of government contracts and incentives, reported by 57 of the 100 largest technology companies, up from 47 in 2014. "There is more competition for government contracts, and we have observed some cuts in defense-related spending and other federal budgetary constraints," says Jamil.

Two risks—cybersecurity and regulation—were cited by all 100 companies in their annual reports. The former completed a steady march upward in recent years; in 2011 reports, only 71% of the largest technology companies reported cyber risk.

That shift has occurred even though technology companies were the victims of only 2.6% of total reported data breaches since 2010, according to TrendMicro. While the kind of data tech firms have may be less useful to wrong-doers than that possessed by financial services, retail, and health-care companies, there is still a great focus on securing internal systems, Jamil says.

But other types of cyber risk are far greater for tech firms than for others. For example, protecting against theft or misuse of intellectual property is among the most important activities. "You can't lock up IP with a physical lock and key, and if somebody accesses it or infringes on it, the company's value can erode quickly and significantly," he notes.

Additionally, many tech firms are exposed to the risk that their products will contribute to breaches suffered by their customers. "Any cyber incident is the result of a vulnerability or flaw in technology," says Shahryar Shaghaghi, leader of BDO's technology advisory services practice. "While the onus is partly on the user entity to implement appropriate protocols and policies, the technology manufacturer or service provider does share in the blame—whether warranted or not."

Regulatory risk, meanwhile, has always been of great concern for the tech industry. One topic that is currently on the minds of many industry CFOs is the new revenue recognition rules slated to take effect in 2018. In BDO's most recent Technology Outlook Survey, 31% of technology finance chiefs admitted that they're still trying to understand the changes.

Jamil characterized that result as "somewhat disappointing," because the new standard was finalized in 2014 and its effective date was delayed for a year. **DAVID McCANN**

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The Wide Wide World of IoT

Think CRM and ERP were transformative? The Internet of Things promises to bring far more dramatic change to business. By Timothy Chou

Many people think the Internet of Things (IoT) is about your toaster talking to your refrigerator. While there will no doubt one day be very useful consumer IoT applications, more immediately there are many industrial applications, and many more potential ones, to consider. This article constructs a framework for precision technology—that is, an organization of the technologies that will enable the building of precision machines.

Most first- and second-generation enterprise software was focused on us—people, whether individuals or groups. Applications were designed to help people do something useful, like buy a book, issue a purchase order, recruit employees, or communicate with others. But things are not people. That may seem obvious, but there are at least three fundamental differences that matter for purposes of this discussion.

There are a lot more things than people. These days, you can't be on the Internet and not see some pronouncement about how many things are going to become connected. John Chambers, former CEO of Cisco, declared there will be 500 billion "things" connected by 2025. That's about 70 times the number of people currently living on this planet.

Things can tell you more than people can. The main mechanism people use to communicate with applications is a keyboard, and most applications use some kind of form to collect simple data from people. Things, by comparison, may have many sensors. A typical cell phone has about 14 of them, including an accelerometer, a GPS, and even a radiation detector. Industrial things like wind turbines, gene sequencers, and high-speed inserters can easily have 100 sensors.

Things can talk constantly. People don't actually enter data all that frequently into Internet of People (IoP) applications for e-commerce, human resources, purchasing, customer relationship management, or even enterprise resource planning. But a utility grid power sensor can send data 60 times per second, a construction forklift once per minute, and a high-speed inserter once every two seconds.

IoP Applications

The first generation of enterprise application software from SAP, Oracle, Siebel, PeopleSoft, and Microsoft leveraged the availability of low-cost, client-server computing to automate key financial, HR, supply chain, and purchasing processes. The business model was based on licensing the application software, and the purchasing company was left with the responsibility (and cost) of managing the software's security, availability, performance, and any updates or upgrades.

Around 2000 there came the second generation of enterprise application software. It was largely differentiated by a fundamental shift in the delivery model. The software provider took on the responsibility of managing the software, and with that change came a change to the business model.

Rather than an upfront licensing fee, a software-as-a-service (SaaS) model emerged, which allowed customers to purchase the service monthly or annually. Key business suppliers from this era included Salesforce.com, WebEx, Taleo, SuccessFactors, NetSuite, Vocus, Constant Contact, and Workday.

As a result, most basic corporate functions—sales, marketing, purchasing, hiring, benefits, accounting—have been automated. You can debate the effectiveness of the automation, but while the resulting improvements in operational efficiency through CRM or ERP software are good, they're hardly transformative. It's really only in the areas of retail (think Amazon) and banking (think eTrade or PayPal) that software has transformed businesses.

Perhaps now, with the changing economics of computing, the continued innovations in communications

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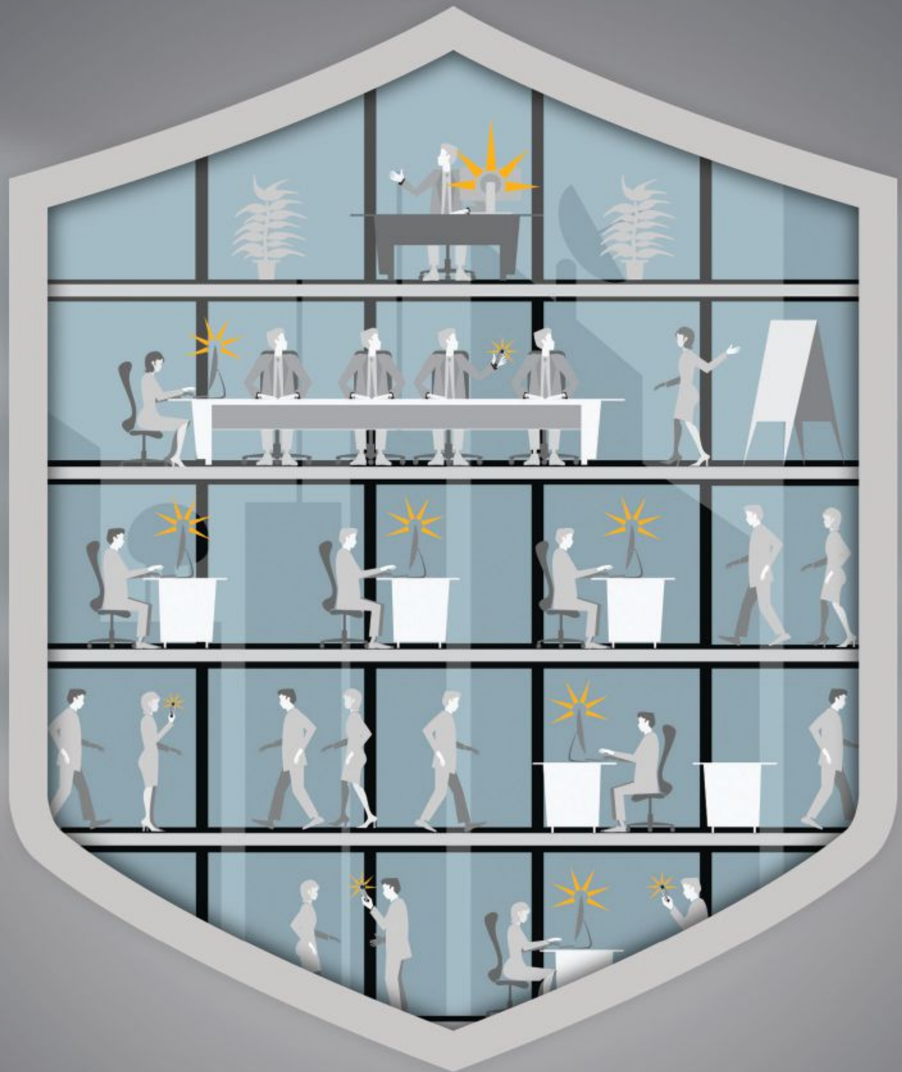

technology, and the decreasing cost of sensors, we can move to a third generation of enterprise software. It will tackle the challenges of precision agriculture, power, water, health care, and transportation, and fundamentally reshape businesses and our planet.

IoT Applications

In order to organize the technology of IoT, let's define a simple five-layer framework. The first layer is composed of things. We'll use the words "things" and "machines" interchangeably.

In the second layer, things are connected to the Internet in many different ways. The third layer consists of technologies that collect the data, which are increasingly time-series data being sent every hour, minute, or second.

The fourth layer is about learning. Unlike IoP applications, which entice people to type something, with IoT applications we will learn constantly in settings like hospitals, farms, and mines.

Finally, there's the question, what's all this technology for? What are the business outcomes? This layer, the "do" layer, describes both the software application technologies and the business models affected by companies that build things, as well as those who use them to deliver health care, transportation, or construction services.

Let's take a closer look at each of the five layers.

Things: Enterprise things, whether you're talking about a gene sequencer, a locomotive, or a water chiller, are becoming smarter and more connected. If you're going to build or buy next-generation machines, you'll need to consider sensors, CPU architectures, operating systems, packaging, and security.

Sensors are beginning to follow Moore's Law, becoming dramatically less expensive every year. They are increasingly attached to low-cost computers, which can range from simple microcontrollers to fully featured CPUs supporting the ARM or Intel instruction set architecture.

As you move to more powerful processors, more powerful software can be supported—but as powerful as that software is, it becomes a point of vulnerability in our hostile world.


Timothy Chou

Connect: Things can be connected to the Internet in a variety of ways. Connecting things requires a diverse set of technologies based on the amount of data that needs to be transmitted, how far it needs to go, and how much power you have. Furthermore, there are many choices at a higher level around how to manage the connection and how it's protected and secured.

Collect: Remember, things aren't people. The sheer volume of data that can be generated by things will be exponentially larger than that of IoP applications. Data might be collected and stored using SQL, NoSQL, or traditional or next-generation time-series collection architectures.

Learn: With an increasing amount of data coming from things, we'll need to apply technology to learn from that data. Learning and analysis products will include query technology and both supervised and unsupervised machine-learning technologies.

Most of the technology for learning from data streams has been applied to learning from data about people. As with all layers in the stack, there is much room for future innovation.

Do: As with IoP applications, there will be both packaged applications (ERP, CRM) and middleware to build IoT applications. Of course, in the end these applications—whether bought or built—will have to drive business outcomes.

As machines become increasingly complex and enabled by software, many of the lessons learned in software maintenance and service will also apply to machine service. As many in the software industry already know, the movement to delivering SaaS has revolutionized the industry. The Internet of Things enables "machines-as-a-service" business models for all kinds of other products, potentially letting many kinds of companies shift from selling products to selling services based on those products.

This model can transform large capital expenditures into a pay-by-usage operating expense. Examples of this trend are emerging. Internet-connected sensors built into products enable tires to be sold by the number of miles driven, compressors by the amount of air compressed per minute, and coal-mining machinery by the number of cubic meters of coal mined.

Such services will often be more profitable than the products they are based on. You may not want to be the first in your industry to do this, but you certainly don't want to be the last. CFO

Timothy Chou is a lecturer on cloud computing at Stanford University.

Editor's Choice

Cyber Exposure

Sixty percent of U.S. companies polled by Ponemon Institute either have cyber insurance (29%) or plan to obtain coverage in the next 12 months (31%). But many companies may be under-covered. Respondents said that, on average, only 35% of a loss resulting from a theft of data assets is covered by their company's current insurance program.

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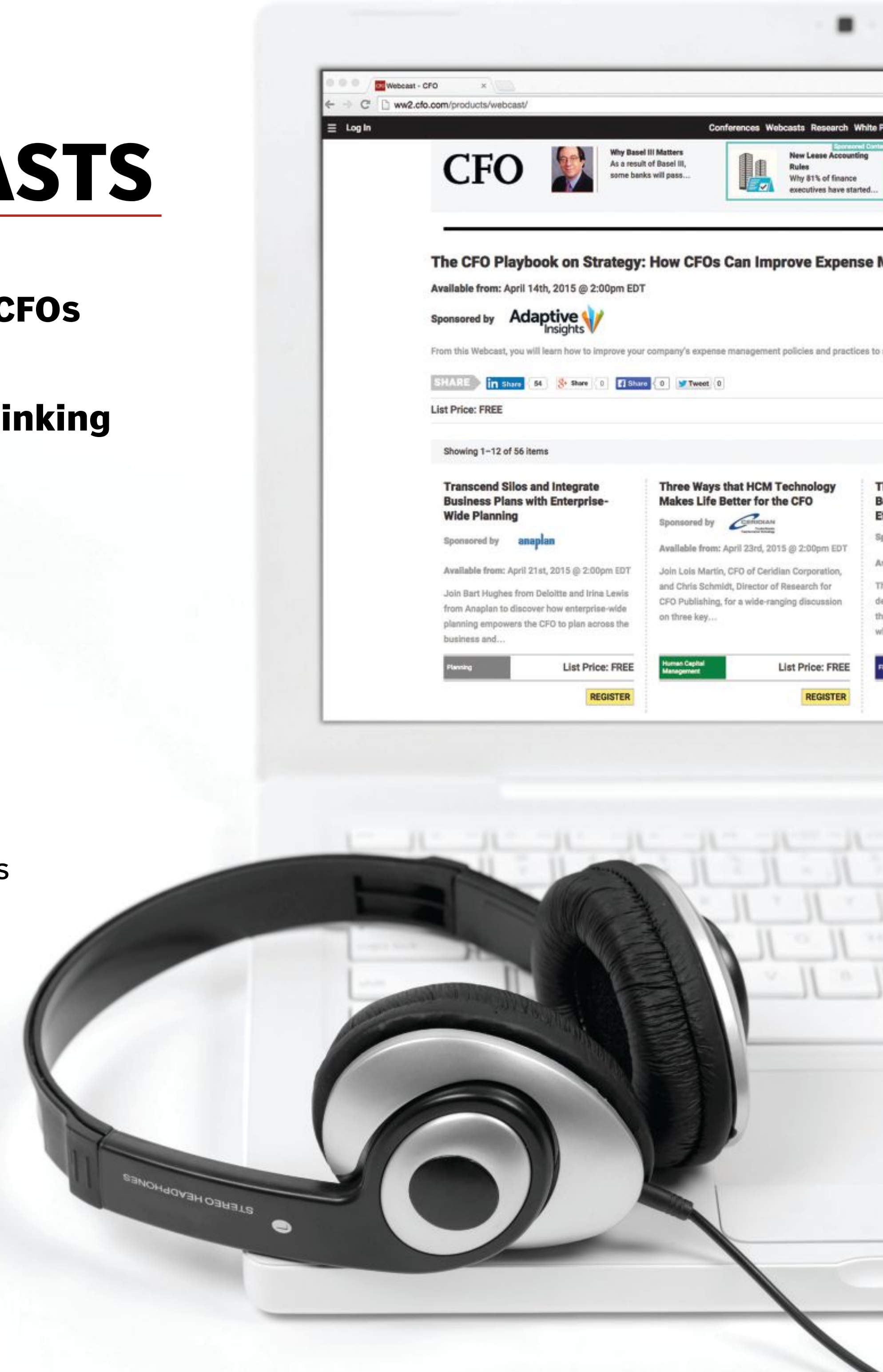

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The Cash-Flow Clash

After years of neglect, cash-flow statements get FASB's attention. **By David M. Katz**

Pity the poor cash-flow statement. The youngest of the three major corporate financial reports, it's gotten hardly any of the attention paid by the Financial Accounting Standards Board to income statements and balance sheets.

As a result, CFOs are at sea about whether to classify many kinds of cash inflows and outflows in the operating, investing, or financing sections of the cash-flow statement. Investors, on the other hand, are confused about how to compare different companies in terms of how they use their cash.

Since launching the cash-flow statement in 1987 under Statement No. 95 (now dubbed Topic 230), which outlined the three sections and provided general rules and definitions for the statement, FASB has provided little in the way of specific instructions on what the statement should comprise.

Thus, finance chiefs have had to rely on their judgments to decide where on their companies' cash-flow statement to put the cash receipts and expenses already recorded on their income statements. The result is that, for example, one company might classify a cash payment in the operating activities section, while another might classify the same item as a financing activity.

On August 26, however, FASB took steps to allay the situation by issuing an Accounting Standards Update of Topic 230 that addresses "eight specific cash flow issues with the objective of reducing the existing diversity in practice."

The cash-flow-statement issues clarified by the board include where to record cash flow involved in prepaying or extinguishing debt, settling zero-coupon bonds and similar debt instruments in certain situations, contingent consideration payments (such as "earnouts") made after a merger, and proceeds from insurance claims settlements.

Other pronouncements cover how to record cash flowing from corporate-owned life insurance (COLI) policy settlements, distributions of returns on investments in other companies, and returns from securitizations. In addition, the update stipulates how to classify payments that have more than one type of cash-flow characteristic (for example, when parts of the payment are cash for investing and other parts are cash for financing activities).

The update will be effective for public companies for fiscal years starting after December 15, 2017, and for interim periods within those years. For all other companies, it's effective for fiscal years beginning after December 15, 2018, and for interim periods within fiscal years beginning after December 15, 2019.

Cash-Flow Conundrums

But what about cash-flow reporting conundrums that go beyond those eight very specific areas? While standardizing accounting practice in this case seems to have no downside for companies and investors, is a detail-by-detail, incremental approach the best way to achieve efficient and transparent financial reporting?

Not everyone thinks so. "The upside of such FASB clarifications is a certain increase in reporting uniformity," according to Baruch Lev, an accounting and finance professor at the NYU Stern School of Business. "The downside: There is no end of regulating any transaction and variant of transaction."

The co-author of a new book called *The End of Accounting* (Wiley), which argues that generally accepted accounting principles are overly complex and fail to reflect the true strategic and intangible values of today's corporations, Lev wrote in an email to *CFO* that the FASB update "is not a game changer," despite its 49 pages.

"It's a response to very detailed

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questions [from] companies about the classification of certain cash flows in the cash flow statement. The transactions are very specific and infrequent," he added. In Lev's view, FASB's attempt to improve cash-flow accounting by adding rules rather than creating a system that rests on broad general principles "increases GAAP complexity."

Charles Mulford, author of *Creative Cash Flow Reporting*, holds a different view of the FASB cash-flow ruling. "Clearly, this goes against a principles-based approach," Mulford says. "There are times when we need rules, we need specific guidance."

"Clearly, this goes against a principles-based approach ... There are times when we need rules, we need specific guidance."

›› Charles Mulford, accounting professor, Georgia Tech

In fact, Mulford, an accounting professor at Georgia Tech, declared in an interview with *CFO* that "you cannot use a principles-based approach to the statement of cash flow." As proof of that, he noted that while Topic 230 has long provided general guidance on how to classify cash flows, companies still aren't following it in uniform ways.

In contrast to Lev's contention that the eight issues crop up infrequently, Mulford's view is that they are "good examples of the many items that are getting inconsistent treatment on the cash flow statement ... that are misclassified all of the time."

Zero-coupon bonds are a case in point. Topic 230 "is very clear" that payment of the principle on a loan should be classified as financing cash flow and that interest payments should be classified as operating cash flow, he notes.

And although the payment of the coupon, or interest, on a zero-coupon bond is by definition zero, Mulford says it's common knowledge that issuers are paying a form of interest because they ultimately pay investors the full face value of the bond even though their initial payment was less than that face value. For instance, an investor might invest only $70 at the outset for a $100 zero-coupon bond, but receive the full $100 when the bond matures. The $30 a corporate bond issuer might ultimately pay is effectively an interest payment, and thus should be classified under operating cash flow, he says.

But companies were universally reporting the entire amount as financing, rather than, as in the example, the $70 as financing and the $30 as operating, according to Mulford, who regularly studies the cash-flow reporting of a wide swath of public companies. "I couldn't find any companies that didn't do it that way. And that's incorrect."

In the update, FASB clarifies that the "interest" paid on a zero-coupon bond should be classified by the issuer as an operating cash outflow. "[The issue] was begging for clarification by FASB," Mulford says.

Overall, although the update represents "a small start," it's a move "in the right direction" for FASB to pay more attention to the cash-flow statement because analysts have been paying a good deal more attention to it in recent years, says Mulford. More specifically, "the focus for analysts has been on operating cash flow and its very close cousin, free cash flow. They're interested in what cash flows are ongoing, recurring, and sustainable," he says. "Cash flows are the lifeblood of the company."

Mulford thinks the update will help CFOs, too. "They are the ones who are classifying cash flows, facing them all the time. They need to decide how to classify that cash," he said, noting that the FASB provisions refer to "common events, everyday transactions that need to be reported. This gives them advice on how to do that. It makes their lives easier." CFO

Reducing Diversity

Instead of relying on their judgment, CFOs can look to FASB for specific guidance on the following eight cash-flow issues:

- Debt prepayment or debt extinguishment costs
- Settlement of zero-coupon debt
- Contingent consideration payments made after a merger
- Proceeds from insurance claim settlements
- Proceeds from corporate-owned life insurance policy settlements
- Distributions of returns on investments in other companies
- Beneficial interests in securitization transactions
- Payments that have more than one type of cash-flow characteristic

Source: Financial Accounting Standards Board

Editor's Choice

Exxon Feels the Heat

The Securities and Exchange Commission is probing Exxon Mobil's asset-valuation methods "in a world of increasing climate-change regulations," The Wall Street Journal reported. In August, the SEC sought information and documents from the oil company and its auditor, PricewaterhouseCoopers.

How to Meet the New Overtime Pay Rules

Employers have several things to consider to comply with the new Department of Labor regulation. Here are some guidelines. By Andrew Volin

Earlier this year the Labor Department more than doubled the minimum weekly salary threshold under which salaried workers are eligible for overtime pay when they work more than 40 hours a week. The change will take effect on Dec. 1, so companies that aren't yet prepared need to focus on this now. ¶ That threshold will rise to $913 per week, or about $47,500 annually. The current threshold is $455 per week, or about $24,000 per year.

The change may lead to a further increase in wage and hour lawsuits, which have already risen dramatically in recent years. They are often brought by groups of employees rather than individuals. Double damages and attorney's fees are available for claims under the Fair Labor Standards Act (FLSA), which provides for the overtime exemption, and defense costs are significant as well. Often, these costs exceed the amount of wages in dispute.

Which Workers Are Affected?

The first thing employers should do is determine which workers are affected by the new regulation. This group primarily includes those who perform exempt duties—i.e., executive, administrative, and professional employees—and currently earn between the old minimum and the new minimum.

The new regulations do not change the duties requirements for the exemptions from the FLSA's overtime-pay provisions. Briefly stated, "executives" must be in charge of part of a business and supervise at least two full-time workers. "Administrative" workers perform duties related to the management or general business operations using discretion and independent judgment. "Professionals" are divided into either learned (highly educated) or creative (artistic) sub-groups.

In addition, there is a second set of "highly compensated employee" exemptions for white-collar workers who earn at least $100,000 annually. These are employees who perform duties that may not strictly meet all of the requirements for an executive, administrative, or professional exemption, but are so close that the employer worries that it may lose a dispute, if one came to pass.

The new regulations increase that annual requirement for such workers to more than $134,000.

Employers must also consider, however, workers who earn slightly more than the new minimum. There are several reasons for this. One is the ripple effect from compensation changes. If one worker's compensation is increased because of these new regulations, the employer may also want to adjust the compensation of people earning slightly more.

Also, the new regulations provide for automatic increases in the earnings threshold every three years. The increases will be based on statistics on compensation for salaried workers. For example, the minimum salary will be based on the 40th percentile in the lowest-wage region in the United States. The annual earning threshold for highly compensated employees will be based on the 90th percentile nationally.

Planning must take the future changes into account as well. Companies may want to switch their normal annual compensation changes to coincide with the December 1 dates of the periodic automatic increases in the exemption threshold.

How Should Compensation Be Adjusted?

Companies must decide how to adjust compensation for the affected workers. Of course, total compensation can include a discussion of benefits, but just in terms of pay, employers may have at least five options for most white-collar workers. In summary, they are:

1. Increase the salary level to maintain the exemption. For most companies, only a lucky few should

Thinkstock (2); courtesy Sherman & Howard expect this outright raise.

2. Convert the salaried worker to an hourly worker, at a rate determined by dividing the current salary by 40 hours. If these employees work overtime, their overall compensation will rise. Accurate records of time worked are necessary to determine total compensation, for this option as well as the remaining ones.

3. Convert the worker to hourly, at a rate determined by dividing the current salary by total hours worked. This is more complex, but on the plus side it might result in no net change in compensation. For example, say Andy has been working 50 hours per week and paid $40,000 a year. Do the math: The hourly rate works out to $14.54, so for 40 hours at straight time, Andy gets $582 per week. The 10 hours of overtime, at time-and-a-half pay, brings him $218, for a weekly total of $800. Fifty of those weeks per year equal $40,000.

4. Convert the worker from salaried exempt to salaried non-exempt. Companies will pay overtime after 40 hours but will have to pay for 40 hours even for weeks when the worker puts in less than 40 hours. This option would be useful for workers who have a consistent number of overtime hours each week.

5. For some workers, consider whether to use a "fluctuating work week" salary. In this situation, the weekly salary is for all hours worked, including overtime hours, except that a worker receives an extra half-hour's worth of pay—rather than time-and-a-half—for each hour worked over 40.

One new aspect of compensation involves non-discretionary bonuses and commissions. The regulations permit employers to count these toward up to 10% of the new minimum salary amount. However, there are special rules about that as well.

What Risks Are Involved?

As suggested above, companies must accurately record all time worked by workers who are moving from exempt to non-exempt. This requires a system that includes developing and training all hourly workers on time tracking, including work that might be performed outside normal business hours and off premises. For example, responding to email, phone calls, or messages counts as time worked under the FLSA. In some situations, being on call, or traveling, also counts as time worked.

"Responding to email, phone calls, or messages counts as time worked under the FLSA. In some situations, being on call, or traveling, also counts as time worked."

In addition to having robust tracking systems, companies should implement measures by which both workers and the company can verify hours worked. This is needed to minimize disputes. An internal complaint mechanism is also necessary. The current requirements for complaint mechanisms under a variety of employment laws, such as harassment, could be used as a model.

Also, management should expect that these new requirements, and the changes that will be necessary, will contribute to discussion among workers about the changes and how the changes impact them. Federal and state laws permit employees to discuss terms and conditions of employment, including compensation. Therefore, communication strategies must be considered to minimize morale problems (or worse) arising as a result of, for example, workers being moved from salaried to hourly positions. Many people attach great importance to their status as salaried exempt workers.

In addition, depending on the new hourly approach used, formerly exempt workers who worked long hours (for example, 60 hours a week) may be quite surprised to learn their new hourly rate is lower than they expected. Also, as workers compare notes with each other about their old and new compensation, there is a risk that people in protected classes (race, color, religion, national origin, gender, age, disability) may conclude that their pay is unfair or discriminatory.

These changes create an opportunity for management to review all of their company's payroll practices to minimize existing risk as well as future risk. CFO

Andrew Volin is a partner at the law firm Sherman & Howard. He advises companies in disputes involving employment discrimination, wrongful discharge, and wage and hour law.

Editor's Choice

The Cost of Corruption
How much is violating the Foreign Corrupt Practices Act costing corporations? According to Stanford Law School's FCPA Clearinghouse, the average sanction for a company that self-reported a violation of the FCPA (during the period 2006 to 2015) was $35.9 million; violators that didn't self report paid an average of $108 million.

Show the Purchasing Department the Door

Purchasing department employees must spend more face-to-face time with suppliers to drive true value. By Christopher Good

During a walk to one of many daily meetings (at a company where I was serving as interim chief purchasing officer) our CFO asked me how we could improve our financials in the procurement area. The budget was under pressure and the forecast needed added upside to make up for recent problems and the probability of more issues to come—not uncommon for any company faced with constant external, internal, and competitive pressures.

Like many companies, a large percentage of costs at this one was related to purchased goods and services. Typically, about 60% of costs go toward purchased components, with the remainder going to value-added costs, overhead, and other items necessary to run a successful enterprise. Reducing the costs of purchased components provides dollar-for-dollar improvement to any company's financials.

Fine-tuning purchasing should always be at the top of the list for examination when financials need a boost.

After my brief conversation with the CFO, I spent some time examining the ins and outs of the company's purchasing division. I was always on the lookout for ways to reduce costs. This time, however, I looked beyond the purchase price variance report and material cost percentages ((budgeted manufacturing overhead X 100)/budgeted direct material cost). Instead, I started to really look at the daily activities of the purchasing department.

What was purchasing actually doing during their 8- to 12-hour days in the office? They were always very busy with purchase orders, attending meetings, making phone calls, and a host of other purchasing tasks essential to properly supporting an organization. Then it occurred to me: It wasn't what they were doing when they were in the office. Rather, it was, what are they doing in the office?

The next day I walked into the CFO's office and said, "We need to show some of our buyers the door!" He looked up and said, "Really? So, how many buyers do we let go and what type of SG&A savings can we expect?"

I paused and then restated my original assertion. "Let me rephrase that: We need all of our buyers to travel to see their suppliers and our other locations. Put simply, we need them to literally hit the road." As such, I explained, we would also need to spend a little more money on travel in order to save much more in the long run on purchased products.

The CFO was, initially, less than impressed. But I implored him to think about what informational resources our buyers currently possessed. They had at their disposal supplier quotes, information provided by suppliers over the phone, internal production data, and product-demand forecasts. Yet, besides comparing data sets and metrics, on what were they basing final purchasing decisions? Most importantly, from where were we generating potential cost-saving ideas?

If our buyers never got to see products being made first-hand, a number of very important questions could not be answered: How could they accurately assess the amount of labor the supplier was quoting? How could they possibly work to develop product lines and methods aimed at significantly reducing labor costs? How could they know whether one supplier was better in quality than another?

As I next contemplated how best to improve our purchasing methods, I discovered three basic roadblocks to buyers spending more face-to-face time with their suppliers:

• Management must recognize and appreciate the potential benefits and be willing to mobilize buyers to visit their suppliers. If there isn't buy-in at the top, it simply will not happen.

• Many buyers don't have significant technical or manufacturing backgrounds. They often don't feel adequately equipped or qualified to visit a supplier. Many organizations also

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employ processes that support visits from quality or production personnel but not from purchasing. One simple solution: have the buyer hit the field along with a more technical colleague.

• Buyers often have little to no time to leave the office and visit suppliers. The root cause of the lack of time, though, is that purchasing is entirely too reactive. There is always a fire to put out, a last-minute purchase order that needs to be issued or expedited, or some other crisis to be handled.

Managing Time

Let's examine time management more closely. In every purchasing management position I have ever held, I begin the engagement by asking the buyers how reactive versus proactive they are during their daily activities. Typically, buyers spend roughly 70% of their day reacting. So, how do we go about changing that dynamic? We can start by acknowledging that the job is not entirely under their control and, from there, gradually work toward decreasing the reactive posture of the buyers, moving instead to a more proactive stance.

"Fine-tuning purchasing should always be at the top of the list for examination when financials need a boost."

›› Christopher Good, managing director, Conway MacKenzie

Yet how, exactly, do we shift from a predominantly short-term, problem-solving posture to a long-term, money-saving modus operandi?

The move from reactive to proactive starts with a simple list. At the end of each day, ask your buyers to write down five things they want to get done the next day that do not constitute putting out fires. Then monitor how many of the items on their lists are actually accomplished.

Some days it will be zero, and other days they will be able to check items off of their list. The key to success with this method isn't the actual list. The success lies in the buyers proactively planning some of their actions in advance and then feeling—and experiencing—that they have at least some control over their day.

By controlling a portion of their day, buyers start to find time for other things: time they can use to get on the road to see suppliers, accomplish their jobs more completely, and save their company money. Minutes saved can translate into many pennies earned. CFO

Christopher Good is a managing director with Conway MacKenzie.

Focus on Days Of Supply

Freeing up cash in the supply chain allows a company to increase shareholder value.

Days of supply is one of those concepts that most people are reluctant to tackle for fear of stock-outs and missed sales opportunities, but remember: Every dollar of inventory you can take out of the supply chain equates directly to a dollar of free cash flow. So how do you reduce days of supply? Two ways.

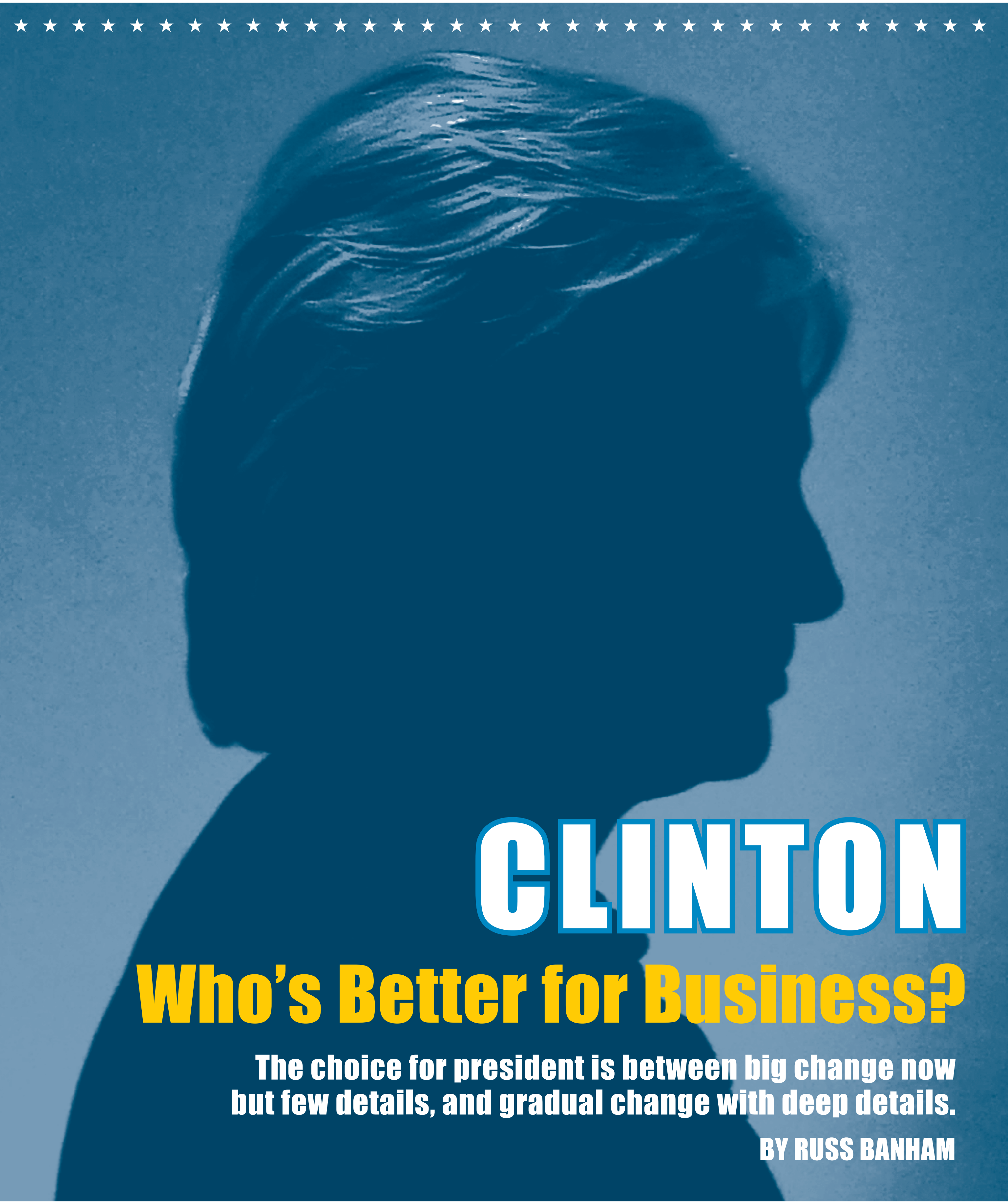
1. Supplier Partnerships. Many companies are reluctant to develop products with their suppliers, because they'd rather maintain complete control over their design process. And while that may offer some intellectual property protection advantages, it doesn't bode well for the partnership. Companies that develop parts with their suppliers actually benefit the most.

Stanford Business School Professor Hau Lee speaks about the inherent value of strong partnerships: "Now, when Nike develops new products with special requirements, instead of looking to the supplier for only procurement, it looks at them as a source of potential ideas and innovation. These suppliers have quick turnarounds for prototypes, meaning it's good for them and for Nike—for the whole invention process." Co-development means specific expertise, shared research and development costs, and, more often than not, more bang for the buck.

2. Real-Time Management. Think about the real-time technology you use every day: new photos on social networks; updates in your professional network; real-time stock, weather, and traffic conditions. There's a wealth of information at your fingertips—so why do the supply chain technologies that underlie $25 trillion of the global economy still take weeks or months to deliver information?

Ultimately, the best way to reduce days of supply is to utilize the wealth of data at your disposal. Chances are, lackluster technology is shrouding much of the chief procurement officer's operations in the form of delayed, self-serving, or miscommunicated updates. Supply chain teams need to be organized in a way that promotes open, transparent, and real-time information sharing, so the team can stay up-to-date on both risks and opportunities. And the tools and processes need to be in place to transform that communication into swift decision-making ability. CFO

Nader Mikhail is founder and CEO of Elementum, a developer of apps for managing the global supply chain.



CLINTON
Who's Better for Business?

The choice for president is between big change now but few details, and gradual change with deep details.

BY RUSS BANHAM

v. TRUMP

As you may be aware, this year's presidential election campaign is like no other. We've heard a whole lot of buzz about the candidates' temperaments and character, about demagoguery and email servers, about bigotry and speaker fees—not to mention marital fidelity, reality TV, pantsuits, and hand size.

What we haven't heard so much about is the impact that Hillary Clinton's and Donald Trump's policy proposals could have on business. However, a measured look at these plans reveals two starkly different visions of the country's commercial future.

To analyze these visions, *CFO* reached out to more than a half-dozen economists of wide-ranging political leanings. We asked them to contrast the candidates' positions on corporate taxes, global trade, health care, immigration, Wall Street, regulation,

and energy. Part of our thinking was that no issue exists in a vacuum; immigration policies, for instance, could affect business relations with Mexico, the domestic economy in general, and the labor market in particular.

In addition to offering up pros and cons of the nominees' stances on the issues, the economists affirmed the difficulty of one party's nominee achieving his or her agenda with a Congress potentially held by the other party. They further noted that there likely would be a delta between what the winning candidate says when running for office and does once in office.

Donald Trump is a tested CEO, but his policy positions are painted in broad brushstrokes rather than fine lines. Hillary Clinton has decades of experience in global and domestic policymaking, and while her positions are highly detailed, they're also more cautious. In other words, Trump seeks huge change now, whereas Clinton prefers more nuanced and gradual change.

Still, both candidates have been criticized for abrupt reversals in policy. Clinton has veered left on some policies to appeal to disappointed supporters of Bernie Sanders. Trump has flip-flopped on taxing the wealthy, the minimum wage, and immigration, although the last appears to be a moving target.

In no particular order, then, here are the candidates' respective positions:

★ CORPORATE TAXES

Both nominees want to halt the trend of corporate inversions, whereby a U.S. company merges with a foreign one in a lower-taxed domicile and reincorporates the business there. The candidates agree that keeping the headquarters of U.S. multinationals in the United States would boost job opportunities and federal tax coffers. However, they differ on how to stem the tide.

Trump's plan is to reduce the corporate tax rate from 35% to 15%. That would make the U.S. rate lower than that of most advanced economies. "If we had a 15% corporate tax rate, we would effectively become a tax shelter country, encouraging foreign companies to headquarter here," says Tom Wheelwright, an adjunct professor in the masters of tax program at Arizona State University and CEO of accounting firm ProVision. "Ireland is at 12%, so we would be on par with them and returning jobs to the U.S."

An influx of operations from overseas companies would spur domestic employment and related tax income, Wheelwright adds. "This is one area where Trump has a better handle on a critical problem than Clinton does," he opines. Clinton wants to maintain the current 35% corporate tax rate and crack down on the corporate inversion problem administratively, penalizing companies that make the migrations.

"She has talked about adjusting the tax code to get rid of the incentives for companies to relocate overseas but has not provided a broad-based plan to dramatically lower corporate rates," says Jim Pethokoukis, an economic policy analyst at the American Enterprise Institute, a conservative think tank.

Several economists agreed that the candidates are exceptionally careful when discussing taxes. "Trump wants to sharply cut the corporate tax rate but has not been explicitly clear on what sorts of tax deductions he would eliminate or cap," Pethokoukis says.

Mark Fratrik, chief economist at research and consulting firm BIA/Kelsey, says that while Clinton will likely lower the corporate tax rate, albeit nowhere near Trump's planned reduction, "she's not in a position to advocate it. She knows she needs to satisfy the liberal wing of the party and is being very careful."

Trump, too, is accused of playing politics. "I and many others doubt he will stick to 15%, which goes too far," Wheelwright says. "Initially he was at 25%, which was Marco Rubio's plan. That would accomplish the same purpose: sending a message to foreign companies to locate here. My assumption is that it will end up at 25%."

According to another expert, neither candidate is seeing clearly on the tax question—although that expert's objectivity may be questionable. "Given that the country is essentially broke, with spending and other entitlement obligations exceeding the present value of projected taxes by $199 trillion, we need to collect much more in taxes, not less," says Laurence Kotlikoff, a professor of economics at Boston University who is running for president as a write-in candidate.

★ GLOBAL TRADE/PROTECTIONISM

The nominees have extremely divergent views on global trade. Trump has charged that many longstanding trade deals have been detrimental to U.S. industry and the economy, whereas Clinton supports most trade pacts as they now stand.

Clinton "doesn't want to be perceived as a 'full speed ahead' free trader, but once in office that will likely change."
— Jim Pethokoukis, American Enterprise Institute

However, she recently changed her position on the Trans-Pacific Partnership (TPP), a trade agreement among 12 Pacific Rim countries to lower tariffs and other perceived barriers to trade. While Clinton previously endorsed the TPP and said it could become the "gold standard" of trade deals, she now sees it curtailing domestic employment. (It may be

Opening spread (2), Getty Images; this page, courtesy the company

➳ Trump and Clinton now both oppose the Trans-Pacific Partnership, a trade agreement Bernie Sanders says was "written behind closed doors by the corporate world."

relevant to note that Clinton's previous competitor, Bernie Sanders, considered the TPP "disastrous.")

Clinton now is having second thoughts about another big trade deal that she had supported as Secretary of State: the European Union's Transatlantic Trade and Investment Partnership. "We're not sure where she stands on these issues anymore," says Dean Baker, co-director of the Center for Economic and Policy Research, a progressive, left-leaning think tank. "She's had a different history on trade. Going forward, we don't know what will happen."

Pethokoukis predicts that Clinton, as president, ultimately would support the TPP. "She's a run-of-the-mill Democratic on trade, despite the protectionist stance that has emerged because of Sanders' skepticism of trade deals," he says. "She doesn't want to be perceived as a 'full speed ahead' free trader, but once in office that will likely change."

Trump, on the other hand, has come out strongly against the TPP. He has also proposed 35% and 45% tariffs on goods from Mexico and China, respectively, and he would harshly penalize countries for violations of trade agreements. Most clear is his promise to renegotiate all past trade pacts, which he charges were "bad deals" for the United States.

Not that he'd be the victor in those negotiations. "To Trump, 'winning' means a U.S. trade surplus, but I don't think other countries are simply going to roll over, despite his alleged negotiating prowess," says Pethokoukis. "He's also very hung up over currency manipulation by China, but that's an old story that is no longer accurate."

Fratrik is similarly dubious: "Is there a policy there other than his promise to win a better deal? Not that I can see."

Given the economists' profession, they take seriously the idea of Clinton or Trump tinkering with free trade. "Free trade is the engine of economic growth," says Kotlikoff. "Every economist I know thinks the TPP is a fantastic deal for the U.S. We give up very little and get back a lot."

David A. Levy, chairman of the Jerome Levy Forecasting Center, is equally alarmed. "The world economy is fragile," he says. "This is not a good time to cause even more international dissonance by walking away from [the North American Free Trade Agreement] or trying to change the TPP," he says.

★ WALL STREET

Both candidates try to appear tough in discussions about Wall Street and banking, given lingering public resentment over the financial crisis that fueled the Great Recession of 2007–2009.

The key difference between them is that Trump wants to shred the 2010 Dodd-Frank Act enacted to address the crisis, whereas Clinton, who praises the law, wants to bolster it. She would also battle for tough new rules governing banks. Trump, who blames the regulatory climate for inhibiting credit and causing the country's dour economic growth, has yet to unveil specific details of proposed legislation that would replace Dodd-Frank, assuming there would be any.

Trump's former campaign manager, Paul Manafort, called for reinstating the 1933 Glass-Steagall Act, banning banks from engaging in real estate, securities trading, and insurance brokerage, although Trump has been mum on the subject.

Trump's been more vocal in his resolve not to break up big banks—even in situations where they pose systemic risks, a power granted the president under Dodd-Frank. "He's more or less saying let's go back to the good old days when Wall Street did whatever it wanted," Baker says.

Clinton has talked about enacting a financial transaction tax (FTT) on high-frequency trades that are part of "unfair and abusive trading strategies," but it's unclear what the FTT rate would be.

Several economists feel she is blowing smoke in her pledge to be tough on Wall Street. "She's saying she'll pros-

Top to botom: Getty Images, Wikimedia Commons

ecute people who break the law, and break up the banks if they impose a systemic risk, but her history has been otherwise," says Baker. "She's gotten a lot of money from people on Wall Street, and ... my guess is she will be no tougher on Wall Street than President Obama."

★ HEALTH CARE

The candidates have similarly divisive positions on the Affordable Care Act. As he has made abundantly clear, Trump would try to repeal the legislation. He would replace the law with a mostly undefined, price-transparent universal health care system based on free market principles, in which buyers are provided different plan choices.

Trump is "more or less saying let's go back to the good old days when Wall Street did whatever it wanted."

— Dean Baker, Center for Economic and Policy Research

He also wants to reduce barriers to the interstate sale of health insurance, break up the health insurer monopolies, and provide a full tax deduction to individuals for insurance premium payments.

But Trump's lack of specificity could be a problem for him, according to Fratrik. "He wants to repeal Obamacare and replace it with a free market system, but he hasn't stated whether he would provide coverage for individuals with pre-existing conditions, as well as other elements of the law that everyone now expects," he says. "Nevertheless, I'm more bullish for the health care marketplace in a Trump administration, as it would be more market-based."

Kotlikoff demurs. "Trump's plan would give the states a fixed amount of money and tell them it's their problem to insure whomever they want,'" he says. "He also wants to allow people who want to be uninsured to be uninsured. Then, when they get sick, they'll have to spend all their money before they can qualify for Medicaid. His is certainly not a comprehensive plan that will address enormous health care costs."

Clinton would maintain the Affordable Care Act with modest changes, such as enhancing provisions for individuals with mental health challenges. She favors the creation of a public-option insurance plan in every state and wants to allow citizens to enroll in Medicare when they turn 55.

"Clinton is a big supporter of the Affordable Care Act and wants to make it better, reducing the cost of some of the insurance policies in the exchanges and making the exchanges work better," says Baker. "This is a big issue now that Aetna has pulled out of most of them."

Aetna attributed its decision to leave the exchanges to a higher-than-expected volume of ill, costlier policyholders. To return to the exchanges, Aetna wants a more balanced risk pool. "I believe Clinton will achieve that administratively," Baker adds.

Others agree. "She'll tweak the Affordable Care Act to bring costs down, cover more people, and give them more choice," says Pethokoukis. "To keep other insurers from leaving the exchanges, she may need to beef up federal subsidies. She hasn't talked about that, but I can see it occurring."

On the other hand, Kotlikoff has significant problems with Clinton's health care agenda. "There's no provision to increase competition among health insurers," he says. "Consequently, insurers will continue to 'cherry pick' healthy individuals, leaving those who are less healthy and poor to fend for themselves."

★ ENERGY

The candidates could not be more discordant on the issue of America's energy needs. Trump wants to lift restrictions on all sources of energy to accelerate employment, increase GDP, and bolster federal and state tax coffers, writing "a new chapter in American prosperity," he has said.

Clinton has a very different chapter in mind, wanting the United States to become the "clean energy superpower of the 21st century," a future she also promises will lead to millions of new jobs and the development of new businesses.

The divergent stances derive from the competitors' starkly different opinions on climate change. Trump stated in a tweet that climate change is a hoax cooked up by China to de-industrialize the United States. He wants the energy industry to be allowed to drill for oil and gas and mine for coal with much less red tape.

He also supports building the Keystone XL pipeline, lift-

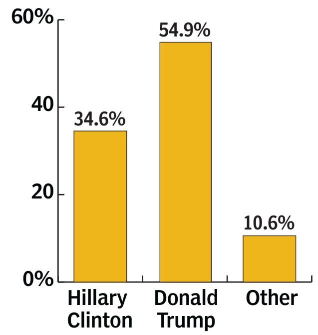
➸ On the Affordable Care Act, the candidates offer a stark contrast: Trump wants to repeal it immediately; Clinton says she will improve the exchanges and bring down the costs of insurance policies.

Top to bottom: courtesy the company, Wikimedia Commons

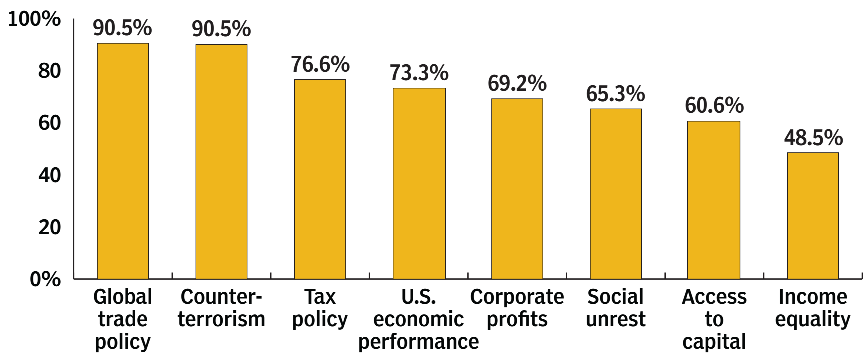
TRUMP GETS THE NOD

In a CFO survey, finance execs pick Donald Trump to be the next president, but they are not enthusiastic about the choice.

Who is your choice for the next president of the United States?



How much of an effect will the next president have on the following issues? (Percent answering "large" or "moderate" effect)



Donald Trump is the overwhelming choice for the next president of the United States among finance executives and other *CFO* readers, with about 55% of 576 respondents favoring him compared with about 35% for Hillary Clinton.

The real estate businessman was also respondents' preferred choice on eight out of nine selected issues, with the former U.S. senator and secretary of state besting Trump only in the area of climate change, 40% to 34% (see charts).

Those who answered the CFO 2016 Presidential Election Survey during the week of September 4 preferred Trump to Clinton by a huge margin on the issue of corporate taxes, 61% to 23%. The survey respondents, largely senior finance executives but also risk and accounting executives, also favored Trump over Clinton by big margins on the issues of homeland security (56% to 31%), health care (52% to 33%), and energy policy (52% to 34%).

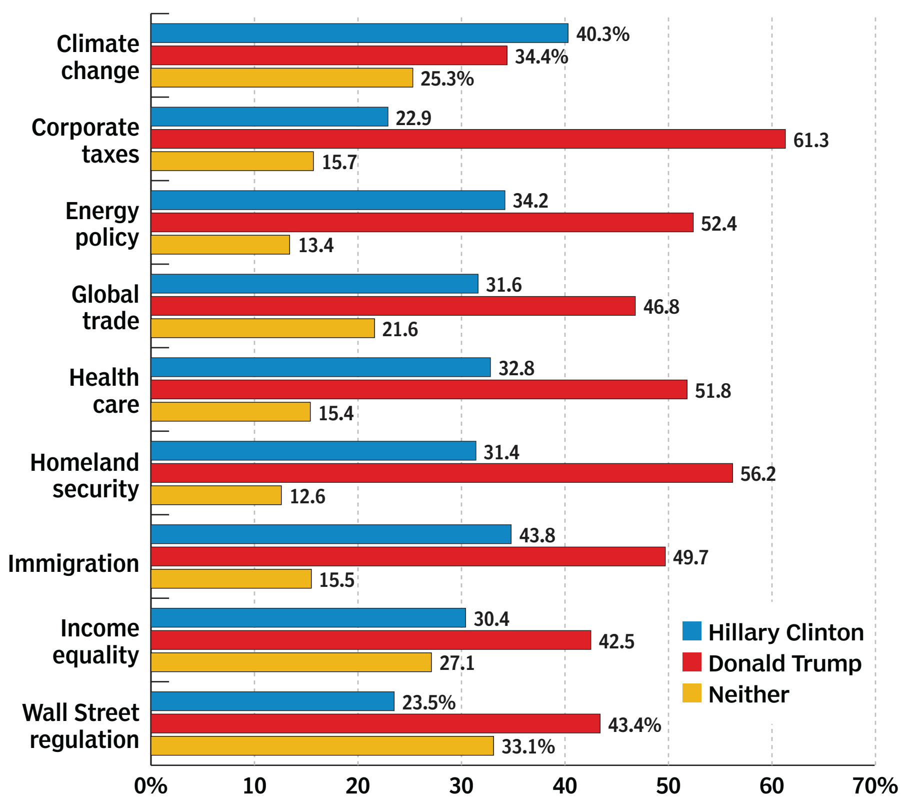
Asked to elaborate on their answers to the survey, many respondents were less than enthusiastic about the choice they'll make on November 8.

Steve Underhill, treasurer and controller of Carmel, Ind.-based electronics firm R.O. Whitesell & Associates, favors Trump, but shared a comment that seems to sum up the view of many respondents: "I think it's an absolute shame that in a country the size of ours, and with the history of ours, we're down to these two candidates for president."

The survey did not use scientific sampling.

— DAVID M. KATZ

Which candidate's approach to the following issues do you most agree with?



Note: Numbers may not add to 100%, due to rounding. Source for all charts: CFO survey of 576 finance executives, September 2016 ing the ban on crude oil exports to foreign markets, and abolishing the Environmental Protection Agency. With regard to sustainable energy sources, he blames wind-generated power for killing birds and causing sickness, and he calls them "industrial monstrosities."

Trump's policy on immigration, including his plan to build a wall separating the United States and Mexico, has been called "immoral" and "economically unsound."

In effect, when it comes to energy Trump would essentially wind back the clock to the mid-20th century. "He talks about bringing back jobs in the coal industry, which means underground mining, something we haven't seen since the 1970s," Baker says. "Do we really want to do that?"

For Kotlikoff, that's a rhetorical question. "Trump is discounting all the evidence on climate change, the fact that the vast majority of scientists around the world concur on the subject," he says. "He thinks he's smarter than all these people but is ignoring a great peril to our country and our planet."

Clinton opposes the Keystone XL oil pipeline system, calling it "a distraction from the important work that has to be done on climate change."

Trump's rhetoric also indicates he would likely reduce or eliminate federal subsidies for solar and wind energy production. Clinton, on the other hand, wants to end federal subsidies to the oil and gas industry, modernize the power grid, and make other moves to transition the energy infrastructure from fossil fuels to cleaner forms of energy like wind and solar. She has also left the door open to discussions of a carbon tax on users of fossil fuels, a key plank in Sanders' platform.

"She's too scared to say she supports a carbon tax outright, given the financial impact it would have on voters using fossil fuels," Kotlikoff says. "This is the difference between a leader and a politician. A leader says exactly what is wrong with the country and here's how to fix it. A politician sugarcoats the truth."

While Trump supports fewer restrictions on hydraulic fracturing, Clinton is not expected to impose additional constraints. "I don't think a Clinton administration would mess with new ways of developing oil and gas, although it might tinker with them a bit," says Fratrik.

★ IMMIGRATION

The divide between the nominees on immigration is vast, with Trump favoring mass deportation of illegal immigrants and Clinton seeking a path toward citizenship and immigrant integration. Trump wants to build a wall separating the United States and Mexico—and paid for by our southern neighbor, although he hasn't said how he'll make that happen.

Clinton seeks less radical means of securing the border, although she has not provided detailed plans. Still, her policy proposals resonate with most of the economists.

"Normalizing a path toward citizenship makes sense," says Baker. "Mass deportations and a giant wall would be a humanitarian and economic disaster."

Offers Fratrik: "Trump's plan is totally populist, bad for the economy, and just plain wrong. Clinton recognizes that immigration is the hallmark of American industry and economic growth, despite the distributional impact it has on employment."

★ THE BOTTOM LINE

Obviously, the stark differences in the candidates' policies—assuming they're the real deal and not just smoke and mirrors—provide a clear basis for picking one or the other. And whether you love 'em or hate 'em (either candidate or both), the winner's decisions likely will have a profound impact on the future of the U.S. economy and business growth. Then again, so will myriad geopolitical and macroeconomic factors outside the president's control. The leader of the free world can only do so much. CFO

RUSS BANHAM IS THE AUTHOR OF 24 BOOKS, INCLUDING "HIGHER," A HISTORY OF AEROSPACE GIANT BOEING.

Wikimedia Commons

The Holes In Human Capital Metrics

Prodded by investors, some companies are disclosing more data about their workforces. But how much value will that information have?

BY DAVID McCANN

After many years marked by varied, mostly unsuccessful initiatives to prod companies to disclose more information about their human capital, the movement is finally gaining some traction. At least two groups of institutional investors representing trillions of dollars in assets under management (AUM) have piloted programs in which they've engaged directly with companies to elicit information on employee turnover and engagement, and spending on training and development.

The institutional investors so far have focused their efforts on large retail companies. One of the groups with a pilot program, Principles for Responsible Investment (PRI), is a United Nations–supported network of about 1,500 institutional investors worldwide. Over the past two years, a subset of 24 PRI members with collective AUM of $1.5 trillion has conducted engagements with 27 global retail enterprises—22 of which have improved their public human capital disclosures as a result, according to Fiona Reynolds, managing director of PRI.

The other group, the Human Capital Management Coalition (HCMC), comprises 25 U.S.-based institutional investors totaling $2.5 trillion AUM. The HCMC seeks enhanced disclosure as one of several goals for elevating

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human capital management as a key aspect of company performance. It persuaded 8 U.S. retailers to provide non-public information on how they address human capital issues.

The investor groups have publicly divulged no specifics on the retailers' additional disclosures and have identified only a few of the companies they've engaged with (none of which agreed to speak with *CFO* for this story). But it's early days for these efforts, and any disclosure of additional human capital information is a big stride forward.

PRI did say it asks for increased disclosure on employee turnover and absentee rates, training programs, and employee engagement scores. And active equity firm Martin Currie, a PRI member, released a bulletin describing the results of an interaction with Russian food retailer Magnit: following the engagement, Magnit tasked its investor relations leader with improving human capital disclosure and for the first time published key performance indicators (KPIs) relating to employee relations, including turnover and training.

Meanwhile, the institutional investors are trying to involve the analyst community in the quest for more human capital disclosure. The HCMC, for example, is talking with analysts to prepare a guide outlining questions to ask during earnings calls, says Meredith Miller, chief corporate governance officer for the UAW Retiree Medical Benefits Trust, which is leading the coalition.

Observes Jeff Higgins, CEO of the Human Capital Management Institute (not to be confused with the similarly named coalition): "The conversation is changing. I've been taken by surprise by how many big investors are getting on board and the speed with which momentum is building."

A Question of Value

How useful will human capital data prove to be? Reynolds says PRI is pushing for human capital disclosure because metrics on things like turnover, employee engagement, and training suggest how well-managed a company is. Tessie Petion, vice president of responsible investment research at Domini Social Investments, which is looking into joining the HCMC, agrees. "It tells you something about priorities in managing the business and is an indicator for whether we want to invest in that business," she says.

But a former finance and marketing executive waves off the notion that such data is a good barometer of management quality. Tom McGuire, now talent strategy leader at Talent Growth Advisors, says: "Whether a company is well-run is a good question, but a more relevant one is, how do its people impact its value? To understand that, you need to look at the company's intellectual capital—patents, brands, and proprietary technologies and methodologies. The only source of any of those things is people."

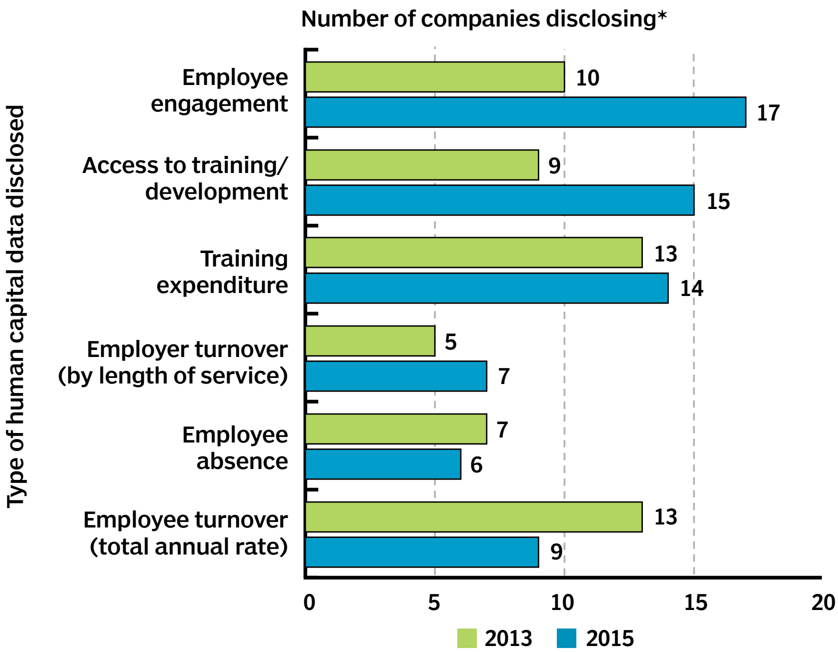
For that reason, McGuire also quarrels with the idea that disclosure about a company's entire workforce has much value. "You want to know about the turnover and engagement of *critical* talent," he says. "At a pharmaceutical firm, those are people in the research area. At a consumer products company, it's people in consumer research and marketing, and some innovation areas. You don't really care if an accounts payable clerk turned over."

Similarly, Higgins points out, if you lose 20% of management in a year, that's way too high. Losing 20% of your call-center workers is OK. It's also fine if 20% of a retailer's customer-facing staff is lost. But it's disastrous if a professional services firm has 20% turnover among customer-facing professionals.

The metrics that come out of the investor groups' engagements with retailers may be used to compare the

People Progress

In most cases, companies increased disclosure of human capital data after engaging with institutional investors.



* Based on Principles for Responsible Investment's engagements with 27 retailers in 2013 and 2015.
Source: Principles for Responsible Investment

companies with one another, but it's unknown how granular the information is, so therefore it's unknown how useful such comparisons will be.

"We still have to go back and huddle with our coalition members, so we're not in a position at this point [to talk about that]," says Miller. "What we're trying to do is distill [from] the metrics the kind of information that would really get at drivers of long-term shareholder value and that is measurable and could be standardized."

"You want to know about the turnover and engagement of critical talent.... You don't really care if an accounts payable clerk turned over."

›› **Tom McGuire, Talent Growth Advisors**

Lisa Disselkamp, a director in the HR transformation practice at Deloitte Consulting, is skeptical that companies can actually provide the kind of information that would allow such efforts to bear fruit. "I'm not a big fan of KPIs and benchmarks," she says. "Most employers don't embrace them much, from an actionability standpoint. They may have turnover data, but what's actionable is the root cause of something."

For example, Disselkamp points out, turnover is a symptom of many things that go on in an organization, like how flexible schedules are, employees' satisfaction with supervisors and management, and what kind of career paths are available. "Turnover is just the result," she says.

Even a great advocate for human capital disclosure like Higgins suggests that the investor groups' approach needs refinement. "They're getting what they want—a number for turnover and a number for engagement—but then what do they do with that?" says Higgins, a former CFO. He says he has encouraged PRI to at least ask for information segregated by basic job groups, like management vs. non-management, STEM workers vs. non-STEM, or sales vs. service. "It's very much about the context," he says.

Another problem with disclosure of human capital data is that it's frankly not too difficult to fudge. "The fudge factor is consistently a problem for things that aren't regulated," says Petion, although she adds that sometimes there are clues as to whether a company is shading the truth, such as the changing of a metric or methodology without explanation.

Still another potential issue, if the goal is to motivate such disclosure on a broad scale, is the administrative burden it might place on companies. For their part—and perhaps to Higgins' point—both Reynolds and Miller say the information they're asking companies for can be easily obtained. "These are metrics that currently exist and are important in running a company and planning," says Miller. "I don't think we're looking at anything that would impose additional costs or reporting."

Looking Ahead

Why start the disclosure push with retailers? For HCMC, it's partly because of the extreme attention focused on the tragic fires at retailers' factories in Bangladesh and Pakistan in 2012. "We decided it was important to also address the kinds of issues that could come up state-side," says Miller. "The retail industry is so labor-intensive and ripe for these kinds of issues." As for PRI, Reynolds says retailers are often in the headlines with respect to employee relations.

But both groups are planning to target other industries. PRI has had discussions with mining companies, and HCMC may opt to look next at the health-care industry.

Ultimately, the investor groups, as well as other interested observers like Higgins, hope that pressure from investors and analysts will result in the emergence of de facto standards for human capital disclosure. "We want to identify a suite of important metrics on which we could engage with companies across all industries and sectors," says Miller.

Might de facto standards, if they do come about, evolve into formal regulation? "Hopefully it won't need to be regulated," says Reynolds. "Maybe it can be just a norm, as other areas have become. We see reporting in different countries around diversity and pay gaps, for example. Some of those are engrained in regulation, and some aren't—there's just investor demand, so companies do it."

Miller is somewhat more strident. "I do think there is a clear opportunity to explore with public regulatory agencies," she says. "[I have] gone through a number of disclosure movements with the SEC and FASB, [so I know that] once there is a public record we can move toward showing that this is a corporate governance best practice and [that it] helps the market value companies."

Higgins, too, thinks the climate is right for an accelerating movement toward regulation. One big reason for that is the developing "gig economy," with more people doing contract work and fewer working for a single employer full time. "That's got to prompt a regulatory response," Higgins says. "If you're disaggregating your workforce, you probably have a responsibility to tell your shareholders about what you're doing, who's an employee and who is not, and why." CFO

Courtesy the company

The Rules of Attraction

How do corporate borrowers keep their bank lenders happy when there is so little profit to be made by providing lines of credit?

By Vincent Ryan

Ann Anthony, vice president and treasurer of South Jersey Industries, is fortunate in that, like most oil and gas utilities, hers is a heavy consumer of capital. In other words, it regularly draws on its line of credit. "The banks tend to like it, they want to put capital to work. With some of the new regulations, they are penalized if they have commitments that are not drawn on," she says.

Although South Jersey Industries' banks are willing to accommodate it with their balance sheets, they are "very vocal" about the need to be compensated for the service. "That's nothing new, but the time to develop a relationship with a new bank is compressed," Anthony explains.

Banks have always expected business in return for credit, but now when new banks agree to participate in South Jersey's $400 million revolver, they want to know immediately which fee-based business they will get, at what price, and when, says Anthony.

Welcome to the undisrupted area of financial services: the relationship between large U.S. corporations and their key banking partners. While fintech startups and swiftly moving online purveyors of credit threaten other areas of banking, commercial banks and corporate clients "continue to dance around each other to find the right mix of risk, reward, and services," says Bruce Lynn, managing partner at The Financial Executives Consulting Group.

That's mostly because financial institutions still have something corporations want: funds in the form of large loans. Key debt and leverage levels among U.S. corporate entities are at record highs, according to an August report from S&P, with aggregate debt levels exceeding those just prior to the financial crisis. Companies have levered up considerably to fund stock buybacks, dividends, and acquisitions.

But ultra-low interest rates, along with other factors, are complicating banking relationships because they make lending to corporations unprofitable. And new regulatory limits that require banks to hold more capital against loan assets increase banks' costs of providing such credit. (See box, "Banks' Balance Sheet Constraints.")

So banks demand ancillary, fee-based businesses, like cash management, debt capital markets, and derivatives, in exchange for credit facility participation. If a bank can't earn an appropriate risk-adjusted return on capital from a business customer, it makes little sense to retain that customer.

"If the banks are actually providing you with credit, it's a money-losing proposition," says Nadeem Ali, former treasurer of Greif, a $4 billion in revenue industrial packaging company. "[Ancillary businesses are the only] way they can justify a long-term relationship."

Banks' Vagaries

How do treasurers handle this? Carefully. Sam Pallotta, vice president and treasurer of Rockefeller Group International, says that "now we almost cater as much to the lender as the lenders cater to us."

Rockefeller Group knows it has something to offer banks: in a regulatory regime in which non-operating deposits are unattractive to financial institutions, banks are very interested in the company's excess cash. "Our deposits tend to be stable," Pallotta says. The real estate development and investment company has "a lot of money set aside for future funding needs and the deposits are not 'high velocity,' so they are very valuable to lenders." He adds, "Our banks have been signaling to us that they appreciate the business, and we always have people looking to get that business."

But Pallotta is under no illusion that all of his banks will be with him through thick and thin. He is very cognizant of having to protect against banks that "might not be open to extensions and increases in [credit] lines at the point in time [when the company] needs them."

In the wake of stricter regulations, Pallotta feels U.S. banks will be "in and out of markets" and "their interest level will wane" due to their own portfolio constraints, appetite or distaste

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for specific property types, or "feeling of being over-allocated" in a specific area. As a result, Pallotta says he needs to maintain twice as many bank relationships as in the past, even though he only needs a handful of banks in his credit line.

"In the past, I could have said I was working with just the big three banks," he says. "Now I have to delve into mid-tier organizations, work with global institutions, and work with insurance companies so I can be assured of my financing when I need it."

The Bundling Problem

The process of rewarding banks that provide credit is strewn with landmines. Anthony of South Jersey Industries finds the need to commit to business upfront equivalent to speed dating. "Having to promise the business when the bank walks in the door without having the opportunity to fully vet the bank's capabilities is challenging," she says. The awarding of business often calls for a full-blown request-for-proposal process and "getting down and dirty in the weeds with the product specialists," Anthony adds. "I can't do that with the relationship manager." In addition, the borrower and lender "don't get an opportunity to get to know one another and each other's strengths and weaknesses," she says.

Eric Ball, who was senior vice president and treasurer of Oracle for 11 years, saw the same thing happening before he left the software giant in 2015. Banks used to participate in credit facilities just on the hope of getting an audience for the lucrative pieces of the business, Ball says. "I think now credit has become even more of a loss leader for the banks, so they don't want just a vague promise or a 'we'll keep you in the mix.' They want more assurance than that."

Ball, now a venture capitalist, says the issue is the pricing of credit facilities. "The pricing is arbitrary and varies from year to year, and in many years the upfront fee that corporates pay to banks has been pretty low," says Ball. "The banks argue it's underpriced. ... The idea is that if you are going to buy the underpriced product—credit—the bank will only sell it to you if you give them a crack at an overpriced [or more profitable] product."

What that does is force the treasurer to bundle services in a way that's "inefficient and frustrating," says Ball. "As a customer, you never want to bundle, you want to pick the best provider for each single product."

"Having to promise the business when the bank walks in the door without having the opportunity to fully vet the bank's capabilities is challenging."

›› Ann Anthony, VP and treasurer, South Jersey Industries

With some products, treasurers do try to stick to a best-of-breed approach. "If you're picking a cash management bank, you have to know who has the boots on the ground in the country you're dealing with, and little else matters," says Ball. But for banking products that are, in essence, commodities—like FX hedging and stock buybacks—treasurers often rotate the business among credit providers.

At Oracle, Ball had a carrot to dangle in front of bankers: the company was regularly issuing a few billion dollars of bonds at a time, and the fees for bond book running were in the tens of millions of dollars. Even more important for the banks, whether or not a bank was in on Oracle's deals could affect league table rankings. "[In some years,] it would be really hard to be on top of the tables if you weren't part of Oracle's deal," he says.

Rotating each of Oracle's banks into the book-running role was no easy task. "I used to tell them, 'We have 10 banks and we have 3 book runners, so you can expect that every 2 or 3 years your odds of getting a book runner deal will be pretty good," Ball says. But even that wasn't enough for some bankers. Since bankers are awarded bonuses on a yearly basis, "I'd have bankers call me and say 'I have to get this piece of business or I am going to lose my job,' and I'd say, 'We just hit you last year,'" says Ball. "Then they would lose their jobs."

Ali, former treasurer of Greif, adds, "It's challenging to figure out how to divide the pie, because there are often too many mouths to be fed."

A Quid Pro Quo

There's another factor that requires careful choreography: the increasing focus by the borrower's upper management on which banks are the strongest customers for the borrower. "The weighting of how much product the bank itself is buying [from the borrower] is increasingly important," says Ball, and the push to include it as a factor began three years after the credit crisis. "When the banks would pitch me, I would say, 'Have you talked to your CIO about his or her purchasing decisions? Are you aware that we have a proposal in front of you to sell 'x'?'"

While a bilateral relationship gives the borrower some leverage, taking that stance requires tighter coordination between the treasurer, as the customer of the bank, and whoever is in charge of selling to the banks. And to

Courtesy the companies

some degree it takes the job of choosing the bank out of the treasurer's hands.

"Now you have introduced decision makers outside of treasury," Ball explains, which can be frustrating to some treasurers. "Before you award a piece of business, the CFO or CEO now asks, 'How much product have they bought in the last year and what might they be buying next quarter?'" But Ball calls it "incredibly liberating, because you are in the loop on the sales cycle, and you may be able to say 'I played a role in closing that contract,' and that can be very rewarding."

Mutual Satisfaction

While having to parcel out business to lenders can be irritating, many treasurers have settled into the notion that the best approach is to make the relationship work for both lender and borrower.

"For me, it's about an open dialogue and a willingness to work together," says Rockefeller Group's Pallotta. "The strongest bank relationships we have are with people who are patient and who realize we only have so much volume to allocate." A bank that has established a rapport with Rockefeller Group is much more likely to get a friendly answer when it calls to say it needs a wider spread on a deal or needs a bit more recourse on a loan, Pallotta says.

"When the banks would pitch me, I would say, 'Have you talked to your CIO about his or her purchasing decisions? Are you aware that we have a proposal in front of you to sell 'x'?'"

›› Eric Ball, former treasurer, Oracle

Even on pricing of products and services, companies may have to be willing to bend a little. "Everyone has to be comfortable with the terms," says Anthony. "I never want to squeeze that last half cent out of you—you need to be profitable to give me good service."

Even though banks can be demanding when it comes time to negotiate a line of credit, Anthony agrees the deals have to work for both parties. "Let's face it, there will be times when you need a favor, when things are not going the way you expected, and you have to be able to call someone [at the bank] and say 'I really need you to do x, y, or z for me,'" she says. "And if you have that longstanding relationship cultivated over time, you're more likely to get a positive response." CFO

BANKS' BALANCE SHEET CONSTRAINTS

The following banking regulatory requirements contribute to making corporate credit lines less profitable and some deposits less attractive to U.S. financial institutions.

Liquidity Coverage Ratio

Requires large banking organizations to hold a minimum amount of high-quality liquid assets (HQLA) that can be readily converted into cash during a 30-day period of financial stress. HQLAs include cash, Treasury bonds, corporate debt, and some municipal securities.

Net Stable Funding Ratio

Measures the amount of longer-term, stable sources of funding employed by an institution relative to the liquidity profiles of the assets funded. Stable funding sources include customer deposits and long-term wholesale funding. The ratio also measures the potential for contingent calls on funding liquidity arising from off-balance sheet commitments and obligations. This ratio is designed to cut down on the use of short-term wholesale funding.

Tier I Leverage Ratio

Measures how leveraged a bank is in relation to its consolidated assets. The ratio counts banks' off-balance-sheet exposures, like loan commitments, standby letters of credit, acceptances, and trade letters of credit. Bank holding companies in the United States with more than $700 billion in consolidated total assets must have a Tier I leverage ratio of 5% by January 1, 2018.

Common Equity Tier I Capital Ratio

Measures a bank's core equity capital compared with its total risk-weighted assets. Shows how well a bank can withstand financial stress and remain solvent. This ratio includes common stock, retained earnings, and other comprehensive income, but excludes all kinds of preferred stock and non-controlling interests.

Sources: Investopedia, U.S. Federal Reserve System

Don’t Tell Me, Show Me

The third-quarter Duke/CFO Business Outlook Survey finds CFOs will slow spending while awaiting a new president’s policy decisions. By Chris Schmidt

26%

Percentage of all U.S. firms that are already delaying investment because of the election

More than a third of U.S. CFOs say political uncertainty will slow their spending plans beyond the presidential election, according to the latest Duke University/*CFO* Global Business Outlook survey of more than 1,200 senior finance executives. The survey, which was completed on September 9, finds at least 33% of CFOs, regardless of who is elected, say they will hold back on investment after the November election as they wait to see how the new president will govern.

Specifically, 40% of CFOs say they will hold off on investment if Hillary Clinton is elected, while about 33% say the same in the case of a Donald Trump presidency. The survey also finds that:

• About 26% of all U.S. firms say they are already delaying investment because of the election.

• Among the 26% currently delaying investment, three-fourths will continue to delay investment if Clinton triumphs, versus roughly half if Trump wins.

• Among the majority of firms not currently delaying investment because of the election, about one quarter say they would change course and delay investment plans if Clinton were elected, and another quarter say they would do the same if Trump wins.

Due in large part to political and economic uncertainty, U.S. firms on average do not plan to increase capital investment or research and development spending over the next 12 months. This follows an already weak level of investment.

However, finance executives of U.S. companies indicate that spending will not be affected by moderate interest rate hikes. Only 1 in 3 firms say that a 1% hike in the federal funds rate would cause their firm to reduce capital spending, and only 12% say the same about a 50-basis-point hike.

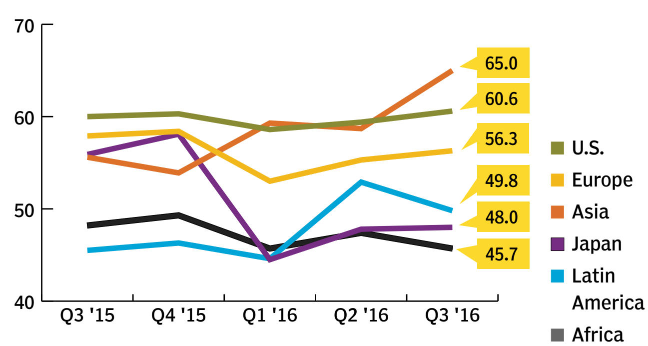
Despite uncertainty in the political and monetary policy realms, the labor market continues to tighten in the U.S. Thirty-six percent of U.S. firms indicate they are having difficulty hiring and retaining qualified employees. Employment in the U.S. is expected to grow 1.4% over the next year, and CFOs plan to hike wages 2.9%, which is nearly double the expected 1.6% increase in product prices.

Still, U.S. CFOs remain upbeat about the domestic economy. On a scale from 0 to 100, financial executives rate their optimism at 60.6, up from 59.4 last quarter and slightly above the long-run average. Besides the aforementioned concerns, U.S. finance executives are also worried about regulatory requirements, the cost of employee benefits, and weak demand for products and services. They expect health-care costs to rise by 6.8% over the next year, more than a percentage point above what many are predicting.

Finance executives responding to the survey also project corporate earnings will rise by 7.3% over the next 12 months. But they were slightly less optimistic about their own firms’ performance in the

Economic optimism rises in U.S., Asia, and Europe

Finance executives rate their optimism about their domestic or regional economy*



*On a scale of 0–100, with 0 being least optimistic

Source for all charts: Duke University/CFO Magazine Global Business Outlook Survey of finance and corporate executives. Responses for the current quarter include 485 from the U.S., 302 from Asia (outside of Japan), 32 from Japan, 160 from Europe, 150 from Latin America (including Mexico), and 112 from Africa.

same time frame. Confidence in their own companies' financial prospects fell to 65.3, from 66.3 in the second quarter.

THE SPEED OF BREXIT

With the United Kingdom set to depart the European Union, the Outlook survey asked U.S. finance executives how much of an effect the pace of the U.K.'s withdrawal would have on their companies. While most said the speed of Brexit would not affect their firms, 12% did say they prefer the U.K. to proceed slowly.

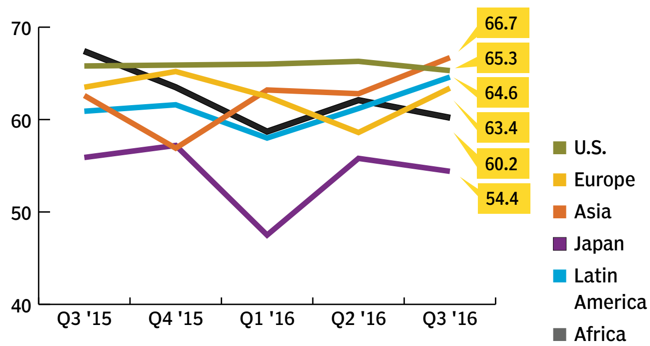
In Europe, predictably, there is more concern. Thirty-one percent of finance executives at European businesses say it would be best for their firms if Britain makes a very gradual exit from the EU. Thirty percent of European CFOs believe that Britain will complete the exit by the end of 2019; 54% say it will happen by the end of 2020.

The reason why European CFOs want a slow Brexit is simple: 27% of European firms say their U.K.-based revenues will fall after Brexit. Among these firms, the proportion of revenues coming from the United Kingdom is expected to fall to 14% from 22%. And some European finance executives think Brexit is just the beginning of trouble in the EU: One in five European CFOs believe that another country will vote to withdraw from the EU within two years. The leading candidates, in order of most mentioned, are Denmark, the Netherlands, Hungary, and Greece.

The wave of unrest is also affecting the political mood in individual European countries. Nearly 60% of European CFOs say they are holding off on investment due to their own country's political uncertainty. Still, the optimism index in Europe increased to 56.3 this quarter, up from 55.3 in June. And since the Brexit vote, European CFOs have grown more confident about their own companies' financial prospects, with that optimism level hitting 63.4, the highest it has been since the fourth quarter of 2015. Finance executives in Europe project wages will increase by 1.7% over the next year, and employment by 1.1%.

Company confidence stronger in Asia, Latin America, and Europe

Finance executives rate their optimism about their own companies' financial prospects*



*On a scale of 0–100, with 0 being least optimistic

MIXED BAG

In Asia, Latin America, and Africa, economic optimism and business confidence were dissimilar. Optimism about domestic economies shot up in Asia, with the index hitting 65, up from 58.7 in the second quarter. But variations ranged from 40 in Singapore, 48 in Japan, and 55 in Malaysia to 65 in India and 70 in China.

Two-thirds of Asian CFOs indicate they are holding back on investment spending due to political risk in their countries, though they expect capital spending to rise by an average of about 5.5%. No spending growth is expected in Japan. CFOs think wages will rise by 4% in Asia (which is modest by historic standards), with growth of less than 3% in Japan versus 5% in India. They also think full-time employment will be flat across the region.

In Japan, finance executives are evenly split on Prime Minister Shinzo Abe's 7.5 trillion yen stimulus plan, with 46.9% calling it "good news" and the same percentage labeling it "irrelevant."

Meanwhile, Latin American economic optimism dipped to 49.8 from 52.9 last quarter, though the optimism index varies widely across the region's individual countries. Optimism in Chile and Ecuador remains below 50, while Brazil rebounded somewhat to 53. Optimism remains strong in Mexico (63) and Peru (69). Averaged across Latin America, finance executives expect their capital spending will rise 2.1% in the next 12 months, with a positive outlook in countries other than Chile.

Full-time employment among Latin American companies is expected to decrease 1.4% overall, but, again, there are wide national variations: Employment is expected to increase 3% or more in Mexico and Peru, but fall in Brazil, Chile, and Colombia. Eighty-eight percent of Latin American CFOs indicate that political risk is causing their firms to be more cautious in business spending. One bright spot is the recent election of President Pedro Pablo Kuczynski in Peru. Ninety-five percent of Peruvian CFOs expect his policies to be helpful to their firms, as do 43% of CFOs in Chile.

Africa was the only region in which finance executives were less optimistic about their domestic and regional economies and their own companies' financial prospects. Economic optimism there dipped to 45.7 from 47.4 in the second quarter. CFO

The Transformers

How finance leaders are developing the capabilities they need to implement dramatic change. By Josh Hyatt

At a time when businesses need to make better, more timely decisions, finance executives need to lead a technology-driven transformation within the finance function and across the enterprise.

Their sense of urgency permeates a recent study, "The Finance Function's Readiness for Change," conducted by CFO Research in collaboration with WNS. In a survey of 156 senior finance executives at U.S. companies with annual revenue of more than $1 billion, respondents revealed how far their companies have to go before they can consider key aspects of their finance function worthy of being labeled as "advanced."

The study asked respondents to rate the current and future states of their finance function along four crucial dimensions: the finance operating model; automation of finance processes and activities; governance, risk, and control (GRC) structures and processes; and adoption of sophisticated analytics and digitization.

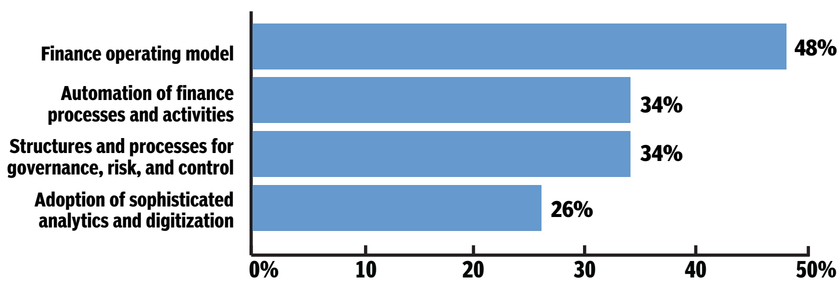
For each of those areas, respondents were asked to choose among three levels of proficiency: basic, intermediate, and advanced capabilities. They were required to not only assess the current state of their organizations but also the level they thought their companies would need to achieve in two years' time. Among the areas included in the study, the one which drew the lowest number of respondents who ranked their finance function as "advanced" was also the most dramatic: adoption of sophisticated analytics and digitization.

Analytics and digitization, in fact, are key in broadening the role of CFOs, who are best-positioned to leverage big data. The fact that only about one quarter of respondents (26%) claim to have reached the highest level in that realm isn't necessarily an indication of where it ranks among finance chiefs' many competing priorities. More likely, it reveals that finance executives are still busy laying the groundwork for that transformation, which first requires directing investments into, and gaining mastery over, the other changes outlined in the survey.

FIGURE 1

Making Progress by Being 'Advanced'

Percentage of respondents who rank these aspects of their financial function as "advanced"



34%

Percentage of finance executives who say that their finance function has reached an "advanced" level in terms of automation.

OPERATING MODEL

Nearly half of respondents (48%) ranked their finance function as "advanced" in terms of the status of the operating model underlying finance—the highest number, by far, in any of the four categories (see Figure 1). By the study's own definition, that translates into centralized control and standardized processes.

Those who chose "intermediate" weren't much fewer in number, comprising 40% of respondents. (In the survey, "intermediate" encompasses global process owners combined with regional operations and external providers.) That number suggests that nearly 90% of companies represented in the survey have made significant progress toward increasing flexibility on an organizational and functional level.

Still, respondents are cognizant of the obstacles ahead of them, including structural complexity, lack of change management capability, and acquisition-driven growth, which can result in an assortment of non-standardized processes, controls, and systems.

AUTOMATED PROCESSES

Finance executives view automation—replacing manual data entry with technology tools—as an important enabler for finance processes and activities. Advanced automation would allow most data to be generated by digital tools, requiring minimal manual intervention. By leveraging automation, companies can reduce costs through streamlined processes and a decrease in errors.

A majority of survey respondents clearly recognize the value of implementing automation to optimize financial processes. Nearly 6 in 10 respondents (57%) believe that, in order for their companies to succeed, they will have to achieve an advanced level of automation for managing financial, process, and performance data within the next two years (see Figure 2). But as committed to that objective as finance executives may be, survey results suggest that a majority of them have been slow to rise to the challenge. Only a third of respondents (34%) say that their companies have already reached an "advanced" level in terms of automation.

As for the perceived benefits of automation, nearly half of respondents (48%) cite the same two benefits on their lists of the top three: realizing efficiency gains in transactional processes such as order-to-cash, purchase-to-pay, record-to-report, and cash management; and the ability to adopt digital performance management tools. In combination with big data, such tools would equip finance executives with valuable insights into the business.

GRC STRUCTURES AND PROCESSES

It's understandable for finance leaders to act hesitantly when it comes to centralizing GRC activities. Mistaken moves, after all, could expose the company to a variety of costly risks, including compliance failures and reputational damage.

The reluctance to tackle such a daunting task may explain why two-thirds of survey respondents classify their own processes for ensuring compliance as either "intermediate" (61%) or "basic" (5%), meaning that their GRC practices either rely on non-standard processes and individual judgment-based metrics or include a mix of both standardized and non-standardized processes.

But a majority of respondents, 58%, believe that their GRC processes will need to progress to an advanced level within the next two years. Advanced GRC processes depend on a high degree of standardization, as well as sophisticated use of technology to provide risk-based metrics and dashboards that define global and functional standards, allowing management to identify exceptions quickly and respond appropriately.

The primary benefit to making such a transition, according to nearly half (48%) of respondents, is in ensuring compliance and avoiding personal liability. (The Sarbanes-Oxley Act of 2002 decreed that corporate officers can be held personally liable for misstatements and errors in regulatory reporting.) Other benefits of advanced GRC structures and processes, as chosen by a substantial proportion of respondents, include enhanced process efficiency and effectiveness (42%), a more agile and scalable control environment (36%), and ultimately, increased operating margins (32%).

FIGURE 2

Aiming for 'Most Improved'—and Soon

Percentage of respondents who anticipate reaching the advanced level within two years

Finance operating model	60%
Structures and processes for governance, risk, and control	58%
Automation of finance processes and activities	57%
Adoption of sophisticated analytics and digitization	53%

ANALYTICS AND DIGITIZATION

By successfully leveraging data analytics technology, finance executives can broaden their corporate roles to become big-picture strategists. Armed with data-derived insights, finance chiefs can identify future opportunities to hasten growth and fatten profits.

But among survey respondents, the vast majority have yet to acquire or master the technological tools that will elevate their duties and their companies to new heights. In the survey, only about one quarter of respondents (26%) say their use of technology is "advanced," a classification characterized by a focus on advanced data mining and predictive analytics as well as an integration of financial and operational information. And 80% of respondents say that the use of spreadsheets is still ubiquitous at their companies. Regardless, more than half of respondents (53%) recognize the need to progress to an advanced state of using technology within two years.

Digitization is a crucial link to developing data-analysis capabilities. Indeed, about a third of respondents say that digitization will allow their companies to build agile business processes in line with market shifts. Clearly, finance executives are aware of the technology's role in enabling them to weave raw data into patterns that form the basis of valuable insights. CFO

THE QUIZ

Reality Check

With all the talk of a revolution in payments and the development of services like Apple Pay, you might be under the impression that 90% of business-to-business transactions are now electronic. But that's far from true; many accounting departments are still awash in paper. How much do you know about how companies are actually using electronic payments? Take our quiz to find out.

1. What percentage of the typical U.S. organization's business-to-business payments are received by check?

   A. 50%
   B. 38%
   C. 25%
   D. 44%

2. What percentage of the typical U.S. organization's business-to-business payments are made by check?

   A. 44%
   B. 34%
   C. 51%
   D. 56%

3. After checks, what is the most popular method of paying major suppliers, used for 34% of payments?

   A. ACH credits
   B. Wire transfers
   C. Purchasing cards
   D. Single-use accounts

4. What is the top factor influencing companies' choice of method for cross-border payments?

   A. Contract requirements
   B. Currency risk
   C. Size and purpose of transaction
   D. Transaction cost

5. Which of the following benefits that companies gain from sending or receiving electronic payments (ACH, cards, wires) is NOT one of the top three cited by finance executives?

   A. Speed of settlement
   B. Working capital improvement
   C. Cost savings
   D. Improved cash forecasting

6. What is the most common barrier companies face when trying to convert to electronic payments?

   A. Lack of integration between electronic payments and accounting systems
   B. Shortage of IT resources for implementation
   C. Absence of standard formats for remittance information
   D. Difficulty convincing customers to accept electronic payments

Source: AFP's 2016 Electronic Payments Survey

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

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