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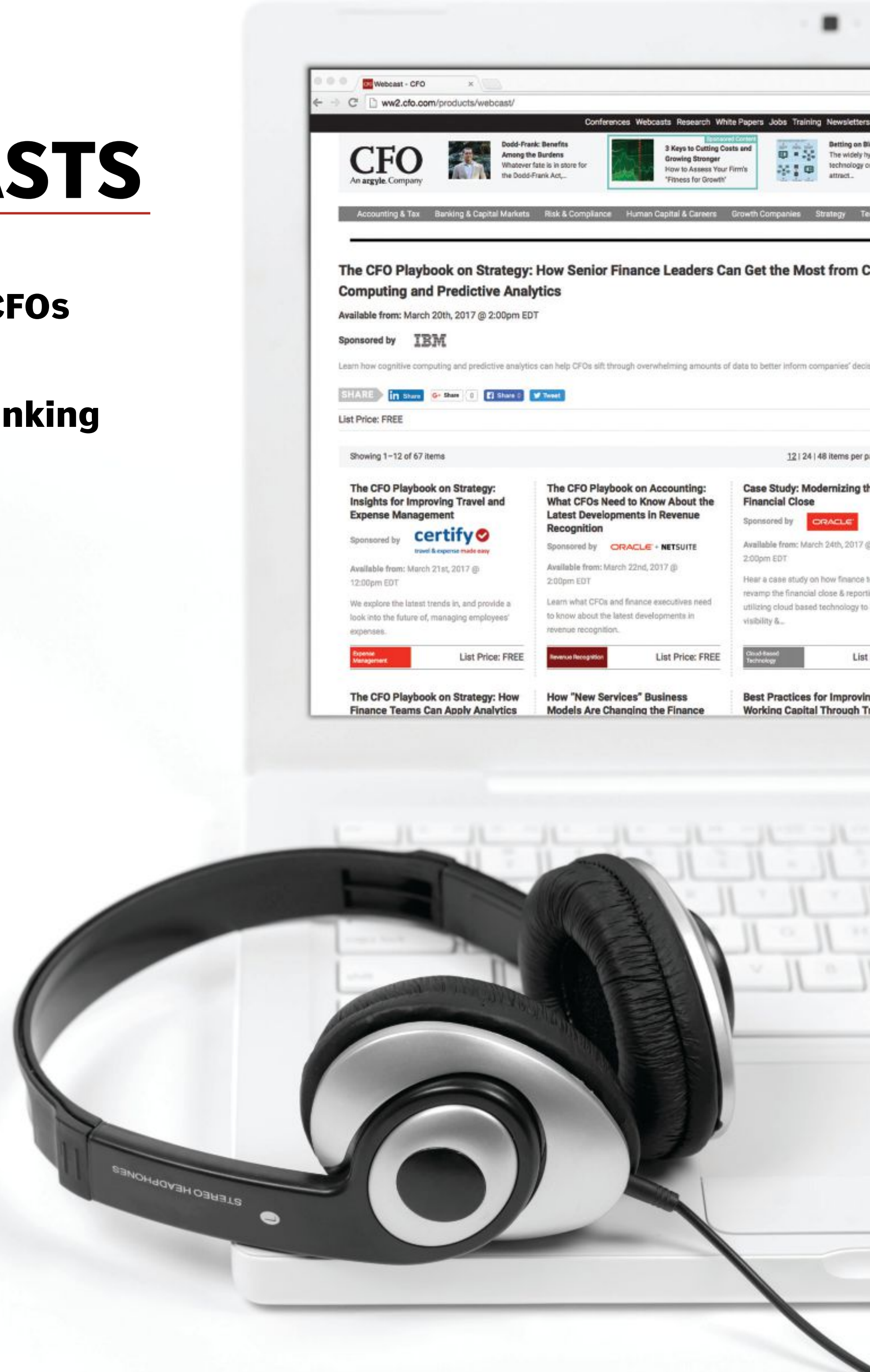

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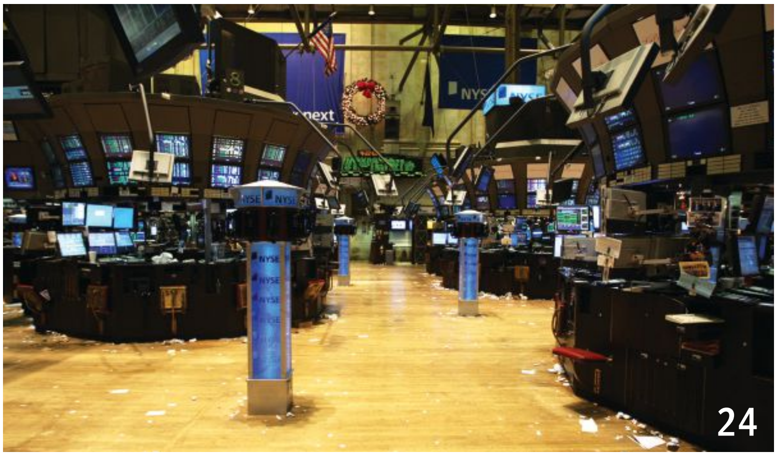

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Up Front

By the Numbers

Clockwise from top right: Thinkstock, courtesy MIT Sloan CFO Summit, Thinkstock (2)

FROM THE EDITOR

Crypto Craziness

If you want to chart the progress of digital (or "crypto") currencies, search for the word "bitcoin" on CFO.com. You'll find 68 stories, starting with a September 2013 piece, "Is Digital Currency Catching On?" What you'll discover, even from a cursory scan, is that bitcoin and other cryptocurrencies haven't evolved much.

In fact, bitcoin's advancement (as a currency) is, for now, over. At least in 2013, we could imagine a practical application: "Free of national boundaries and financial institutions' fees, [bitcoin] allows its users to send money out of the country quickly and economically, an advantage for companies pursuing growth in a global context."

Few experts talk about cryptocurrencies as a medium of exchange anymore. Some companies, like payments outfit Stripe, have dropped their support altogether: "Bitcoin has become better-suited to being an asset than being a means of exchange," said Stripe product manager Tom Karlo, not least because, by the time a transaction is confirmed, bitcoin's price volatility means the payment is for the wrong amount.

So what we wrote in 2013 still stands: Cryptocurrencies are more a commodity for "hobbyists and technology enthusiasts" than a real currency for businesses. But bitcoin's price is still over $8,000. More companies (some fraudulent) launch cryptocurrencies every week. And entrepreneurs are falling over themselves to start businesses to support the cryptocurrency craze. (See "Lender Taking Bitcoin as Collateral," page 16.)

All of this provides an air of legitimacy to cryptocurrencies. Don't buy the hype. Except for the value of their underlying technology, which may benefit corporate finance someday, bitcoin and its cousins are purely instruments of speculation.

At *CFO,* we too are also embracing the digital world. This year, we are moving to a six-times-per-year publishing schedule. Look for us in your mailbox in April, June, September, October, and November. In between, be sure to check us out online, at CFO.com, where we post the same high-quality original reporting, case studies, CFO interviews, daily corporate finance news, and how-to advice that we have provided for more than 30 years.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

FINANCE
The **CFO Rising East Summit** is right around the corner. Taking place March 7–8 in Boston, the event features the CFOs of Wolters Kluwer, IZotope, and the director of finance at Biogen. See the full speaker list on the Innovation Enterprise website.

STRATEGY
In **"The Art of Strategy Is About Knowing When to Say No,"** Brian Halligan, CEO of HubSpot, details his journey from approving every new product initiative to saying no to excellent ideas that don't fit the company's mission, even when besieged with "post-decision hallway lobbying." Read more on the Harvard Business Review website.

TECHNOLOGY
In **"What AI Can and Can't Do (Yet) For Your Business,"** three McKinsey partners investigate the limitations of artificial intelligence that will require "considerable effort to overcome." Among the challenges: having to hire people to label and categorize the underlying data that help train AI systems and dealing with AI models that can't generalize what they have learned to tackle new tasks. Read more on the McKinsey Quarterly website.

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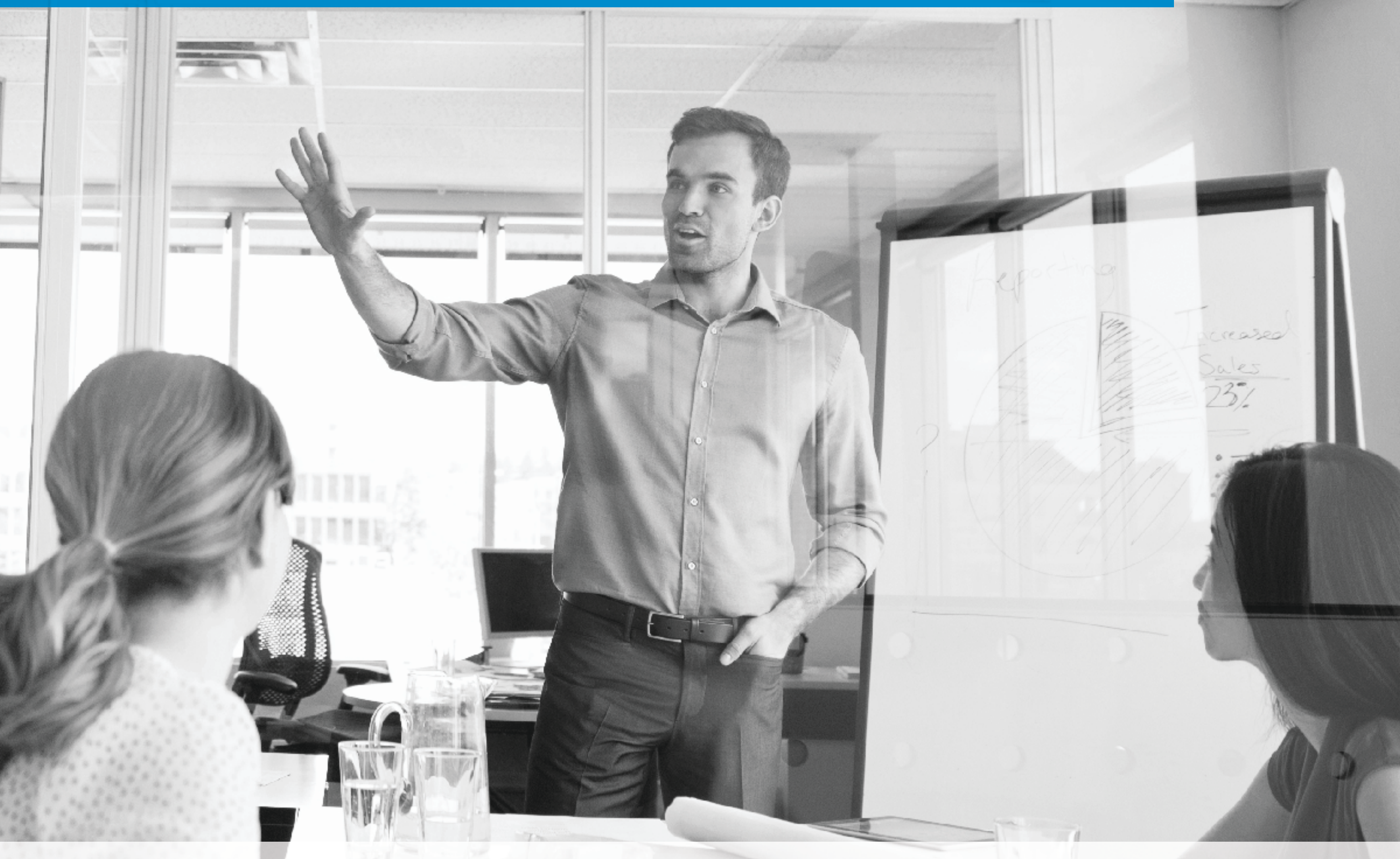

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INBOX

Is Amazon good for business? It's a debatable topic. After all, while the massive but nimble e-tailer is fundamentally changing the way business is done, sometimes in quite positive ways, its broadening reach is raising questions about its impact on competition in a range of industries. Predictably, when we wrote about this issue on CFO.com, it sparked some heated responses from the audience.

Wrote one reader, "Amazon grew because it didn't have to collect sales taxes. Equally, people could view and try items at brick-and-mortar stores before ordering [less expensively] from Amazon. **Without these major advantages, I don't think Amazon would be as big or profitable as it is.**

"As more states require that Amazon report sales so they can collect sales taxes," he continued, "the company now will face some of the limitations that other retailers do, as well as the tax consequences of setting up distribution centers in states that now have a nexus for both sales and income taxes."

Chimed in another, even more vitriolic Amazon critic in the audience, "For Amazon to be a true world-beater (and not just a modern version of the Sears-Roebuck catalog of yesteryear), it will have to cause the layoffs of millions of public-sector jobs. **Kill the parasite and watch our economy flourish for all businesses**—digital and brick-and-mortar alike."

In **"Share Buybacks: Who Really Benefits,"** contributors Kurt Schacht and Sviatoslav Rosov suggested that buybacks may no longer be an appropriate corporate activity. "The real questions," they argued, "are whether share buybacks are the best tool for returning capital, and whether they're sometimes used for the less-wholesome reasons of management entrenchment or enrichment." The article concluded, "The current practice of management share buybacks has fewer and fewer defenders outside of public companies' C-suites."

Another anti-buyback individual offered his own take: "The point that is often ignored in this debate is that **a buyback is tantamount to a fraud on small shareholders who cannot in reality participate,** given their minute number of shares." Responded another CFO.com visitor, taking sides with the authors, "Not really. A small shareholder will see the share price increase and can choose to sell the stock or hold it. The real fraud is management bonuses tied to misleading metrics that may not reflect operations one bit."

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STATS OF THE MONTH

16.67 million
Current supply of bitcoin

$4.9B
Average 24-hour trade volume in bitcoin

$257 million
Largest amount raised in an initial coin offering, 2017

$983 million
Total funds raised in ICOs in the last four months of 2017

253
Number of ICOs in 2017, up from 46 in 2016

All data as of January 30, 2018
Sources: Coinschedule, ICO Watchlist, Bitcoin.com

HEALTH BENEFITS

After Another Cadillac Tax Delay, Now What?

With the tax perhaps unlikely to ever take effect, should companies still factor it into benefits planning? By David McCann

The new two-year delay in the implementation of the Affordable Care Act's "Cadillac tax" points to a key question for companies: What, if anything, should they do differently now with respect to benefits planning?

Under the new timetable, the tax—a 40% excise tax on the cost of health plans above an established threshold—won't be assessed until 2022. The delay, the second for the tax, was included in the emergency government funding bill that President Trump signed on Jan. 22.

The question is pertinent because, with the delay, there are even greater doubts as to whether the tax will ever be implemented. Unless sentiments change, such an action will be a non-starter politically. No one wants it—neither Republicans nor Democrats, nor employers or employees, nor insurance companies or health-care providers. Bipartisan legislation to fully repeal the Cadillac was introduced in Congress last year, but that effort has lain dormant for months while other priorities took precedence.

Now, with the new delay in place and efforts toward a full repeal of the ACA having run aground last year, repealing the tax likely will become Congress' top health-care priority, according to Steve Wojcik, vice president of public policy for the National Business Group on Health (NBGH), a coalition of 400-plus large employers. Plus, over the past few years the Congressional Budget Office has been consistently revising downward the tax's estimated impact on the federal budget. That will "make it easier to get rid of," Wojcik notes.

But is that enough for companies to disregard the tax when setting long-term benefits-planning strategies? "They have extra breathing room on the tax now, but 2022 is not that far out into the future, so you still have to factor it in," says Wojcik. In the meantime, the NBGH will be working alongside other employer coalitions and advocacy groups, including the American Benefits Council, to get the tax repealed. The ABC is a key member of The Alliance to Fight the 40, a coalition of businesses, patient advocates, unions, local governments, health-care companies, consumer groups, and other stakeholders.

For Mercer, a big human capital consulting firm that is a member of the alliance, the reasons for the push-back are twofold. First, when the ACA was passed in 2010, the firm immediately surveyed employers, who said the Cadillac tax was their top concern even though it was scheduled as the last provision of the law to take effect. That stance

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"Every day employers are having to make decisions that could intersect with the Cadillac tax, without knowing ultimately what that will mean."

—Tracy Watts, senior partner, Mercer

hasn't wavered in the years since, notes Tracy Watts, a senior Mercer partner and the firm's U.S. leader of health-care reform.

Second, the design of the tax is significantly flawed, according to Watts. "Using cost as a proxy for the richness of benefits just doesn't work," she says. "There are so many factors beyond plan design that impact cost, including the age of an employer's [employee] population, geographic location, the number of dependents covered, and whether unions are in play, to name just a few."

With respect to the tax still being scheduled to eventually take effect, the biggest issue for companies isn't doing the financial modeling to understand whether or when their health-care spending will reach the threshold for triggering the tax, according to Watts.

"It's more the lack of guidance for exactly how [the tax's implementation] will work," she says. "We're working with just a couple of pages of content that are in the original ACA law, and nothing else." For example, the law says employers must include the cost of on-site health centers in their Cadillac-tax calculations. "But it doesn't tell us how to do it," Watts notes.

When the ACA was passed, Mercer told lawmakers and regulators of concerns that the anticipated influx of new insureds might make health care more difficult to access. With onsite health centers positioned to help alleviate some of that pressure, why should their costs be taxed?

"They said not to worry about that because they'd deal with it when they wrote regulations [for implementing the provision]," recalls Watts. "But that hasn't happened. Every day employers are having to make decisions that could intersect with the Cadillac tax, without knowing ultimately what that will mean."

Wojcik notes that if the tax ever does take effect, "employers will have some hard decisions to make. It's highly unlikely that they would acquiesce to paying it." CFO

ACCOUNTING

PwC Liable in $2B Bank Fraud

The firm failed to meet professional standards in audits of Colonial Bank mortgage loans.

PricewaterhouseCoopers has been found liable in an accounting malpractice case that alleged it failed to detect the $2 billion fraud that led to one of history's biggest bank collapses. The alleged fraud involved executives at Taylor, Bean & Whitaker, a defunct mortgage firm, and counterparts at Colonial Bank, an Alabama-based lender that supplied TBW with loans.

PwC gave the bank's parent, Colonial BancGroup, a clean audit for years before it emerged that huge chunks of Colonial's loans to TBW were secured against assets that did not exist. Colonial collapsed in August 2009.

In the malpractice case, U.S. District Judge Barbara Jacobs Rothstein agreed with the Federal Deposit Insurance Corp. that PwC failed to meet professional accounting standards in its audits of Colonial. The FDIC sued the firm after incurring a $2.8 billion liability from Colonial's collapse. "PwC did not design its audits to detect fraud and PwC's failure to do so constitutes a violation of the auditing standards," Rothstein ruled.

The fraud, centered in Colonial's mortgage warehouse lending division, was orchestrated by Lee Bentley Farkas, the chairman of TBW, with the aid of Catherine Kissick, the head of the MWLD, and other Colonial employees. PwC said it was duped by Farkas, who skimmed millions of dollars from Colonial to buy a private jet, vintage cars, and a vacation home. But Rothstein faulted PwC for, among other things, failing to inspect or even request to inspect the underlying documents for some TBW mortgages.

"PWC argues that even if it had attempted to inspect the underlying loan documents, it would not have uncovered the fraud because the fraudsters would simply have created fake documents," Rothstein noted. "This, of course, is something that we will never know. However, what we do know is that Ms. Kissick, one of the key fraudsters, testified that if PWC had asked to see even just ten loan files '[t]he jig would be up.'"

The case now moves into a damages phase, where the FDIC is seeking up to $2.1 billion. | MATTHEW HELLER

This page: top, courtesy Mercer; bottom, Thinkstock

BUDGETING

Sorry Jodie Foster, Big Movies Win

Jodie Foster may think big-budget films will ruin Hollywood, but, with rare exceptions, financially they perform better than their smaller-budget counterparts, according to a Standard & Poor's analysis. In analyzing the box-office performance of 3,406 big-studio films released between 2000 and October 2017, the credit rating agency found that movies with production budgets of $200 million or higher have "greater, more predictable" returns.

S&P also assessed box-office predictability by calculating the correlation between production budget and receipts. Worldwide, the big-budget films in the study generated box office returns of 3.69x their production budgets. These films also had the strongest correlation between budget size and box-office returns. The performance of such films compared with an average 2.99x box-office return for movies with budgets of $100 million to $199 million, and 2.52x when budgets were $20 million to $99 million. Surprisingly, films with production budgets of less than $20 million earned higher average worldwide returns (3.28x) than other films with budgets of $199 million or less.

"Despite the unpredictability, film studios continue to make a large number of these films because of their modest production budgets and the oversize returns if a film is successful," the report says. As an example, it cites STX Entertainment's 2016 movie "Bad Moms," whose worldwide returns were 9.1x.

The average film released since 2010 costs 30% more than the average from 2000 to 2010. It seems film icon Foster dislikes the trend. "Going to the movies has become like a theme park," she told *Radio Times*. "Studios making bad content in order to appeal to the masses and shareholders is like fracking—you get the best return right now but you wreck the earth." | **VINCENT RYAN**

COMPENSATION

Incentives Questions

Compared to other effects of the Tax Cuts and Jobs Act, its impact on executive compensation has received relatively little attention. But the new law raises questions with respect to performance-based incentives.

Many companies have rolling performance measurement periods of at least three years. That is, top executives' pay is determined each year in part by performance metrics relative to established goals for the preceding three or more years.

Given the big drop in the corporate tax rate starting this year, bottom-line-based goals such as earnings per share will be much easier to attain at the end of performance periods already in progress, notes Steve Seelig, executive compensation counsel for Willis Towers Watson.

Companies presumably will adjust for the change when establishing performance measures for multi-year periods that begin this year. But what, if anything, companies will do to alter executive pay for periods already in progress remains to be seen.

The new tax law also may spur fundamental changes in how some companies pay executives, according to Seelig. Companies can claim a maximum $1 million tax deduction on compensation paid to a "covered employee," which under the new law includes the CEO, CFO, and the three other top-earning executives.

Until now, performance-based pay was exempt from the $1 million limitation. That has driven many companies to cap executive salaries at $1 million and provide any additional pay under performance programs. But the Tax Cuts and Jobs Act eliminates that exception.

That may not prove too painful for most companies, considering the new tax-rate windfall. "You have to take into account the entirety of the tax reform," Seelig says. At the same time, he suggests, some companies may follow the lead of Netflix, which announced on Dec. 29 that it will convert some performance-based pay for top executives to straight salary. | **D.M.**

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REGULATION

Hospital CFOs Lag Behind

Medical-industry CFOs report that they're struggling to keep pace with the demands placed on their organizations by the transformation the industry has been undergoing for the past decade, new research suggests.

Macroeconomic forces have created strong momentum to reduce health-care costs, notes Kaufman Hall, a management consulting firm with a health-care practice. At the same time, "new technologies and competitors are offering consumers and other health-care purchasers improved value through new care settings, connectivity, and delivery models," the firm writes in its survey report.

Among 361 health-care finance leaders surveyed, 88% of them employed by hospitals, only 15% said their organizations were "very prepared" to manage evolving payment and delivery models with current financial planning processes and tools.

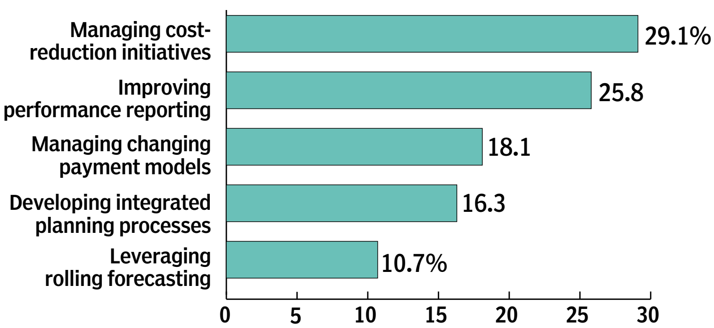
Also, just 25% of those surveyed said they were "very confident" in their team's ability to quickly and easily make adjustments to strategies and plans. Further, only 8% of participants said they were "very satisfied" with the performance management reporting at their organizations.

The data are particularly disturbing given that they are similar to the results of a survey the firm conducted a year ago, indicating a lack of progress. "As the mix of [payment and delivery] models evolves, health-care leadership teams must know how they are performing in managing populations and reducing costs, with increasing accountability for value in both inpatient and outpatient settings," Kaufman Hall writes.

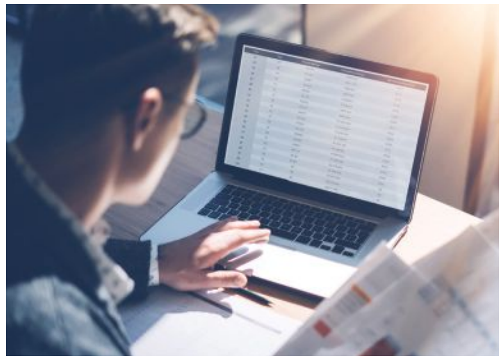
Another area of concern is the budgeting process, with 69% of respondents saying it takes more than three months from initial rollout to board presentation. | D.M.

Priorities in Health Care

Cost cutting tops the list of what health-care CFOs are focused on.



Source: Kaufman, Hall & Associates; January 2018 survey of 350 senior finance executives at hospitals, health systems, and other health-care organizations



ACCOUNTING

FASB Relaxes Lease Rules

Driven by companies' complaints that complying with the Financial Accounting Standards Board's new lease-accounting standard will cost them substantially more than they previously thought, FASB is proposing what it thinks is a cheaper compliance option.

Instead of companies having to apply the requirements of the standard to their 2017, 2018, and 2019 balance sheets, FASB proposed that companies should have the choice to report "the cumulative effect" of the changeover in just their 2019 financials.

The idea is that trimming the paperwork and analysis could cut compliance costs like those incurred in acquiring software, upgrading lessees' lease-accounting systems, and signing on consultants and accountants.

As companies have started to comply with the new lease rules, "many preparers have cited their plan to implement new systems and are observing some unanticipated costs and complexities," according to the proposal. Executives have had a particularly tough time with the need to provide detailed comparisons for all three years, according to FASB.

Because of the unanticipated costs their companies were experiencing, corporate lessees asked FASB to provide an added and optional transition method. Under the proposed accounting standards update, companies could apply a "cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption," which starts January 1, 2019. | DAVID M. KATZ

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LAW

Workplace Class Actions Soared in 2017

The monetary value of the top workplace class-action settlements rose dramatically in 2017, eclipsing the previous high reached two years earlier by almost 10%, according to the latest annual report by law firm Seyfarth Shaw. The top 10 settlements last year had an aggregate value of $2.72 billion, compared with $2.48 billion in 2015. The new record was also 55% higher than the 2016 level of $1.75 billion.

Whether the surge in settlement dollars was the beginning of a long-range trend or a short-term aberration remains to be seen. But evidence suggests that another new record may be established this year, Seyfarth Shaw says.

On the other hand, evolving case-law precedents and new defense approaches resulted in better outcomes for employers in opposing class certification requests, the law firm notes. For example, employers won 27% of the 257 wage-and-hour certification decisions in 2017, up from 24% the prior year. And employers' success rate in case-breaking decertification rulings jumped to 63% (15 out of 24), compared with 45% in 2016.

The report also notes that filings and settlements of government enforcement litigation in 2017 "did not reflect a head-snapping pivot from the ideological pro-worker (and anti-big business) outlook of the Obama administration to a pro-business, less regulation/litigation viewpoint of the Trump administration."

Instead, government enforcement litigation actually increased in 2017. For example, the Equal Opportunity Employment Commission (EEOC) alone brought 194 lawsuits, compared with just 86 a year earlier. Further, the aggregate value of the top 10 government enforcement cases skyrocketed from $52.3 million to $485.3 million.

However, as 2018 opens, it appears that the content and scope of government enforcement litigation will change character. "Trump appointees at the [Department of Labor] and the EEOC are slowly but surely 'peeling back' on positions previously advocated under the Obama Administration," the report says. | D.M.

COMPENSATION

Grant Thornton Pay Gap Tops Big Four

Grant Thornton reported a larger gender pay gap than any of the Big Four accounting firms have, attributing the difference to the imbalanced structure of its workforce.

The smaller firm's workforce is split almost equally by gender: 51% men to 49% women across its combined entities. But the mean gender pay gap is 26.6%, and there's also a 51.8% gap in the size of bonuses. Among the Big Four, KPMG has the largest pay gap at 22.3%, followed by EY at 19.7%, Deloitte at 18.2%, and PwC at 13.7%.

Grant Thornton noted that there are more women than men in its first grade bracket, but men predominate at higher levels—64.5% at senior manager, 64.5% at associate director, and 75.9% at director.

"The problem we need to solve is much greater than an issue about pay alone—and we are confident that we pay men and women comparably for the same or similar work, or work of equal value," it added. "Our gender pay difference is a symptom of the overall gender gap that manifests itself as our people's careers progress, and the fact that there are more men than women in senior positions."

According to *Accountancy Age*, the Grant Thornton numbers support "other gender pay gap research that suggests the disparity does not stem from a lack of women in the workforce, but rather structural and cultural barriers that prevent women from traveling up the corporate pipeline." In its 2017 gender survey, the American Institute of Certified Public Accountants found that partnership on average remains overwhelmingly male, with women representing only 22% of partners in accounting firms.

Grant Thornton said it has set targets of reducing the pay gap to 18% to 20% by 2020 and increasing the percentage of female partners from the current 16% to 22% by 2020 and to 25% by 2022. | M.H.

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ACCOUNTING

Investors Blast GAAP

Non-GAAP metrics command far more attention from investors than do the official numbers, research says. By David McCann

After the Securities and Exchange Commission issued new guidance on the use of non-GAAP metrics in May 2016, investor relations advisory and services firm Clermont Partners observed increasing consternation among its corporate clients, said Clermont founder Elizabeth Saunders. ¶ Although guidance is intended to make regulations clearer, that year's pronouncements, combined with the SEC's increasingly rigorous enforcement, left some companies confused as to what non-GAAP measures they could use and talk about.

Even more pronounced was their frustration that in so many cases the official numbers provided less insight into a company's performance than the unofficial ones.

Clermont's buy-side contacts had similar feelings, Saunders said. So, the firm decided to survey buy-siders on the topic to find out just how deep their discontent ran and whether they thought about the use of non-GAAP metrics as rigorously as the SEC wanted them to.

Clermont identified and sent surveys to 580 U.S.–based, actively managed buy-side investment funds and firms (excluding actively managed exchange-traded funds) with more than $200 million in assets under management. Almost 10% (56) of them responded.

The eye-opening result, although Saunders characterized it as unsurprising, was that 74% of the participants said they rely more on non-GAAP metrics than on GAAP in performing their analyses. Also, only 36% of them agreed with the statement, "GAAP presentations of financial statements provide an accurate picture of financial performance."

And exactly 9 in 10 respondents said they carve out their own view of a company's financials to some degree by making adjustments to GAAP numbers. "It's interesting how many times we heard things like, 'GAAP means nothing to me, I completely ignore it because of all the non-recurring adjustments,'" said Saunders.

Decline and Fall

Clermont hosted a webinar on the topic in December 2017, whose other panelists were Christopher Marangi, a portfolio manager at investment firm Gamco; Elizabeth Lilly, founder and president of Crocus Hill Partners, an investment firm specializing in small-cap equities; and Baruch Lev, professor of accounting and finance at New York University's Stern School of Business.

Lev presented findings from a research study he co-authored showing that in the years just before and after 1990, a "perfect" investor—a hypothetical one who could predict every public company that would meet or beat analysts' consensus GAAP earnings estimates—would earn a quarterly return of just under 6%. That number has generally been declining ever since, reaching 2% by 2015. The conclusion: GAAP earnings "no longer reflect what they should reflect," said Lev.

He also noted that, until the mid-1980s, there was a strong correlation between two GAAP metrics: earnings and book value. Since then, the relationship has consistently declined. That trend has coincided with decreasing investment in tangible assets—property, plants, equipment—and increasing investment in intangible assets: R&D, patents, brands, information systems.

That growing gap "correlates well with the demise in the value of GAAP information," Lev said. "All those huge investments are basically expensed in the income statement [along with] regular expenses like salaries, interest, and rent, which completely destroys

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"It's interesting how many times we heard things like, 'GAAP means nothing to me, I completely ignore it.'"

—Elizabeth Saunders, founder, Clermont Partners

the income statement and, of course, the balance sheet."

Lev has been talking about the diminishing value of GAAP for years and co-authored a book on the topic, "The End of Accounting" (Wiley, 2016). He and co-author Feng Gu examined hundreds of conference calls in order to more fully understand what was important to investors. What they found was that investors placed the most value on what economists call "strategic assets"—ones that are unique to a company.

The number of industries providing good, comprehensive information on such assets is growing fast, said Lev. Currently, the group includes pharma/biotech (product pipeline data); Internet service providers, telecom, and media (customer data); oil and gas (information on exploration and renewals); insurance (policy renewal, frequency, and severity of claims); and retail (same-store sales).

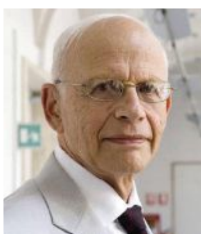
Just a few years ago, Lev said, during a consulting engagement he advised a pharmaceutical company that it should disclose complete information on its product pipeline in order to entice investors. "They said, 'Are you crazy?'"

For Marangi, the decline of GAAP "has been an evolution over many decades as the nature of the economy has changed and the financial sector has gotten larger and more sophisticated," he said. "There are more financial professionals with more data who are trying to get an edge on one another."

But, he said, no matter what data is used, the value of a company comes down to the present value of future cash flows. "When we look at a company today we're really asking three questions: What is its true cash-flow power today? How fast will that cash flow grow? And how predictable and defensible is the cash flow? And those questions are primarily informed by non-GAAP measures."

An interesting test of just how powerful non-GAAP metrics are in the market (and whether they are really driving valuations) will be the changes to the revenue recognition standard, said Marangi, whose belief is that ASC 606 "doesn't affect cash flow and won't have much economic impact."

Lev also strongly criticized the hefty new standard. "I don't think a rule that stretches over 709 pages is reasonable," he said. "This is accounting gone mad." The Financial Accounting Standards Board worked on the new rules for many years. Still, after FASB released its exposure draft in May 2015, the rules' effective date had to be delayed for a year because "it was so complex, no one understood it," Lev noted.



GAAP earnings "no longer reflect what they should reflect."

—Baruch Lev, NYU's Stern School of Business

According to Lev, FASB needlessly responded to an avalanche of comments on the exposure draft by adding more and more details to the standard, addressing very specific scenarios. "Basically, the rule didn't change anything," he said.

Approach with Caution

Despite the usefulness of non-GAAP measures, investors do have to take more care when relying upon them. At Crocus Hill Partners, the firm conducts very detailed reviews of companies' financial statements, including footnotes, to establish whether the audited metrics correspond with what the company is portraying in its non-GAAP metrics. "The more correlated they are, the more comfortable we are," said Lilly.

She added that it's crucial for analysts to "do the math themselves" and to determine what expenses are truly non-recurring or otherwise extraordinary. Companies are "not always forthright" in their non-GAAP earnings measures, she said. If they were, she pointed out, the non-GAAP figures would not, as is almost always the case, be higher than the GAAP numbers.

For example, Lilly criticized companies, of which there are many, that drop stock-based compensation expense in calculating non-GAAP earnings. "It's an outlay of company shares that dilutes the ownership of other shareholders," she said. "It is a real expense."

Additionally, Lilly said her firm is "very leery" of serial acquirers that eliminate acquisition expenses in their non-GAAP reporting. These companies often do, however, include the revenue added from acquisitions. "You never truly understand what the ongoing earnings of these companies are," she said.

She also railed against the SEC for failing to provide clear-cut rules for including or excluding expense items in non-GAAP presentations. "What companies adjust for in their non-GAAP calculations gives true insight into how they view themselves," she said. "Are they using the non-GAAP measures to help people truly understand the business? Or are they trying to improve the way investors perceive the business?"

The best measure for purposes of valuing companies, according to Lilly, "is somewhere between GAAP and non-GAAP, because non-GAAP can overstate earnings and GAAP can understate earnings." CFO

This page, courtesy the companies

Lender Taking Bitcoin As Collateral

Firm provides a "bridge to liquidity" for investors and businesses by originating loans secured by the cryptocurrency. By Vincent Ryan

Would your business accept bitcoin as collateral? Would it feel confident securing an obligation with an asset whose price could fall 20%, 25%, even 30% in a few days? Would it feel comfortable with murky laws that do not clearly define what it means to be custodian of a digital asset? Would it be OK with accepting bitcoin despite the fact that in the last few years billions of dollars of the cryptocurrency have been filched by online thieves?

A handful of financial services firms are saying "yes" to those questions and building businesses around originating loans secured by bitcoin. Unchained Capital is one of them. The firm provides cash loans to borrowers who post bitcoin (and, in the future, Ethereum) as collateral. Unchained has permission to conduct business in 28 states, including Texas and New York. (California is coming on line soon, the company notes.)

Unchained Capital's founders, Joe Kelly and Dhruv Bansal, were co-founders of Infochimps, a provider of Big-Data infrastructure tools that was sold to professional services giant CSC in 2013. In the bitcoin arena, they say they want to "bring a degree of freedom" to the asset class. Borrowers are able to get a loan or line of credit secured by a portion of their bitcoin assets, enjoying the fruits of bitcoin's price appreciation while maintaining their long position in the cryptocurrency. Kelly and Bansal estimate that bitcoin holders have about $20 billion to $30 billion of the volatile currency to borrow against.

While some other startups are nibbling around the edges of cryptocurrency financial services, the Austin, Texas–based firm has been lending to a pilot group "quietly" for the past year. In the fourth quarter of 2017, it officially opened up lending to the public. Unchained Capital is backed by private capital providers (which the founders are not yet ready to name) that purchase the loans Unchained originates; Unchained sits in the middle, servicing the loans and the collateral.

The firm has capital commitments north of $10 million and has other partners at various stages of development that may "bring larger pools of lending capital as the market and customer segment develops," says Kelly.

Setting Boundaries

Of course, lending against bitcoin requires some precautions. Unchained Capital has set a 50% loan-to-value ratio, so borrowers looking for a $100,000 loan need to put up $200,000 in bitcoin. Loan terms run from 3 months to 2 years, during which the borrower pays only the interest. The principal is due at the term's end. Interest rates run from 10% to 14%, inclusive of Unchained Capital's 1% origination fee.

Several of the company's early customers are bitcoin miners, and the loans are often used as capital for more mining equipment purchases, Kelly says. There is also demand from cryptocurrency-native businesses, such as exchanges and crypto-funds, that have U.S. dollar–based working capital and cash-flow needs.

"Bouncing between fiat [currencies] and cryptocurrencies is still a challenge for many bitcoin and cryptocurrency businesses, and exchanges have historically been the only bridge for liquidity," Kelly says. "In providing crypto-secured loans, we are helping

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real companies keep a foot in each world to better manage their businesses."

How does Unchained protect against bitcoin's peaks and valleys? If there's a 25% drop in the price of bitcoin, it requests more collateral from the borrower. Foreclosing on the loan doesn't occur until the value of bitcoin drops 45%. The "long buffer" between a collateral maintenance action and the trigger for a foreclosure event lessens the likelihood of a default event, which could result in repossession of the collateral, the company says.

Skeptics would note that a drop of 45% is not that far outside the realm of possibility, given bitcoin's price movements in December 2017 and January 2018. "We can't do much about bitcoin's volatility, but we do feel good about the boundaries we've set," says Kelly.

"It's a ceiling most capital providers are fairly comfortable with—and clients know that nothing will be sold out from under them," he says. Unchained has had only one instance in which the 25% drop was hit. That occurred when there was news about China banning bitcoin. Clients posted more collateral quickly to cover the shortfall; on average, they took only 90 minutes to do so. In some cases, the collateral value had rebounded within that timeframe. "Every one of our clients is very sensitive to not losing any of their bitcoin," says Kelly.

In a foreclosure, the repossession and liquidation of bitcoin could also take place very quickly, unlike the lengthy and costly process a real estate lender has to go through, Kelly notes.

Unchained makes sure its borrowers aren't leveraging all of their assets, so that they will be able to come through in a maintenance-call scenario. "Our risk model is heavily weighted toward the actual asset,"

"We can't do much about bitcoin's volatility, but we do feel good about the boundaries we've set."

—Joe Kelly, co-founder, Unchained Capital

says Kelly. "We pay attention to the person's overall crypto holdings and ensure they have a source of income for the interest payment—we don't use credit scores or anything like that."

By having borrowers sign a statement as to the loan's purpose, Unchained also ensures that the borrower isn't taking out a loan to buy more cryptocurrencies. "That's a margin loan," says Bansal. "It's a smaller fraction of loan requests than you would think."

Unchained says it may offer different terms on different forms of collateral as the market changes, or if requested by its capital partners. But Kelly also points out that cryptocurrencies are evolving very quickly. "With the advent of options trading on CBOE, CME, and LedgerX, lending and options contracts will work in complement to provide stability for both lenders and borrowers in the near future," he says.

As to the "physical" security of the collateral Unchained Capital holds, the company's information page says it uses unique per-customer, per-loan multisignature addresses for all bitcoin held in escrow. "We do not operate a network-connected hot wallet of any kind for any purpose, and our hardware wallets are in geographically separate locations and must be simultaneously accessed to authorize spending."

Unchained says borrowers have the ability to check their collateral balance at any time using a block explorer, a browser that displays the content of individual bitcoin blocks and transactions and the transaction histories and balances of bitcoin addresses. Kelly and Bansal also stress that the company is fully compliant with the Bank Secrecy Act, the Consumer Financial Protection Act, the Truth In Lending Act, and the Equal Credit Opportunity Act.

However much it wants to ride the cryptocurrency wave, Unchained Capital still has a couple of toes in the old world. For one, it is not using blockchain—the digital ledger technology underpinning bitcoin—to automate any part of the lending or collection process. "As much as I love bitcoin, I'm nervous about people putting business logic into smart contacts," says Bansal.

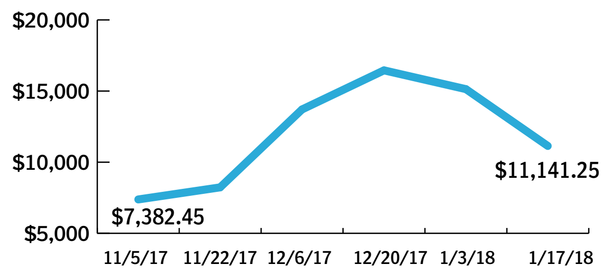
Second, under the Uniform Commercial Code, Unchained has to file paperwork to take a security interest in a borrower's bitcoin assets. The irony of having to use paper to claim a security interest in an asset that is built on a secure, digital distributed ledger is not lost on Kelly. "We kind of find it funny and backwards," he says.

Legislators are still working out what it means to control a digital asset and even how "control" is defined. In addition, there is an absence of case law around how bitcoin assets get carved up by the courts in a bankruptcy. "There are still pieces that have to be solved," says Kelly. However, "there's enough clarity for us to operate." CFO

Big Moves

Bitcoin's volatility makes it a risky asset to accept as a pledge against a loan.

Bitcoin price (in $U.S.)



Source: Coindesk

Zero-Based Budgeting "My Way"

CFOs can embrace a more innovative approach to budgeting without committing to the entire ZBB process. By Hal Polley

"Regrets. I've had a few ..." ¶ Much like Frank Sinatra, finance executives who have wrapped the laborious budgeting process are also likely to have a list of unmentioned regrets. If they were inclined to articulate them, no doubt zero-based budgeting (ZBB) would land atop the heap. ¶ Because it's a concept so often misunderstood or misused, let's avoid our own regret and pause for clarification: ZBB, first introduced in the 1970s, is a process of budgeting that requires managers to build their budgets from zero on an annual basis. It employs a methodology wherein finance breaks costs into decision packages, assigns each package to two owners with differing perspectives, and requires decision-makers to force-rank priorities.

ZBB's focus on exposing and eliminating unproductive costs and understanding cost drivers has earned it a renaissance of late, particularly among executives seeking more sophisticated value-creation tools.

The aforementioned "unmentioned" regret tends to fall into two distinct camps: the "Just Dids" and the "Never Wills."

The "Just Dids"

This clan is composed of those CFOs who, given fund sponsor or stakeholder pressure, undertook a ZBB approach to budgeting, only to find its sullied reputation true: It was indeed not only prohibitively complex, but it also positioned the office of the CFO as a burdensome antagonist to the business.

More regretful was the fact that it just didn't work. The Just Dids fall into the 65% of companies that employed ZBB but failed to meet budgeting goals, according to a 2016 Deloitte survey.

A deeper dive into the ZBB-user survey statistics shows even more reason for regret: 41% who have employed ZBB point to poor design and understanding as a reason for goal failure; 47% point to the poor business case for its use.

The "Never Wills"

Of course, the flip side to those who went through a failed ZBB pilot are the CFOs who never will. These are the ones who have either heard the ZBB horror stories (see above) or who simply elect a more traditional approach to budgeting.

Why the regret, then? Because these are also the (mostly private equity–backed) CFOs who have substantial cost-cutting targets to meet and now, on the back end of budgeting season, realize the traditional approach won't get them there. These are the CFOs who know that, post-deal, PE investors retain the existing CFO only 25% of the time. In addition, they are concerned about their level of "replaceability" with an executive more amenable to unorthodox budgeting philosophies and more confident about meeting aggressive value-creation targets.

ZBB-Light

With apologies to Sinatra, what neither the Just Dids nor the Never Wills seem to understand is that there is a "my way" approach to ZBB that avoids the pitfalls of going all-in, while still embracing a more innovative approach to budgeting.

We call it ZBB-light. This edited approach borrows many of the ZBB principles and applies them to certain costs within specific business depart-

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ments and functions. (It's particularly applicable to costs that are not directly related to revenue.)

Leveraging some of ZBB's core concepts (like decision units and decision packages) can force the organization to think about alternative ways to perform functions without burdening the business with some of ZBB's labor-adding exercises.

Sound too good to be true? That's because in some ways it is. Yes, ZBB-light strips some of the risks from the unabridged approach. But implementing the light approach effectively still requires the meticulous up-front planning of its Full Monty cousin. In fact, one might argue that because ZBB-light targets only certain, applicable units of the business, the upfront diligence required to identify those units must be even more meticulous.

It raises the question: Given the heavy lifting required for even an abridged ZBB approach, why do it at all? Putting aside the "not getting fired" incentive, smart CFOs recognize that the benefits of ZBB, particularly in a PE-environment, are plentiful and meaningful:

- A well-justified budget aligned to strategy rather than history
- The avoidance of “”automatic” budgetary increases
- The improvement of operational efficiency via a rigorous challenge of assumptions

"ZBB's focus on exposing and eliminating unproductive costs and understanding cost drivers has earned it a renaissance of late."

—Hal Polley, managing director, Accordian

First, We Cleanse

Doing ZBB-light and doing it right are two different things entirely. For the latter to occur, the planning phase for year-end budgeting has to happen, well, now. And that planning must take the form of a three-step robust data hygiene exercise, the purpose of which is to create a single source of financial truth to inform cost-cutting targets.

Step 1: Diagnostic. The diagnostic phase helps identify the lowest-hanging fruit for ZBB-light applicability. CFOs must create a matrix of corporate financials (by functional area, department, and cost category) focusing on selling, general, and administrative expenses versus gross margin. This data diagnostic exercise will enable the corporation to target the right functions and departments and will provide an accurate assessment of the total scope of potential margin improvement.

Step 2: Benchmarking. Now that the data are clean, the CFO has an accurate point of departure for comparison. That comparative exercise must take place both internally and externally: Finance must take a full inventory of what the company has done historically by function and department. Those internal benchmarks need to assess specific costs as a percentage of revenue over, say, a previous five-year period, in order to paint a clear picture of company-specific investment and outcome ratios. The exercise must then contrast that with industry norms and best-in-class numbers. Those two comparative measures, when combined, will allow for informed target-setting and achievable, yet still aggressive, goals.

Step 3: Defining Success. This final step must take a very granular approach toward defining success per department or function. For example: in human resources, what does success look like? Achieving lower recruiting costs? Decreasing worker attrition rates? In sales, is success counted as reducing sales cycle times? Attracting a larger customer base? Increasing share of wallet? Defining targets requires an understanding (via the data hygiene exercise) of the drivers of success and their correlation with spend.

Only when the three-step data hygiene and analytics exercise is complete can companies effectively begin any strategic ZBB implementation, light or otherwise. It's an undertaking, to be sure, but one that can pay significant dividends in the form of potential margin improvements upwards of 1,000 points.

With margin improvements like that, maybe Sinatra was on to something: CFOs embarking on a meticulously planned ZBB-light implementation may, in fact, wind up with too few regrets to mention. CFO

Hal Polley is managing director and head of strategic finance at Accordion, a private equity financial consulting firm.

Editor's Choice

FUELED BY CASH

Only two out of nine S&P 500 business sectors studied recently by Georgia Tech researchers—energy and utilities—didn't have enough free cash to cover their dividends in the 2012 to 2016 period. Three free-cash-flush industries—telecommunications, IT, and health care—were liquid enough to cover both their dividends and share buybacks.

Top: courtesy Accordian; bottom: Thinkstock

HUMAN CAPITAL

Who Qualifies To Be A Tech CFO?

Experience with certain lifecycle stages and business models may be more important than knowledge of a company's industry niche. By David McCann

Many finance chiefs ably switch industries, such as jumping from manufacturing to retail. It seems, though, that finance executives who grew up in the technology field tend to stay in it, right up through the CFO level. ¶ Of course, "technology" is not a single industry but an umbrella covering many subsectors. And just as the CFO skillset is generally deemed fungible outside the technology sphere, within it finance executives can typically move around fairly easily.

The most important determinant of who's suitable for a position as CFO of a tech firm is the stage the company is at in its lifecycle, according to Tony Callini, finance chief at digital typesetting firm Monotype Imaging.

"I've been in fintech, media tech, and now creative tech," says Callini, a panelist at the MIT Sloan CFO Summit near Boston. "I think it would be hard for me to jump to the biotech space, but I believe there are some consistencies around working in a small, dynamic environment where you just have to roll your sleeves up and figure out how to get things done."

At the extreme ends of a spectrum, the role of the finance leader is obviously much different at Oracle than at a $10 million startup. Callini finds himself in the middle, guiding a $200 million company that's just starting to go international—and he's feeling the stretch, which means hiring managers for his team that have specific capabilities.

"There are parts of my job that I'm not qualified to do," he says. "I'm sure it's a theme along many career paths where if you're used to a certain company structure, shifting to [another level] could be hard. So, you need to recognize your limitations and [bring in] people who have those complementary skill sets."

Monotype Imaging CFO Tony Callini and Kim Drapkin, CFO of Jounce Therapeutics, participate in a panel at the 2017 MIT Sloan CFO Summit.

Kim Drapkin, finance chief at startup biotech firm Jounce Therapeutics, agrees that a company like the one she works for would pose the most difficult transition for CFOs from other technology subsectors. "When I talk to investors, I need to be able to talk about the science in a credible way," she says. "I'm not a PhD, but the person sitting across from me might be, and they're going to ask me about our drug's mechanism of action."

At the same time, Drapkin identifies with Callini's just-get-it-done approach. A small, not-yet-established biotech company like Jounce "would probably be better off hiring Tony, who has no biotech experience, than the CFO of Pfizer, who [may not] know how to roll up his sleeves," Drapkin says.

Further, Drapkin says she's "very comfortable" hiring a vice president of finance or controller from a different technology sector. "We're all doing the same SEC reports and following the same revenue-recognition guidance."

That perspective didn't resonate with other Jounce leaders when Drapkin recently presented a controller candidate she'd worked with previously. "I faced a lot of resistance because he didn't have drug experience," she says. "I said, 'Listen, he's very smart and he'll get this.' We were trying to go public at the time, and I said I'd much rather have a strong SEC person who knows how to do an S-1 than worry about whether someone can cost out clinical trials."

More important than a specific in-

Courtesy MIT Sloan CFO Summit

dustry background is experience with a company's business model, says Sean Quinn, CFO at Cimpress. The company makes products that can be customized and printed online, like invitations.

A Cimpress business in Brazil recently hired two people away from airlines because the company needed to rethink its pricing structure, given the business's fixed capacity and high-volume, low-order nature. "That smells like the airline industry," says Quinn. "The same thing applies at the CFO level—I think it can actually be a strength to not come from this very specific industry, so long as there's experience with the characteristics of [the] particular business model."

"It can actually be a strength to not come from this very specific industry, so long as there's experience with the ... business model."
—Sean Quinn, CFO, Cimpress

But while a company can likely find a CFO with any type of experience, it may not be able to locate one with all the experience on its wish list. "The reality is that candidates are going to be good in some areas and not as good in others, so the company has to pick what's most important," says Quinn. "Recruiters call around and say they're looking for someone who has been a public-company CFO, also has private equity experience, has been in, say, biotech, and really understands SaaS models. I mean, who is this person they're describing?" CFO

M&A Advice: People First

Success depends on keeping the teams of both buyer and seller engaged, says a veteran of nine M&A deals.

Acquisitions are invariably driven by numbers: potential revenue, time to market, eliminating competition. But once a deal closes, success depends on keeping both teams engaged and on the same page.

If companies don't take a people-first approach, it often results in an overly aggressive integration playbook, without much or any input from the acquired company, that quickly imposes on the new team a rigid checklist of activities and processes. This can be demoralizing and frustrating for the acquired team and lead to attrition and a range of other roadblocks.

To retain the very magic that made the acquisition appealing in the first place and make the integration as seamless as possible, here are my top five best practices for ensuring success following an acquisition:

1. Listen. It's important to make the new team members feel highly valued, and nothing will discourage a team more than being told to do things differently without allowing for any input on what made the company successful in the first place. Listening to what had been working prior to the acquisition and looking for ways to fold that into the new organization and a go-forward plan will help new employees feel heard and understood.

2. Identify, acknowledge, and leverage the new expertise that the acquired team brings. Treat the new team members as equals, be open to new ideas, and solicit suggestions for how things can be done better and faster. Even if the ideas can't all be implemented, taking the newly acquired team's thoughts into consideration and explaining the reasoning behind a certain approach will help create buy-in of the go-forward process.


Jenny Kray, CFO, Calabrio

3. Determine a realistic pace at which the required changes can be rolled out. Putting an unrealistic timeline in place for cutting over processes and systems is detrimental. Establishing reasonable timelines that balance the expectations of the stakeholders with the needs of the day-to-day teams ensures changes will be well received. This will also ensure that the execution of the integration plan is effective for everyone, including customers.

4. Work toward a unified vision. If you happen to be on the buy side, don't assume the acquired employees have any understanding of the rationale for the acquisition and the keys to go-forward success. If you're on the sell side, don't assume that the acquirer understands everything about how the business operates on day one of the acquisition. Through one-on-one discussions or group meetings, be sure that both teams understand the mission, the strategy for accomplishing it, the pace of change, and how they fit into the bigger picture.

5. Keep taking the pulse. Over the integration period, don't measure success merely by whether objectives are being met. It's important to also look at the intangibles: Are communications regular and productive? Are problems being voiced and resolved? Conduct frequent check-ins. Don't be afraid to adjust expectations and timing, if needed, and make sure teams are focused on the right priorities. | JENNY KRAY

Jenny Kray is CFO of Calabrio, a provider of work-optimization software.

Courtesy Calabrio

TECHNOLOGY

Will Tech Keep Capital Cheap?

On the contrary, those who say technological advances will help keep bond yields low are off-base, a top analyst says. By David McCann

With each passing day, it seems, technology wields more influence over human activity. Nothing resembling a slowdown of that progression is in sight, and in fact it's very likely to last indefinitely. Those sound like plain facts. Yet a new report from *Fortune* 500 financial firm INTL FCStone offers some counter-arguments, at least with respect to technology's influence on capital markets and corporate productivity.

The author, global macro strategist Vincent Deluard, has been making a case recently, as have other observers, that a long-term upturn in bond yields is in the offing. His case is based on demographics, especially the shrinkage of China's and Germany's surpluses, which would help produce a global savings squeeze.

Deluard was briefly knocked off course, though, by talk at an event that technological progress could be a game-changer. "At the time, I could only agree," he acknowledges. "The global economy will run out of cheap capital, but it may not matter because artificial intelligence, the Internet of things, and the sharing economy are already allowing many companies to produce more with less capital."

However, upon further thought, he writes, he could have offered several rebuttals, which he makes in a report titled, "Will Unicorns and Robots Kill My Case for Higher Rates? Four Reasons Why Tech Will Not Prevent a Global Savings Squeeze."

First, even machines have physical limits, Deluard points out. Integrated-circuit components "are approaching atomic size, which will eventually end the easy productivity gains of Moore's law," the report states. Gordon Moore himself has made the same argument. "Moore's law has powered the remarkable progress in video games, weather forecasts, missiles, spreadsheets, cell phones, and PCs," Deluard writes. "However, an intrinsic property of exponential growth (or shrinkage in this case) is that it cannot go on forever."

Another example of how the real world presents physical barriers to human inventiveness can be found in batteries, he continues. Batteries are made largely of copper and lithium, which aren't necessarily inexhaustible resources. Tesla's own website notes that achieving its planned production of 500,000 electric cars per year, starting this year, "will require today's entire worldwide supply of lithium-ion batteries."

Second, he writes, the practical impact of many disruptive technologies may be overhyped. For example, while AI machines beat humans at chess, they fail to write logical paragraphs or understand the meaning of language.

Deluard adds that many Silicon Valley innovations will not work in developing markets without massive investments in old-world infrastructure. For example, "Fleets of self-driving Ubers [taking] engineers to their offices may be a realistic vision in the orderly suburbs of Palo Alto, but much less so in the endless traffic jams of Sao Paulo and Jakarta."

The progress of artificial intelligence in image recognition, sound processing, and, to a limited extent, general intelligence may have led to a sense of overconfidence, he opines.

Third, according to Deluard, many technology giants and unicorns alike have been able to keep prices low because "investors never asked them to turn a profit.... In an age of free money, venture capitalists gladly burned investors' cash in the hope of finding the next Google." But when bond rates normalize, he notes, unicorns will need profits, which will require higher prices, and "investors will not be so willing to bleed money."

He points to the "curious case" of

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Netflix's market capitalization, which has increased by more than $50 billion since 2014. Over the same period, the company's operating cash flow totaled negative $3.6 billion. And Blue Apron, he notes, spends $63 to acquire a single customer that, on average, delivers a profit of just $102 over three years.

Deluard says that the question posed in the report's title—would unicorns and robots destroy his case for higher rates?—is actually upside down. Rather, he adds, whether *higher rates* will destroy *robots and unicorns* "seems like a more fitting question for the times."

Fourth, he writes, "humans' ability to innovate may be infinite, but societies' tolerance for disruption is not." The extant second machine age has created inequalities that in turn have triggered a backlash. Regulators, he says, are "sharpening knives" to come at "the FAANGs"—Facebook, Apple, Amazon, Netflix, and Google.

"Humans' ability to innovate may be infinite, but societies' tolerance for disruption is not."

—Vincent Deluard, INTL FCStone

"Voters are rallying around class and race totems as the politics of anger and identity spread via social media," Deluard observes. "The cost of capital should increase to reflect these new political and social risks."

By its very nature, Deluard continues, technological progress disrupts social order, forcing humans to change behaviors, customs, and habits that were formed over centuries. "Contrary to computers, our brains cannot be wiped clean of their past and rewired to accommodate a new software." CFO

Out of Options

Clearinghouse confronts a mammoth task in replacing its outdated platform.

The privately held financial-market utility that settles and clears transactions for all 15 U.S. option exchanges and 3 futures exchanges has a problem: Its technology is woefully outdated.

That's not quite the disaster it may seem. Options Clearing Corp.'s existing, 20-year-old system is "incredibly stable and still manages our processes on a daily basis, well within the [service-level agreements] we've set with our clearing members," says Amy Shelly, the organization's finance chief.

The problem, though, is that the current system was built in a fully integrated fashion; most of today's best-of-breed software tools are more modular in nature. That scenario hinders OCC from improving its technological capabilities and operating with optimal efficiency.

Shelly is a point person for a recently begun project to completely replace OCC's technology within three to four years. It's the biggest strategic priority for the clearinghouse, a for-profit organization that's regulated by both the Securities and Exchange Commission and the Commodity Futures Trading Commission.

About 90% to 95% of OCC's revenue is derived from fees for its clearing and settlement services, according to Shelly. Under its SEC-approved capital plan, half of its pre-tax profit is distributed to its approximately 115 clearing members (U.S. broker-dealers, U.S. Futures Commission merchants, and non-U.S. securities firms representing both professional traders and public customers). The other half of the earnings is distributed as dividends to the five securities exchanges that own the company.

Amy Shelly, CFO, Options Clearing Corp.

The organization also manages the risk it takes on, as guarantor that the obligations under the contracts it clears are fulfilled, by setting the clearing members' "margins"—the funds they're required to post that serve as insurance.

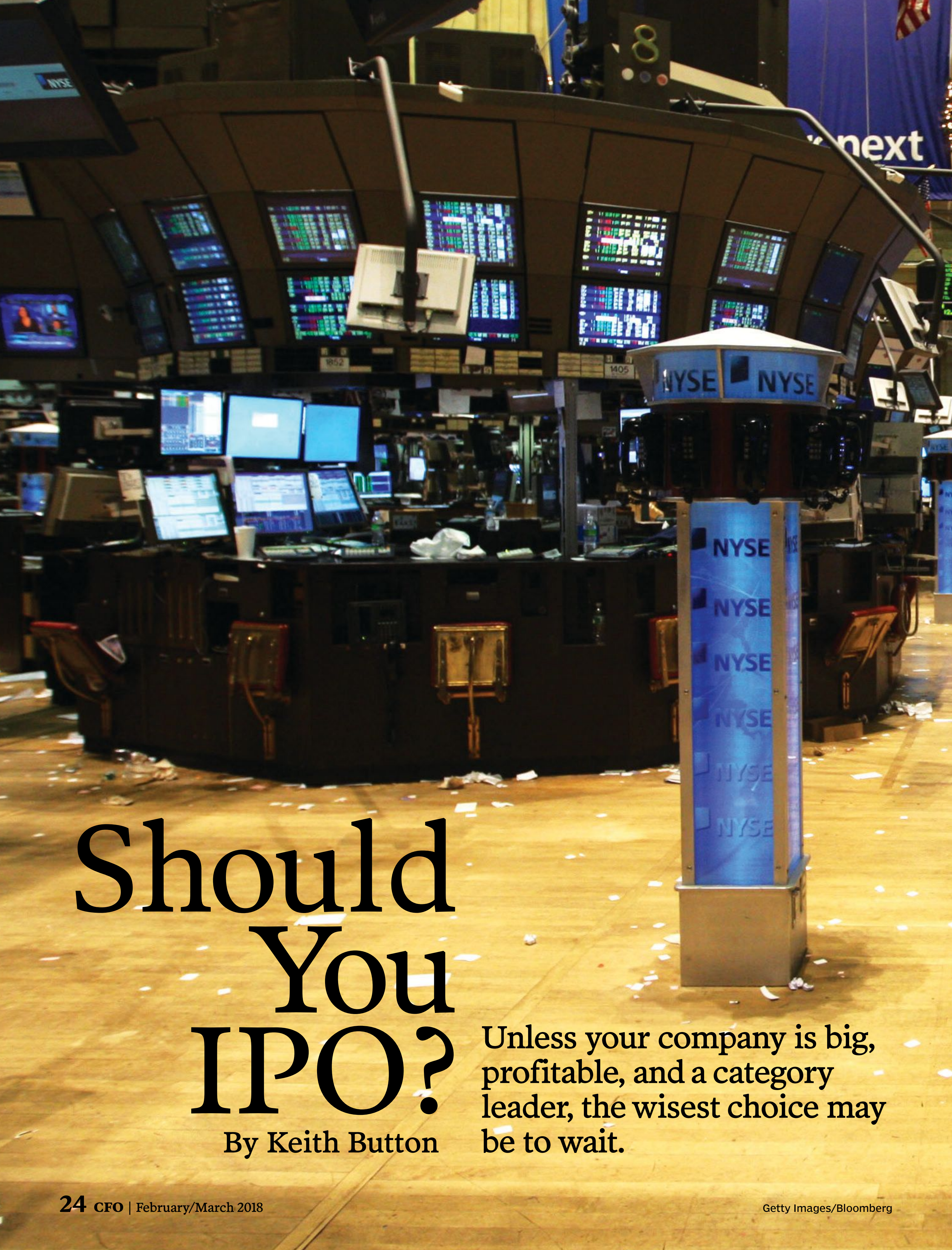
With its technology transformation, OCC may opt to build proprietary functionality to handle its risk management activities, as nothing adequate is commercially available, Shelly says. That problem probably won't apply to new systems for clearing and settling transactions, for which there are commercial applications used by other clearinghouses.

But financing the new technology could prove tricky. OCC is required to maintain liquid net assets equal to or greater than its shareholders' equity, which weighs in at $247 million. "We have to be very mindful of how much cash we use," Shelly says.

Aside from operational efficiency, another goal of the technology upgrade is to "free up our development time so that we are in a better position to bring to market the new products we are being asked for," says Shelly.

The implementation process will be complicated by the need to work with the clearing members, who will have to make corresponding changes to their own systems. "We don't want to be a disruptor to the marketplace," the CFO says. | D.M.

This page, courtesy the companies



Should You IPO?

By Keith Button

Unless your company is big, profitable, and a category leader, the wisest choice may be to wait.

Getty Images/Bloomberg

The number of U.S. tech IPOs over the past few years has been disappointingly low, and that trend could continue. Investors hoping to catch an early ride on the next Facebook or Google initial public offering may be waiting a long time. On the issuer side, fewer startup employees and C-suite executives may have a chance at realizing their IPO dreams. ¶ In spite of near-perfect market conditions—booming performance of equities plus historically low volatility for tech stocks—only about 30 technology companies went public in 2017 (not counting those with offer prices below $5 per share),

Should You IPO?

according to University of Florida professor Jay Ritter. Meanwhile, the list of private tech companies worth $1 billion or more, also known as unicorns, swelled to 276 worldwide, according to Crunchbase. That list of richly valued tech startups includes 16 “decacorns,” or unicorns valued at $10 billion or more.

Why are so many growing tech companies (and firms in other industries) choosing to sit on the bench, and for so long? Unicorn CFOs, investors, and consultants say that easy access to continued rounds of venture capital funding, with too much capital chasing not enough deals, makes it much easier to stay privately held. Changes to U.S. securities law have also made it easier to delay issuing on the public markets. Notable tech IPOs that fell flat last year have also induced caution.

Snap raised $3.5 billion in its March 2017 IPO, and shares jumped 44% on the first day. But the company’s shares are down 50% since then.

If Snap, owner of Snapchat, had performed better after its March 2017 IPO—it went public too early with a valuation that was way too high, analysts claim—more tech IPOs probably would have launched in 2017, says Barrett Daniels, CEO of Nextstep Advisory, an IPO adviser in Burlingame, Calif.

“Because Snap didn’t [perform well], I think it opened up a lot of eyes, especially at the other really big companies, and made them step back and say: Maybe we have a little bit of work to do before we go down this path,” says Daniels. Blue Apron didn’t help when it followed a couple of months later with “quite possibly the worst IPO of our lifetime,” Daniels says.

But there are deeper reasons why many companies hesitate to issue equity to the public anymore. For one, going public is no longer necessary for raising capital; in fact, it’s best to have all the capital you need before going public. Being public also limits subsequent funding options, forces companies to be overly precise with forecasts, and opens the door to aggressive short-sellers and activist investors. And that’s just the beginning of the disadvantages list.

NO NEED

From the CFO’s perspective, there are two reasons to go public: raise capital for the business or provide a liquidity event to employees and early shareholders, says Jason Child, CFO of Opendoor, a $1.1 billion unicorn in San Francisco that buys and sells homes directly online.

Before 2010, if just one of the two factors was in play for a company, that company would conduct an IPO, says Child, who worked through IPOs at Amazon (he was there for 12 years) and Groupon (where he served as CFO). Today, CFOs are much more cautious about moving ahead with an issuance. The CFO weighs whether the company needs capital, and then looks at the potential sources. Because the amount of private capital now coming into the early-stage market for tech companies is so large, the bar for CFOs going public is much higher.

“You can be a little more stringent on making sure you’re ready, because of the fact that you can still probably get capital for the business,” Child says. “It might come with a different set of terms, but at least you have that capability.”

Venture capitalists invested $84 billion in about 8,000 tech startups and other entities in 2017, the most since the early 2000s, according to Pitchbook and the National Venture Capital Association. And unicorns, like Lyft and WeWork, received $19.2 billion, or 23% of all investments. There’s reason to expect this trend to continue, with U.S. venture capital firms raising $32 billion in 209 funds in 2017, marking the fourth consecutive year of surpassing $30 billion.

Liquidity events for employees and shareholders are also less dependent on IPOs these days. The IPO is the most efficient market for a private company aiming for liquidity: There’s a seemingly infinite availability of potential buyers to set the right price, Child says.

But there are other options—employees can sell private shares on secondary markets and even borrow against their options through companies like Sharespost. Private companies can also conduct direct sales, allowing a new investor to purchase outstanding shares directly from one or more

“Don’t go public until you’re ready for the fact that people can short your stock, and they can short it for a bunch of reasons.”

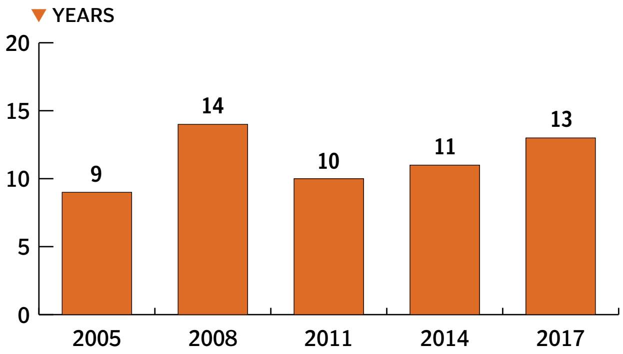
—JASON CHILD, CFO, Opendoor

Top: Bloomberg/Getty Images; bottom: courtesy Opendoor

Getting Older

Tech firms are putting in more time before pulling the trigger on an initial public offering.

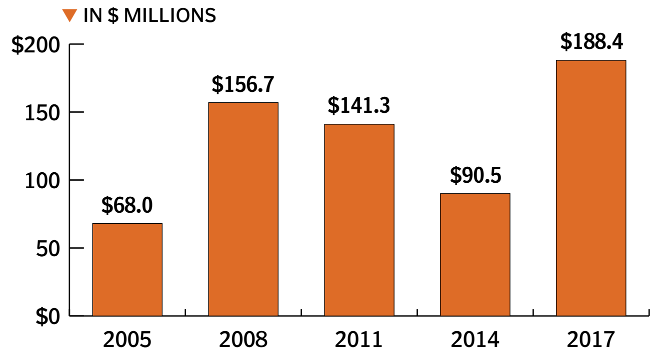
Median age of tech companies at IPO*



Size is Prized

Since the Great Recession, the median IPO firm has increased in revenue, reaching a 37-year high point last year.

Median revenue of tech companies at IPO*



*Includes IPOs on U.S. exchanges with an offer price at $5 per share or above. Excludes American depository receipts, closed-end funds, acquisition companies, REITs, and banks.

Source: Jay Ritter, University of Florida

existing stockholders, according to law firm WilmerHale. Or a company can take an investment followed by a stock redemption—a new investor injects funds directly into the company in an amount that exceeds the company's current needs, and the company then uses the excess funds to redeem a portion of the stock held by one or more existing stockholders.

BIGNESS REQUIRED

While more IPO alternatives are available, breaking through on the public markets is more difficult. Equity investors have informal requirements for what they want in an IPO company, and fewer and fewer firms qualify. To launch an IPO today, a company needs to be bigger, more profitable, and growing faster than it would have had to be 10 to 15 years ago, says Hollie Haynes, founder and managing partner of Luminate Capital Partners, a San Francisco–based private equity firm.

Amazon's successful public offering in 1997, for example, raised $54 million. The company's revenues were only $16 million in the quarter it debuted, and the business was unprofitable. Snap's "unsuccessful" IPO in 2017, in contrast, raised $3.5 billion.

More tech companies are driven to launch as a large-cap stock now because of the greater demand by the investing public and institutional shareholders for large-caps, agrees Sonya Brown, general partner and co-head of growth equity at Norwest Venture Partners. "Both the [need for] liquidity in the market and the cost of being public have forced companies to focus on being larger than they have been in the past," Brown says.

Another factor is the lack of boutique market makers and research firms to support smaller IPOs, says Paul Pedevillano, whose VE Advisors provides CFO services to early-stage tech companies. As those niche banking firms have died off, it's become harder for small tech companies to maintain investor interest.

"The irony here is that the IPO is a fundraising event, but it's really only available to companies that don't need the money."

—HOLLIE HAYNES, managing partner, Luminate Capital Partners

From the business perspective, unless a company can claim category leadership, with a large addressable market and competitive advantage, it's probably also going to have a difficult time, Child says. Public markets are not a great source of primary capital, and public investors don't want to fund business plans, Haynes emphasizes. "The irony here is that the IPO is a fundraising event, but it's really only available to companies that don't need the money," she says.

HELD TO ACCOUNT

If it sounds challenging to squeeze through the eye of the IPO needle, there's more to consider. To help answer when an investor asks about Opendoor's timeframe for going public, Child keeps a mental scorecard. For example, the top question on the scorecard is: Are the "table stakes" in place? In other words, does finance have a tight accounting close process, where the CFO knows the numbers within five to six days, and the results are as forecasted for the month,

Courtesy Luminate Capital Partners

quarter, and year?

If a CFO can't forecast the top-line and bottom-line numbers with accuracy of 95% or better for quarters or 75% to 80% for the year, then the company is probably not ready to go public, Child says. Shareholders will measure a publicly traded company by how well the company, and its CFO, deliver on its forecasted numbers and execute against the forecast.

"The market does not love volatility," Child says. "Public markets punish your lack of ability to forecast or to really understand what's going to happen in the next quarter or next year. That is something that's a key part of the calculus or decision process of whether or not a company is ready to go." The CFO also has to be skilled in explaining the business and helping the investor understand it, Child says.

If a company doesn't meet these specifications, the going can be rough. Company founders and CFOs who take their companies public need to understand and accept the criticism they will be opening themselves up to, along with the fact that their stock will become open to shorting, Child says. "Don't go public until you're ready for the fact that people can short your stock, and they can short it for a bunch of reasons," he says.

Another disadvantage is that once a company goes public, its financing options are basically limited to more public equity issuance or debt financing, says Luminate Capital's Haynes. "When you're private, you can do all sorts of different types of structured securities with a million different venture and private equity investors," she notes. "If you are really good at marketing, you can find somebody to invest in your company in some creative way. It just gets a lot harder to do that once you're public."

SoftBank Group's $100 billion Vision Fund, which includes investors Apple, Qualcomm, and Sharp, is a prominent example of a liquidity financing option available to unicorns. In January, SoftBank's fund completed a deal to become the largest shareholder in Uber, providing liquidity to Uber's early employees ahead of the company's planned 2019 IPO.

A HEALTHY TREND

Putting off an IPO like Uber has clear advantages. Even for investment bankers and exchanges, which want to set good expectations of new issue performance and promote confidence in IPOs, it's better to have no deals than experience more Snaps and Blue Aprons.

Changes to U.S. securities law under the Jumpstart Our Business Opportunities Act may be helping in this regard. Before the 2012 law was passed, private companies with 500 shareholders were required to follow SEC registration and reporting requirements; the JOBS Act changed the threshold to 2,000 shareholders and eliminated options holders from the count.

Beginning Of A Rebound?

+43%
Number of U.S. tech IPOs in 2017*

+212%
Total 2017 proceeds*

11.7%
First-day return in 2017, all IPOs

-11%†
IPOs in the pipeline for 2018

*Compared with 2016
†As of December 19, 2017, according to Renaissance Capital
Source: Jay Ritter, University of Florida

Because nearly all tech startups issue shares or options to their employees, and because the SEC reporting requirements were just as onerous as simply going public, the 500-shareholder rule essentially meant that companies would file IPOs as they neared the threshold, says Nextstep's Daniels. Now, fewer companies are being "pushed" into the public markets prematurely.

The longer period of being private can help the evolution of a tech company's technology and business model. Brad Schneider, CFO of Rocket Lab, a commercial satellite launch business based in Los Angeles and valued at $1 billion, says tech companies have to make sure that they don't neglect funding their technology development in favor of building out manufacturing capacity or pursuing other investment priorities of later-stage companies. "Tech development needs a lot of capitalization and a lot of patience from investors," he says.

"Born from experimentation and innovation, these business models often take years to develop," echoes Nikhil Abraham, CFO of Udacity, an online education firm. "If a company has figured out enough of its model to raise significant private capital to fund operations, it seems sensible to continue experimenting to improve financials out of the public eye."

And patience appears to be more common now, as a change in thinking at the single biggest capital source for tech startups—venture capital firms—takes hold.

In 2017, the number of venture-funded companies exiting through either an initial public offering or an acquisi-

"The relationship between the VC investor and the company used to be much more combative."

—PAUL PEDEVILLANO, founder, VE Advisors

Courtesy VE Advisors

JUST ANOTHER OK YEAR?

The last really good year for U.S. tech IPOs was 2014.

The number of tech-company IPOs in 2017, 30, was slightly below average for the last 10 years, according to figures compiled by Jay Ritter, professor at the University of Florida. From 2013 through 2016, the number of tech companies launching IPOs was 43, 53, 36, and 21, respectively. In the years prior to the recession, the tech IPO numbers were much higher, peaking at 75 in 2007.

The 2014 number, 53, generated great expectations for tech IPOs for subsequent years, but tech companies failed to deliver, despite excellent market conditions, says Barrett Daniels, CEO of Nextstep Advisory. "You would think that the IPO market would be having an absolute heyday, but it's not. It's just been OK."

In 2018, the conditions again could be ripe for a monster tech IPO season, Daniels says. Overall, by January 24, nine issuers in the U.S. IPO market had raised about $6.2 billion, according to Renaissance Capital. The biggest tech deal completed ($2.3 billion) was PagSeguro Digital, a Brazilian fintech operation that offers payment services to small and midsize companies. Big names that could come to market this year include Lyft, Dropbox, Adyen, Airbnb, Pinterest, Zuora, and Credit Karma.

Daniels anticipates just another "OK" year, though, for the same reasons that tamped down offerings in 2017. He worries that aging unicorns staying private longer could be stifling the rate of startups and innovation over the long term.

"The nature of Silicon Valley is people leaving startups to go do new startups, and that has fundamentally changed," Daniels says. "Employees are being locked to these companies for much longer than they used to. Who knows if the next Google is handcuffed to a desk at Airbnb because the person doesn't want to leave $2 million in options behind? And who would?" | **K.B.**

tion dropped to 769—the lowest since 2011. Pedevillano of VE Advisors says a key difference with the newest generation of venture capitalists is that they're more interested in building good relationships with the founders and bringing in successful entrepreneurs to mentor and provide services to the companies they invest in.

"The relationship between the VC investor and the company used to be much more combative," Pedevillano says. "When I got started, the one thing VCs wanted was their entrepreneurs to be poor so that their entire focus was on making the company successful and having the big liquidity event."

He explains: "The VCs now are more amenable to founders getting some liquidity prior to an IPO or prior to a sale to take the pressure off of short-term thinking, because the founder may have kids in college, or they've never had a hit, or whatever," he says.

Companies and their early-stage investors are increasingly creating separate series of shares for founders that can convert to preferred shares in later rounds of equity financing, so the investors in those later rounds buy those shares from the founders to give them some liquidity, Pedevillano says.

Venture capitalists want to maintain the growth momentum of the early-stage tech company, he explains, focusing on how to accelerate growth and investing more money if that will help the company grow faster. The sale or IPO discussion begins only when growth slows.

"I've never sat in a board meeting where an investor says we're going to build this to flip it to somebody," Pedevallino notes. "They want you to build the greatest company possible, because if you build a great company, price will never be an object when you either go public or sell the company."

UNAVOIDABLE?

As unicorns age, their investors will eventually seek an exit, which could spur more of them to commit to IPOs, however unattractive they may seem. And not every company is going to follow the unicorns' route—some will try to list earlier. That's because the financial profile of a company that is heavily funded by private capital for years is not something desirable to retail and institutional investors in public markets.

A company with total capital invested that is high relative to the size of the business, and that is still burning through lots of cash, makes for a financial profile difficult for the public market to accept, says Haynes.

In essence, the easy availability of venture capital for new rounds of financing can become a crutch for companies to put off the phase of development when they start to show profits. "Showing current profitability or a very near-term path to it is really important," Haynes says. "It's a top-three issue for [public market] investors." CFO

Keith Button is a freelance writer based in Valley Cottage, New York.

Courtesy Nextstep Advisory


SLAM
401

OUR LOVE/HATE RELATIONSHIP WITH AMAZON

Is the company a shining example of innovation or an anticompetitive scourge? Four experts weigh in on the issue.

EDITED BY DAVID McCANN

Amazon is cool, right? Who wants to spend hours shopping in a mall? For that matter, who wants to look through a bunch of different websites when you can get everything you want from just one? Either way, who wants to pay more for the privilege of not buying through Amazon?

Rhetorical questions all? Maybe. Here are some other questions to consider: Do you know anyone whose job or business got trampled by the raging online behemoth? What might be the potential implications for markets and prices over the long term, were Amazon's growth march to continue indefinitely? At what point should the federal government start thinking about whether and how to limit the company's capacity for anticompetitive influence?

The summary question is this: Is Amazon, on balance, good or bad for business and the U.S. economy?

Getty Images

As the commentaries that follow demonstrate, there are loads of plausible arguments on both sides of the issue. Fortunately, or not, as one of our contributing authors puts it, this genie isn't going back in the bottle. Amazon is fundamentally changing not only the way business is done, but the way we think about the world.

Nothing Not to Love

Larry Light, CEO, Arcature

Amazon is all about making people's lives easier. There are three dimensions of ease: ease of choice, ease of use, and ease of mind. Amazon's creativity and understanding of people's needs, problems, and occasions hits on all three. We're able to choose goods and services across categories; we find the site easy to navigate and can get help at any moment; and we trust Amazon to stand behind what it sells, putting our minds at ease.

"Amazon is forcing businesses to face the facts of change, ditch cultures of complacency, and jettison the idea that what worked yesterday will work today." —Larry Light

Some perspective: The wide availability of television was a creative, disruptive, life-changing force. Television changed the way products were advertised. It changed the way people were entertained and the way news was provided. It opened up a new way of viewing the world, altered our perceptions of our place in that world, and allowed us to see history as it was happening.

Amazon is a similar revolutionary force. It is changing the way we shop, our ideas about privacy, and our willingness to trust in a relationship where we do not see or interact with a third-party partner. It offers us conveniences and options and varieties of products and services. In effect, Amazon has given us the gift of time.

In the business arena, the retailing giant is a compelling driver of needed change. In the retail industry, for example, Amazon has forced department stores and other retail outlets to re-examine the way they sell. Retail is now evolving into a collection of relevant, differentiated experiences instead of being a building with lots of branded goods. Amazon began the system of having customers rate the books they read, which has morphed into sites like TripAdvisor and Yelp. Amazon has also shown retailers how to use customer buying data to personalize recommendations and to provide other choices for consideration with its "people who bought this also bought...."

But the revolution the company has wrought won't stop there: Amazon is also changing the logistics of delivery, working with 7-11 to install lockers at convenience stores for people who don't live where there is front-door staff or who don't want packages sitting on the front porch. It's also experimenting with different pricing strategies for goods and services, a development that might have widespread effects.

On a broader scale, Amazon is forcing all businesses to face the facts of change, ditch cultures of complacency, and jettison the idea that what worked yesterday will work today. The so-called "Amazon effect" is spurring businesses to reevaluate and recalibrate business models that may be or will soon be outmoded. For example, Walmart is focusing less on opening new stores and more on improving its online offerings. And CVS plans to buy Aetna to create a bulwark against a potential Amazon entry into medical services and prescriptions.

There will always be detractors of any force that pushes us to alter the way we navigate our lives. In the long run, businesses and consumers will be thankful for Amazon.

We Need to Break Up (Amazon)

Saagar Govil, CEO, Cemtrex

Amazon may be good for consumers, but it isn't good for businesses. It's clear that Amazon is steadily marching toward becoming a monopoly, and monopolies are bad for competition and in opposition to American capitalism.

Amazon is a driving force in retail and manufacturing as well as an e-commerce powerhouse (books, electronics, consumer products) that has squashed mom-and-pop stores across the country. Its e-commerce sales were expected to grow 32% in 2017, to $196.8 billion—or 43.5% of total U.S. e-commerce sales, according to eMarketer.

That's a huge leap from Amazon's U.S. sales of $149 billion and 38% market share in 2016. Still, the company is already the biggest e-commerce outfit and represented close to 4% of all retail sales, online and offline. While brick-and-mortar retailers founder, estimates are that by 2020 more than half of all e-commerce will take place through Amazon.com.

All this, and yet some consumers still may not know that Amazon's reach has extended far beyond books and household items. Among the verticals it has entered are industrial parts, competing directly with traditional distribution companies like Grainger and McMaster, and paper products, taking on Georgia Pacific, among others.

> **"Some consumers still may not know that Amazon's reach has extended far beyond books and household items."** —Saagar Govil

The next step would be for Amazon to sell electronic components, putting pressure on industrial supply companies like Arrow Electronics. It's not too difficult to imagine Amazon as the leading supplier of industrial goods, much like its present status in the consumer-goods arena.

The near future also may see Amazon directly competing in the soap and toothpaste markets with Prime-branded products. Today Sears is in danger of going out of business; tomorrow it may be Johnson & Johnson.

There are, indeed, huge potential long-term implications for a majority of industries in the American economy. Innovation and good business models are to be applauded and invested in. However, Amazon's $654 billion market cap is, for example, already 40 times greater than Grainger's $15.5 billion. After a certain point, no amount of innovation will allow the latter to compete. Amazon can undercut Grainger on all of the products they both sell and not flinch, even if Amazon doesn't make a profit on any of them. And Amazon can continue to do this until Grainger goes out of business.

With Amazon already nearing control over half of all e-commerce sales in the United States, what's to stop it from reaching, say, 75% before too long? At that level, could any other e-commerce platform compete at all? That's why allowing Amazon to get much bigger is a dangerous prospect. Simply put, the Justice Department must break up Amazon in order to protect the U.S. economy.

A Good Partner for Many

Nicholas Farhi, Partner, OC&C Strategy Consultants

Boy, do we ever read a lot of headlines about Amazon these days. And they are so polarized: either breathless stock-pickers claiming Amazon is going to dominate the world, or breathless doom-mongers claiming the same. The truth is less newsworthy: Amazon has been a positive force for business, and it isn't going to dominate the world, as long as regulators stay alert.

Let's first take the loudest complainers: old-world retailers. Their problem isn't Amazon; it's that new technologies mean their established way of selling products is no longer the best way. Amazon just happens to be the leading user of that new technology.

But the genie isn't going back in the bottle, and some of the businesses that felt Amazon's force earliest have successfully adopted these new technologies and married them with their store estate to successfully defend against Amazon. Note that Best Buy's shares are trading near an all-time high.

A legitimate complaint is that Amazon's shareholders forgo profits today for growth. But that's not an Amazon phenomenon; it's a technological-change phenomenon. Think of the capital spent building railroads in the mid-1800s. It was a tough time to be in the blacksmith business, but the opportunities created by railroads enabled huge opportunities for other businesses.

> **"Amazon's Marketplace and Fulfillment By Amazon offerings have made running a small e-commerce retailer a breeze."** —Nicholas Farhi

So how is Amazon already good for business? One of the biggest but least-obvious ways is that a vast number of businesses are Amazon customers. Just like consumers, businesses can buy their supplies cheaper, quicker, and more conveniently than ever. And businesses also buy $4.5 billion worth of great-value cloud services from the Amazon Web Services (AWS) division.

Amazon is also good news for small retailers. They excel at sourcing and curating product but are often horrible at marketing and shipping it. Amazon's Marketplace and Fulfillment By Amazon offerings have made running a small e-commerce retailer a breeze.

For producers that sell on

Courtesy the companies

Amazon, the story is more nuanced: Amazon has steepened the competitive advantage for the best over the rest. Who chooses a two-star product nowadays? This will only become more pronounced as search shifts to voice, where Amazon will pick the top-ranked product for you. Producers who are all brand and no quality: beware!

Regulators need to be watchful of Amazon's growing power to steer consumers to their preferred brands, and its ability to parlay a strong market position from one area to another (for example, from e-commerce to logistics to movies). But there is no reason to believe regulators won't get this right, eventually.

One area yet to feel the "Amazon effect" is automotive services—selling, servicing, fueling, repairing, and reselling automobiles. Digital technologies could substantially improve the consumer experience, helping find inventory or services and helping choose the best shop through star ratings. And these low-engagement requests are strong candidates for voice search: "Alexa, get my truck serviced."

Amazon is causing, and will continue to cause, headaches for CFOs of old-world companies that refuse to adapt their strategies, products, and distribution to a new era. But the rollout of new digital technologies that Amazon exemplifies, properly regulated, will create enormous direct benefits for a majority of businesses—those that it sells to and on behalf of—and for new business models spurred or necessitated by Amazon's success that haven't even been imagined yet.

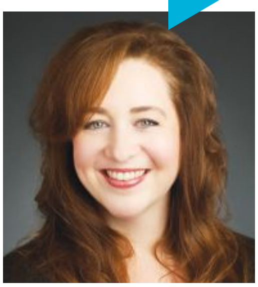
Destroying Connections

Heidi Pozzo, Founder, Pozzo Consulting

Say "Amazon" and almost everyone today thinks immediately of the online retailer. And they love it. Amazon has been ranked number one in customer satisfaction by the American Customer Satisfaction Index for the last nine years. Why? Because the company obsessively puts the customer at the center of everything it does.

Leveraging its Prime membership and the ease of one-click ordering, Amazon has captured almost 44% of all U.S. Internet retail sales. But Amazon isn't just about selling stuff online. It has a much broader business model that touches nearly every aspect of life.

"Selling below cost and putting companies out of business has become Amazon's hallmark." —Heidi Pozzo



For years Amazon has been investing in a network of distribution facilities, services, and data to support its customer-centric business model. At the core of its business is machine learning and artificial intelligence. Because of its scale, Amazon is able to understand the buying habits of its customers and make recommendations with great accuracy.

And it isn't just customer buying habits that Amazon understands. AWS offers cloud computing, artificial intelligence, and data services, aimed at helping businesses run better. It is also the largest worldwide provider of private cloud storage. With this business, Amazon understands how companies are looking at data to make better decisions.

Amazon's impact on business is so pervasive that 10% of U.S. earnings calls now mention the company. While some of these calls mention partnerships, more look toward the potential disruption in the reporting company's business and declining market share.

The one-click convenience that consumers enjoy comes at a price, though. Amazon has eliminated more than 149,000 jobs. Wages are typically lower in warehouses run by Amazon than in other comparable local warehouses and many organizations that competed with Amazon have gone out of business.

Even as it continues to eliminate local businesses, cities and states are clamoring to be selected as the site of Amazon's second headquarters. The company has also received more than $1.24 billion in incentives related to its current facilities.

The Institute for Local Self Reliance published a scathing report on Amazon's impact. By controlling infrastructure, data on buying habits, and access, and setting the terms for conducting business, Amazon is creating a system of winners and losers. Selling below cost and putting companies out of business has become its hallmark. Those that participate in Amazon's world get access, those that don't are blocked or see their ability to buy or sell diminished.

In the era of technology, the link between businesses and flourishing communities is being broken. As long as customers continue to appreciate the convenience of the one-click purchase, Amazon will continue to grow, with its impact on jobs and businesses largely unseen by consumers. Unfortunately, that will mean more job losses and lower wages to come.

Courtesy the company

2018

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No Pain, Just Gain

Supply chain financing lets companies stretch payment terms without hurting their suppliers' cash flow. **By Randy Myers**

For Atimi Software, this was a reasonably big deal. Kellogg, the cereal and snack food giant, had just hired Atimi to produce a mobile app for use in Kellogg's marketing activities. The contract wasn't unusually large, but it had the potential to lead to further business with a big customer. ¶ Less exciting? Two years earlier, in 2014, Kellogg had lengthened payment terms to its suppliers to 120 days. For a smallish outfit like Atimi—the Vancouver-based company does about $10 million (Canadian) in annual sales—waiting that long for money could crimp its cash flow.

Fortunately, Kellogg also offered its suppliers an alternative. Rather than wait 120 days to collect in full, directly from Kellogg, they could get paid in a matter of days by a bank or other lender—if they were willing to accept a small haircut on their receivables, maybe a percent or so. Atimi took the haircut.

"It was a good idea," says angel investor and business consultant Pieter Dorsman, who until early this year had been serving as Atimi's CFO. "If we didn't have that early-payment option, we might have had to take our accounts receivable to a factor, but they would have charged 3% or more. Going to a bank would have involved a lot more paperwork and been even more challenging."

On the buyer's side, extending payment terms to suppliers has always been a tricky business. Make suppliers wait too long and they eventually push back, perhaps offering less favorable pricing, perhaps terminating the relationship. Or they could be driven out of business.

But the payment alternative Kellogg offered Atimi and many other suppliers was designed to keep them financially viable and satisfied. Sometimes known generically as "reverse factoring," because it is similar to traditional supplier-initiated factoring but is initiated instead by buyers, it is now called supply chain finance (SCF). Proponents argue that SCF not only solves most of the problems associated with extended payment terms, but also helps suppliers by offering them a cheaper source of financing than the other options—bank borrowing, simple discounting for early payment of invoices, or factoring.

"If we didn't have that early-payment option, we might have had to take our accounts receivable to a factor, but they would have charged 3% or more."
—Pieter Dorsman, former CFO, Atimi Software

How It Works

In a typical SCF application, a company extending its payment terms contracts with a bank or third-party provider to connect to that provider's SCF platform. The buyer then reaches out to its biggest suppliers to encourage their participation. Once suppliers are onboard, they begin submitting invoices through the platform.

When the buyer approves qualified invoices, usually within days, it triggers payment through the SCF provider on discounted terms. The size of the discount is negotiated between the provider and the supplier, but reflects the credit rating of the buyer, not the supplier. Later, the buyer pays the SCF provider the full amount of the invoice according to the buyer's new standard payment terms.

Note that in the case of a bank-operated SCF program, the bank itself may fund the payments to suppliers. Alternatively, it may choose to sell the receivables to a third party in cases where it doesn't want to keep the credit exposure on its own balance sheet. Or it might hedge the associated credit risk using credit default swaps. Third-party providers, by contrast, typically link banks and other lenders to their platforms to fund payments to suppliers.

Note, too, that while the company

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establishing an SCF program will want to know what kind of discounts its suppliers are being offered, it won't know the actual terms. Otherwise, explains Enrico Camerinelli, a senior analyst with research firm Aite Group, the commercial liability represented by the company's accounts payables would have to be reclassified as a financial debt to the banks, which could impact the company's debt ratios and eat into its credit limits.

A Big Market

Supply chain finance took root in the auto industry in the 1980s. It gradually migrated into the retail sector, grew quietly for years, then exploded in popularity when the 2008 credit crisis left companies scrambling to conserve cash. Now that credit is again plentiful and big companies are awash in cash, SCF is touted not just as a way for buyers to improve their cash flow, but also for them to ensure their supply chains remain financially viable.

Management consulting firm McKinsey & Co. estimates there are $2 trillion in financeable, highly secure payables globally, representing a potential revenue pool of $20 billion; only $2 billion of that was being captured as recently as 2015. Revenue from such programs grew at 20% from 2010 to 2015, says McKinsey, and was expected to continuing growing at around 15% annually for three to five years thereafter.

Amy Fong, an associate principal with the Hackett Group and head of the firm's purchase-to-pay advisory practice, says her firm's latest study suggests that only about 23% of companies are using any kind of trade financing. Most users are large companies with investment-grade credit ratings.

"In many cases, we can show suppliers there is more economic value to them post-implementation than pre-implementation."

—Geoff Brady, head of global trade and loan products for North America, JPMorgan Chase

Banks vs. Fintechs

A handful of large global banks, including JPMorgan Chase and Citibank, dominate the SCF market. But a growing slate of third-party providers—fintechs such as Orbian, PrimeRevenue, and Ariba, an SAP company—could help push SCF to smaller companies. That's because the fintechs tend to work with a broader array of lenders.

When choosing between providers, companies may want to consider a bank if they already have a relationship with it. The bank will likely have in-depth knowledge of the company's business and financing, says Hackett Group Associate Principal Veronica Wills, and so may be able to better understand the potential benefits of an SCF program to that company—and reflect that in its pricing. Banks also often absorb many of the upfront costs that companies incur to link to an SCF platform.

Fintechs are more likely to charge for connecting to their platform, says Fong, but also may have a broader product offering that includes more process improvement and automation solutions. They also will typically handle more of the heavy lifting associated with onboarding suppliers.

When German industrial giant Siemens AG launched a supply chain finance program some years ago, it didn't go with a big bank. The goal, says Mark Schiffers, now a managing director at SCF provider Orbian but then a Siemens finance executive in charge of the program, was to improve Siemens' own working capital performance while at the same time making sure it "worked in a fair way with its suppliers, so that it wasn't overpowering them."

Siemens initially hoped to enroll 1,000 suppliers, but the banks it approached were willing to take on only about 50 to 100, Schiffers recalls. Not only was Siemens unwilling to accept those constraints, it also worried that if a bank changed its strategy and exited the business, Siemens' suppliers would lose their liquidity source. Furthermore, Siemens didn't like the idea that a bank might sell its trade receivables in the secondary market or use credit default swaps to hedge the bank's credit risk with Siemens.

In search of alternatives, Siemens turned to Orbian, which works with multiple banks and other institutional investors to fund its programs. Orbian was open to operating on the scale Siemens wanted. Today, Schiffers says, the program has more than 2,500 Siemens suppliers participating.

Costs and Benefits

Many of the direct costs to buyers for setting up an SCF program are relatively minor for very large companies, especially if they work with a bank. According to the 2014 Aite Group study, buyer expenses can include time spent by IT teams connecting to the SCF platform, and by legal teams revising or establishing commercial contracts with suppliers and service contracts with platform providers.

More substantial costs revolve around gaining access to an SCF platform if not working with a bank. Buying software directly from a platform provider can cost on the order of

Courtesy the companies

$600,000, Aite Group reports. Alternatively, a buyer can pay a per-use license fee in which costs might run as little as $2,000 for an annual spend of $1 million to as much as $600,000 for an annual spend of $10 million.

Companies also can incur ongoing costs for staff to manage relationships with participating suppliers, onboard new suppliers, provide legal review of onboarding procedures, and manage the overall SCF program.

For suppliers, the direct costs are negligible. There may be some training required to use the SCF platform and to analyze the benefits of participation, but otherwise the principal cost is the discount agreed upon in exchange for early payment.

"In many cases, we can show suppliers there is more economic value to them post-implementation than pre-implementation," says Geoff Brady, head of the global trade and loan products business in North America for JPMorgan Chase.

For buyers, the benefits can be significant. In April 2013, Procter & Gamble announced that it was implementing an SCF program in conjunction with an extension of its payment terms to 75 days from an average of about 45 days. The *Wall Street Journal* reported that the program was expected to free up as much as $2 billion in cash. Kellogg has reported that its supplier financing program generated about $330 million in extra cash in one year.

"There are many internal efficiencies that can be realized before moving to offer discounts to a supplier base."

—Veronica Wills, associate principal, The Hackett Group

Adoption Considerations

Adopting an SCF program can be a smart move for buyers who know they can't otherwise continue to extend their payment terms, says Camerinelli. Wills is generally OK with the idea, too, but argues that it should be one of the last in a series of payment-practice improvements. "There are many internal efficiencies that can be realized before moving to offer discounts to a supplier base," she says.

Introducing an SCF program isn't without risk, either. Wills warns of a "significant public relations element" in which the buyer could be seen as "the big bad guy squeezing suppliers." Companies that establish programs with their relationship bank also need to be careful that it doesn't prompt the bank to reduce other lines of credit.

For suppliers, the key determinant in whether to participate in an SCF program is to calculate whether taking a discount for early payment is the least costly source of capital. In other words, does getting paid, say, 99% of an invoice total in 7 days cost less than getting paid 100% in 90 days? And is it less than borrowing from a bank or going to a factor? For many, it is. CFO

Randy Myers is a freelance writer based in Dover, Pennsylvania.

Starting Out

Supply chain finance programs can be enticing, but they don't suit every company.

Before and after a company decides to launch a supply chain finance program, there are a number of things it can do to improve the odds of success, say experts.

• **Get payment processes and technology in order.** "Where we see good, sustainable results," says banker Geoff Brady of JPMorgan Chase, "is where buyers have very efficient payment processing technology. If it takes them 30 days to get an invoice through the system and approved, there's not as much time to discount it, which means there's not as much value for them, the supplier, or us."

• **Create a cross-discipline SCF project team.** "The most successful programs have a dedicated team that can make sure everyone is on the same page," says Brady. The team should include not just finance personnel, says Enrico Camerinelli of Aite Group, but also representatives from procurement and logistics. They can be instrumental in the program's success and help identify which suppliers should be involved.

• **Look to the biggest suppliers first.** Even if the ultimate goal is to onboard as many suppliers as possible, it only makes sense to first target the largest, as their participation will have the biggest impact on cash flow. By the same token, if top suppliers indicate they won't participate, the company may consider forgoing a program.

• **Expand the program to as many suppliers as possible after launch.** "This is volume-based business," says Camerinelli.

• **Keep payment terms within or near industry norms.** Payment terms under an SCF program can vary dramatically, but Brady encourages buyers to be sensitive to the norms in their industry, or risk alienating suppliers. "You don't want to be an outlier," he says. | R.M.

THE 2018 *CFO* IT SURVEY

A (Digital) Dream Deferred

Many finance chiefs avoid falling in love with the latest digital tools because they recognize the risks and costs to the enterprise.

BY VINCENT RYAN

Heard about the "digital CFO?" Of course you have. Hot on consultants' lips and dripping from every whitepaper aimed at a corporate finance audience, the term "digital CFO" is supposed to foretell an era in which finance chiefs finally harness the power of promising digital tools and transform the enterprise. Armed with these tools, posit the "experts," CFOs will become true enterprise-wide strategists and leaders of innovation, utilizing technology to both scan the bigger picture and quickly respond to real-time business changes.

Would that it were as easy as vendors and consultants claim. The truth is the digital transformation of both the finance function and the enterprise occurs in fits and starts, hampered by the obstacles to implementing new, imperfect systems and by the people doing the implementing. That notion might be disappointing to the salespeople and marketers hawking the latest must-have software, but to most CFOs it's no surprise. As we discovered in this year's *CFO* IT Survey, many finance chiefs have a very level-headed view of technology: they're fully aware that it often raises as many problems as it solves.

Personal Profile

CFO's fourth annual IT survey, conducted in early January by CFO Research, garnered responses from 203 finance executives. Almost 30% of respondents were chief financial officers. Another 25% were controllers and 16% directors of finance; 9% were either a managing director, president, or CEO.

How does this population feel about technology? Finance executives don't have their heads in the sand. In the survey, about 77% "agreed" or "strongly agreed" with the statement that, currently, their "organization's IT strategy is an essential component of [its] growth strategy." Only 22% disagreed with that statement.

At the same time, most finance chiefs aren't ready to swallow vendors' promises hook, line, and sinker. When asked to complete the phrase, "For most CFOs, technology is ..." finance executives gave a wide range of responses, not all positive. They ranged from "a chance to differentiate" to "a necessary evil." Some executives echoed what consultants and vendors have been preaching for years: technology is essential to staying competitive and that "every CFO should stay current on technology; if you don't your business will suffer."

Getty Images

A (Digital) Dream Deferred

But many finance executives are leerier, viewing technology as "a never-ending learning curve in that both hardware and software [are] constantly being upgraded at significant expense," as one respondent put it. Or, in a more traditional finance view, technology is "a difficult cost to manage effectively," said one CFO.

As skeptical as many finance chiefs might be, they have a clear-eyed view on the requisite technology know-how for future CFOs. About 90% "agreed" or "strongly agreed" that the CFO of the future will require a much stronger technology skill set than is presently required of CFOs. However, only about half of respondents took any specific actions to upgrade their technology expertise in 2017 (slightly more, 57%, plan to do so in 2018).

That lack of initiative to upgrade skills was consistent with the way most CFOs characterized their personal relationship with technology. About 10% of the survey respondents labeled themselves as "enthusiast/geek" and 17% as "early adopter." On the other side of the spectrum, 16% said they were either "a generation behind" or "a few generations behind" in their familiarity with the latest enterprise technologies. In the middle were 57% of finance executives who said they were "staying current."

Finance executives judged their enterprise's use of technology to fall along similar lines. Although a greater percentage deemed their companies to be "leaders" or "fast followers" (31%) relative to other companies in their industry, 56% said their organizations were merely "staying current."

A Potential for Loss

Is it enough for a CFO or an enterprise just to stay current with the latest technologies? Jeff Thomson, CEO of the Institute of Management Accountants, falls in the camp that thinks CFOs should be thinking more innovatively. If finance and accounting teams "don't step up to advanced analytical competencies, in data science and things of that sort, 10 or 20 years out they could easily lose their relevance in the modern enterprise," says Thomson.

FIGURE 1

"I am (or would be) very comfortable in a role providing management oversight of my organization's enterprise IT strategy (e.g., with the CIO reporting to me)."

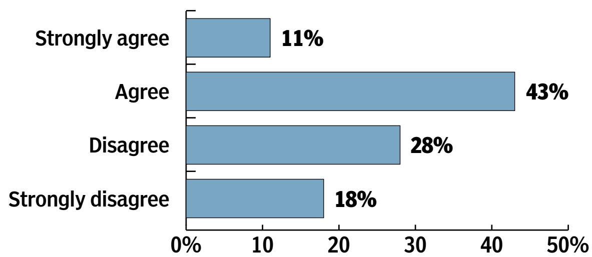
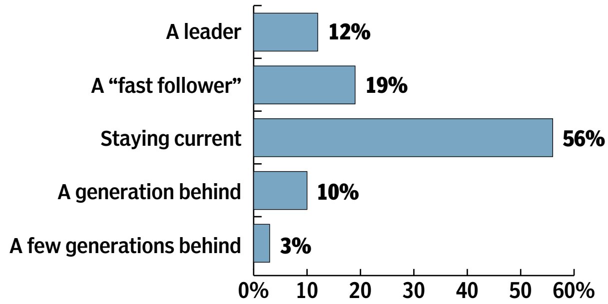


FIGURE 2

How would you describe your enterprise's use of technology today, relative to other companies in your industry?

We are ...



"You have to have your sensors up, whether it's cloud computing or robotic process automation or blockchain ... you have to be looking for every competitive edge, and technology is one way to that edge," Thomson says. "There needs to be a balance of running the business and anticipating the future of the business. 'Staying current' is very reactive."

On the other hand, CFOs do not have to be "tech enthusiasts." They don't have to know how to code or be conversant in "the bits and bytes" of hardware protocols, says Thomson. Nor does the CFO have to know "how to take hundreds of datasets on customer behavior patterns, correlate them, and come out with a conjoint analysis," he adds. "But he or she does have to know that data analysis can be used to unearth or unleash opportunities that the human eye can't see."

Inside the Organization

One common perception is that the digital CFO should be providing management oversight of his or her organization's enterprise IT strategy. For the finance executives in the survey, control over the IT department seemed less important. About 54% of respondents said they would be comfortable in that kind of role, that is, with the chief information officer reporting to them. But 46% disagreed or strongly disagreed that they would embrace such a position. (See Figure 1.)

Whether or not they oversee the IT department or the CIO, finance executives still have perhaps the toughest job related to technology: assessing the risks of adopting new technologies. We asked finance executives about the biggest risks organizations assume from automating processes and adopting new technologies. Their answers included the standard concerns of "compliance," "cybersecurity," and "unexpected costs and project bottlenecks."

But there was another risk that this group of finance executives was acutely aware of: technology adoption's effect on those in the trenches. In some ways, this may be connected to many of these CFOs' personal orientations toward IT: tech enthusiasts rarely have full recognition of the human costs of digital disruption. Many of the CFOs surveyed, in contrast,

Source for all charts: CFO Research survey of 203 U.S. executives, January 2018 were fully aware that getting users (finance staff and others) on board with change is of paramount importance.

One finance executive, for instance, listed as the top risk "concern regarding how well the staff will adapt," and another cited the "employee turnover from those who resist the change." A commonly cited risk was "implementation and training" for staff, especially, as one finance executive put it, given "a flat organizational structure and minimal resources."

Full Steam Ahead

Despite the risks, both human and technological, according to the survey a majority of survey respondents' organizations are diving into IT projects. A larger percentage of many finance department budgets will be devoted to technology in 2018, respondents indicated. About 10% of respondents said the portion of finance's total budget earmarked for tech would "substantially increase" in 2018 and 49% said the increase would be "modest."

In addition, the finance executives surveyed had high expectations of their technology investments this year. Inside of finance, they expect the largest positive impacts in the areas of process efficiency (38%), followed closely by cost reduction (35%), reporting accuracy (34%), and data/analytics availability (34%). Compliance effectiveness and error reduction fell further down the list.

"You have to be looking for every competitive edge, and technology is one way to that edge."

—Jeff Thomson, CEO, Institute of Management Accountants

Process efficiency and cost reduction are what Thomson calls "table stakes" for today's CFO. "Those are things that organizations are expected to have honed by now," he says. However, the reality is that organizations are burdened with legacy systems, and can't just "flip a switch" and be migrated to the latest tools and software that provide cutting-edge process automation, he notes.

Outside of finance, CFOs should be looking for tech investments that are competitive differentiators, explains Thomson. What differentiates CFOs and companies is investing in "activities that could be a little bit of a bet, but could actually propel the organization's growth beyond its run rate," he says.

When asked which enterprise technology investments outside of finance they expected would have the largest positive impact this year, finance executives chose "customer experience," followed by "financial analysis/modeling," "strategic direction-setting," and "competitive differentiation." Further down the list were "business unit decision-support" and "board decision-support."

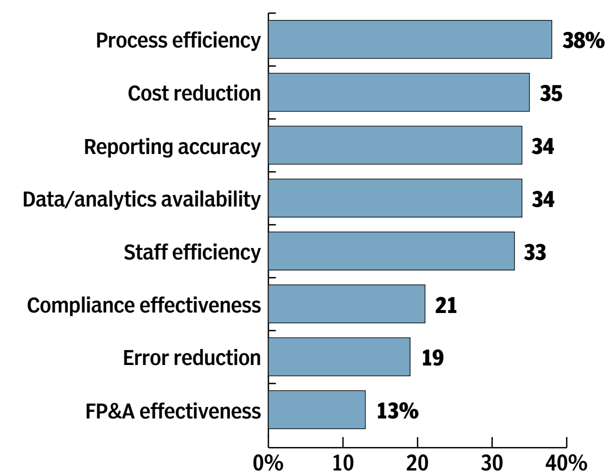
Thomson says it is particularly heartening to see market-facing investments at the top of the list. "Customer experiences, websites, portals—knowing more about customer purchase patterns than [the customers] do—that is the future."

Finance chiefs may be a few years away from achieving the dream of the digital CFO, but that may be OK if their organizations are investing in the tools that will be needed in the digital era. Companies need leaders of innovation, for sure, but they also need executive team members that ensure tech investments deliver value. CFO

Vincent Ryan is Editor-in-Chief of CFO.

FIGURE 3

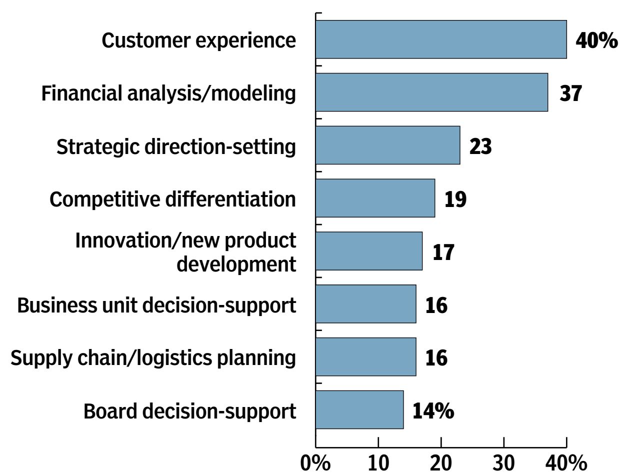
Where inside of finance do you expect your enterprise's 2018 technology investments to have the largest positive impact?



Note: Up to four responses allowed

FIGURE 4

Where outside of finance do you expect your enterprise's 2018 technology investments to have the largest positive impact?



Note: Up to four responses allowed

Courtesy Institute of Management Accountants

Tax Cuts Trigger CFO Optimism

U.S. finance chiefs see earnings growth in 2018, but they also expect higher wage and benefits costs. By Chris Schmidt

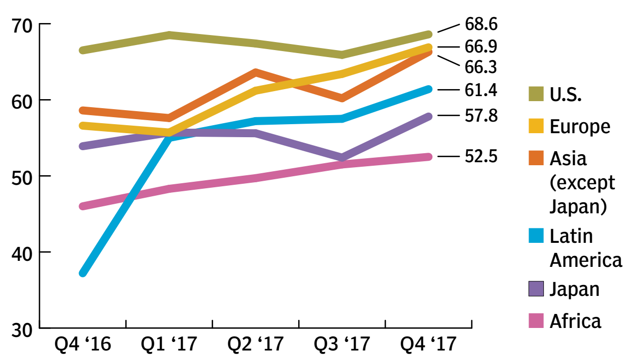
Happy days are here again? For U.S. finance chiefs, it seems, they are. At least that's the prevailing mood since Congress passed the Tax Cuts and Jobs Act, the biggest overhaul to the tax system since 1986.

Business optimism among finance chiefs in the U.S. and some other countries reached record levels in the fourth quarter of 2017, according to the more than 800 CFOs responding to the latest Duke University/*CFO* Global Business Outlook Survey. The survey's CFO optimism index in the U.S. rose to 68.6 on a 100-point scale, the highest recording of 2017. (The lowest was 65.9, recorded in the third quarter.) Among the CFOs who responded to the late-November-to-early-December survey after the U.S. Senate passed its version of the tax cut bill, optimism spiked to 73, which is the highest U.S. CFO optimism level ever recorded.

CFOs' confidence in the performance of their own companies also strengthened in the quarter, as the optimism index rose to 71.3, up from 70.2 in September. In a reflection of that optimism, U.S. CFOs projected that both capital spending and employment at their firms would increase by a weighted average of 3.2% in 2018. They also forecast average earnings growth of 5.6% and tech spending growth of 4.8%. To finance some of this, U.S. CFOs expected to be able to increase product prices. On average, surveyed CFOs said the prices of their own firms' products would increase 2.7% in 2018.

Economic Optimism Rises Globally

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



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

Tight Labor Market

While CFOs' moods are buoyant, they know full well that a growing economy boosted by high employment has a distinct down side—difficulty finding the workforce and talent to execute on their plans and investments. In the fourth quarter, the proportion of firms that indicated they were having difficulty hiring and retaining qualified employees was at a two-decade high for the survey—43% of CFOs called the issue a top concern.

U.S. firms said they plan to increase employment by a median of 2% in 2018. But they also expected to pay higher wages to achieve that increase. They forecast median wage growth of about 3% over the next 12 months. Wage growth should be strongest in the tech, energy, and retail/wholesale industries, according to the survey results.

After the labor market, the next biggest concern among U.S. CFOs was also human-capital related: the cost of employee benefits. Health-care costs are expected to rise by more than 8% in 2018. Nearly half of U.S. CFOs surveyed indicated that the cost of employee health benefits crowded out their ability to spend on long-term corporate investment. Health-benefits costs ranked even higher than government regulation and (prior to the U.S. tax cut) corporate taxes in that respect.

On the list of CFOs' top concerns, data security issues rose to third place, its highest ranking ever, followed by government policies, regulatory requirements, and employee productivity.

Pace of Innovation

While it's tempting to attribute the forecast of higher tech spending and employment at many U.S. firms solely to CFOs' sunny disposition over a tax cut, the truth is that organizations are also being pushed by competitive forces, namely, the overall rapid pace of innovation.

In the fourth-quarter survey, 62% of CFOs indicated the pace of innovation at their firms and within their industry had picked up in the past three years. Among those companies, 63% indicated the rapid pace of change had caused their firms to focus more on the near-term, and 40% said they now choose projects with shorter lives.

CFOs at those firms also indicated that they have had to invest more to keep up. As a result of more rapid innovation, 76% of respondents indicated they boosted capital spending and 46% said they increased research and development outlays. Nearly one-third (31%) said innovation has spurred them to tackle ambitious, "moonshot" projects.

62%

U.S. finance executives who indicated that the pace of innovation at their firms had picked up in the past three years

Striving for Balance

One potential constraint on all of these plans for 2018 could be the stamina of CFOs. In a series of special questions, the survey found that finance chiefs would like to spend less time at their jobs. They spend two-thirds of their waking hours working, they said, and many would prefer to be on the job much less than that. The preference to work fewer hours was pervasive, regardless of the current number of hours worked.

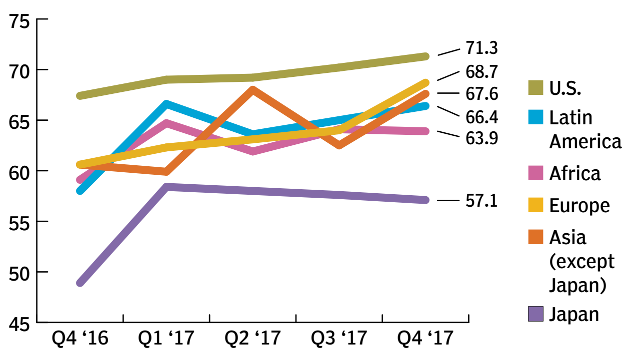
Most CFOs who work 80% of their waking hours would prefer to work between 50% and 60% instead, while CFOs who currently work 50% of waking hours would prefer to work 40% or fewer. Those trends held across industries and around the world.

The typical CFO of a company in Asia works 73% of his or her waking hours, slightly higher than CFOs in Europe (72%), Africa (70%), and Latin America (69%). CFOs from all regions indicated they would prefer to work about 20% fewer hours per week.

"The role of the CFO has widened over the last two decades. CFOs are accountable for the bottom line as well as helping shape corporate strategy," said John Graham, a finance professor at Duke's Fuqua School of Business. "One hopes that finance chiefs are not overworking themselves to the point of jeopardizing their health, which in turn could put the financial health of the company at risk."

Company Confidence Strengthens In Most Regions

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



*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 292 from the U.S., 74 from Asia (outside of Japan), 22 from Japan, 148 from Europe, 215 from Latin America (including Mexico), and 55 from Africa.

Around the Globe

In tandem with the economic confidence in the U.S., CFO optimism increased around the world, according to the survey results:

- Optimism among finance chiefs in Canada remained strong, hitting an index score of 64. Capital spending was forecast to increase by about 4% and employment by about 2%, on average, in 2018.
- Optimism in Europe jumped to 66.9 this quarter, the highest level in a dozen years. Capital spending was projected to increase 4.8% and full-time employment 3.9%. For the second consecutive quarter, the top concern among European CFOs was attracting and retaining qualified employees, followed by regulatory requirements, government policies, and data security.
- Optimism was also strong in Asia, clocking in at 66.3. Median 5% growth in capital spending and 2% employment growth were expected in 2018. Difficulty attracting employees, economic uncertainty, and regulation and government policies were top concerns.
- Latin American optimism continued to rebound in most countries, climbing to 73 in Mexico, 71 in Peru, and 61 in Brazil. In stark contrast, optimism was only 28% in Ecuador. CFOs projected that median capital spending growth in the region would be 5% next year, while median employment would be flat. Economic uncertainty was the top concern among Latin American CFOs, with 62% of firms listing it as a top four concern. They were also worried about governmental policies, weak customer demand, and productivity.
- Business optimism in Africa increased 1 point to 52.5 this quarter, still the world's lowest. Capital spending was forecast to increase by about 1% and employment by 3% in 2018. The biggest concerns for African CFOs were economic uncertainty, governmental policies, and currency risk. CFO

Thinkstock

Risky Business

Among the various threats to corporate well-being, one—the vulnerability of sensitive data—stands out from the crowd. By Josh Hyatt

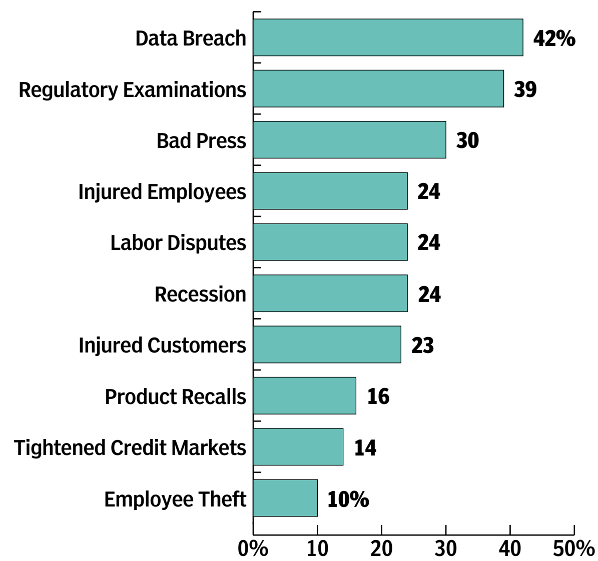
Companies face risks of many shapes and sizes but sometimes struggle to prioritize them. Yet it's a flat-out certainty that, today, the greatest perceived threat to business health and success is the scourge of bad actors aiming to gain access to corporate information systems.

A recent CFO Research survey, conducted in collaboration with global insurance provider Hiscox, asked 204 senior finance and risk executives to identify the risks that concern them most. Topping the list, chosen by 42% of survey respondents, was "data breach." (See Figure 1.)

When a major cyber-attack or breach makes headlines, it's natural for companies to look inward at their own preparedness. However, it's not enough to elevate cybersecurity only in the wake of an attack. Today's environment demands that companies keep it at the top of their risk-management concerns. Detecting and protecting against an ever-shifting landscape of exposures requires a commitment to staying equipped with the most advanced technologies and other resources available to the company.

FIGURE 1

Which types of occurrence cause the greatest potential concern for your organization?



Note: Multiple responses allowed

For executives responsible for detecting and managing cyber-risks, that means battling an influx of what may look like new and unfamiliar threats, even if they are hackers' latest strategies for achieving their goals. To be sure, in recent years executives have become far more cognizant of cyberthreats, as reflected in companies' intensifying efforts to mitigate them. Still, the level of risk continues to rise.

What makes hackers especially difficult to thwart is that they're continually changing their attack strategies and seeking new vulnerabilities.

So it's up to companies to keep locating—and sealing—cracks in their protective bubbles. Indeed, the importance and difficulty of managing cyber-risks is such that nearly 7 in 10 companies (68%) represented in the survey have a position dedicated to risk management.

Protect What You Can

It's crucial for executives to realize that hackers' perpetual inventiveness shouldn't discourage companies from addressing the risk, even if they can't eradicate it. The risk management function, like cyber-attackers, must continually evolve—not only to shield the company from cyberthreats, but also to minimize the potential impact of any such events that do occur. Says one executive who responded to the survey, "Risk elimination is not our goal. Risk reduction is our goal."

It's easy to understand why so many senior executives share the same unease. Given the stakes, companies can't afford to be complacent. Beyond compromising sensitive data about customers or suppliers, cyber-breaches can critically impair relationships with any and all business partners, including investors.

Cyber-attackers have successfully breached brand-name retailers, high-profile financial organizations, and others, including Equifax. In the aftermath of such breaches, the damage can spread in many directions, not only contaminating a company's reputation but also poisoning its bond with customers by exposing them to identity theft and subsequent financial losses.

Retail giant Target's 2013 breach sent quarterly profits into a plunging spiral and ultimately cost the CEO his job. An awareness of how far and wide such damage can spread exemplifies why almost 3 in 10 respondents (29%) chose "bad press" as a top concern.

Cyber-attackers typically share a common motivation: money. There's a liquid market for customer information, including Social Security numbers and credit card data. Companies are clearly aware of their responsibility to protect customers from being compromised. Among respondents, a clear majority (59%) cited customers as their top-most concern in terms of potential litigants. In second place, named by significantly fewer respondents (40%), were regulators, followed by employees at 33%. (See Figure 2.)

Cybersecurity has become a hot topic among lawmakers, who have been seeking a definition for "reasonable" security measures. Such a classification could theoretically become part of a law that would hold companies responsible for breaches in which they could legally be deemed "negligent."

Efforts to require companies to report certain aspects of their business practices that have created potential vulnerabilities have foundered—so far—because such disclosures could also provide a treasure map for hackers.

10%

Companies that would be "completely comfortable" purchasing cyber-breach expense coverage without the counsel of an insurance agent or broker

Other Priorities

Ranking second on the list of top risks—and not far behind data breaches—was "regulatory examinations," cited by 39% of respondents. There is good reason for assigning a high level of risk to such actions, and it relates to cybersecurity.

The two types of insurance that ranked highest on survey-takers' list of policy purchases under consideration were cyber/network/privacy liability coverage (29%) and cyber-breach expense coverage (25%). Those were selected by about as many respondents as indicated they already hold such policies (31% and 39%, respectively).

What does that have to do with regulation? Companies are all too aware of the large sums they've already had to spend to comply with federal and state disclosure requirements—for example, for encryption technology.

This year, the risk posed by cyber-regulation is particularly vivid to companies doing business in Europe. Under the European Union's new General Data Protection Regulation, slated to take effect May 25, fines for noncompliance range up to a whopping 4% of a company's worldwide revenues. To suggest that companies will do whatever they must to avoid such an onerous penalty qualifies as a rank understatement.

Just as regulators serve as significant sources of anxiety in the realm of risk management, so too, as noted above, do customers and employees. Almost a quarter (24%) of survey participants ranked "injured employees" as a risk of great concern, and nearly as many (23%) said the same about "injured customers." Further, 24% of those surveyed cited concern over potential labor disputes.

Such concerns help explain why a vast majority (90%) of companies represented in the survey have internal legal counsel. It underscores the seriousness of the challenge businesses face in identifying concerns even before they mature into full-blown risks.

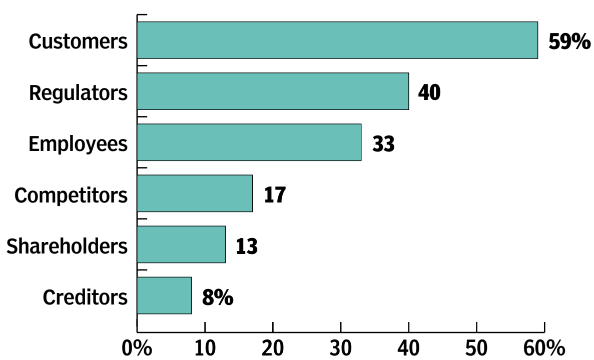
Another factor fueling the need for legal cousel within the corporate structure is an unprecedented level of organizational complexity, with key emerging risks—in the regulatory arena, for instance—requiring legal guidance specific to a company's priorities and practices.

Companies need to take a consistent approach toward any litigation, no matter the source, advises one executive. "Fight nuisance lawsuits tooth and nail and get a reputation out there that you will continue to fight these types of lawsuits, which will reduce the propensity of 'ambulance chasers' to sue your company," he says.

Seen through a different lens, regulators, customers, and employees are also crucial sources of corporate stability. But the fact that respondents rank them so highly as potentially damaging risks highlights what makes risk management so challenging. Whether it's cyber-hackers or other risks, they may be hiding in plain sight. For senior executives, it's crucial to have the tools necessary to see them clearly. CFO

FIGURE 2

Which types of potential litigants cause the most concern for your organization?



Note: Multiple responses allowed

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High-Stakes Games

This year's Olympics in South Korea are likely to cost far less than the $21.9 billion spent on the 2014 winter games in Sochi, Russia, experts predict. Yet hosting these events can bust a city's or country's budget. Since 1960, 47% of the games have had cost overruns above 100%. How much do you know about the cost of putting on previous Olympic games?

1 The most expensive Summer Games over the period of 1960–2016 cost which city $15 billion?

A. Rio De Janeiro
B. Athens
C. London
D. Beijing

2 Montreal, Canada, experienced the largest cost overrun for a Summer Games, way back in 1976. By what percentage did those games exceed their budget?

A. 266%
B. 720%
C. 151%
D. 90%

3 The Olympics have been found to have the highest average cost overrun of any similarly scaled project. What's the average percentage overrun of the games since 1960?

A. 156%
B. 125%
C. 230%
D. 110%

4 What was the average cost of the six Olympics held from 2004 to 2014?

A. $12.8 billion
B. $8.9 billion
C. $16.3 billion
D. $15.6 billion

5 Held in 1964, the cheapest Summer Games cost $282 million in 2015 dollars. In what city were those games held?

A. Tokyo
B. Mexico City
C. Moscow
D. Munich

6 The cheapest Winter Games, held in Innsbruck, Austria, also occurred in 1964. How much did they cost in today's dollars?

A. $135 million
B. $215 million
C. $22 million
D. $164 million

7 Since 1960, what have been the average costs in 2015 dollars for the Summer Games and the Winter Games, respectively?

A. $7.5 billion and $4.2 billion
B. $4.8 billion and $2.6 billion
C. $5.2 billion and $3.1 billion
D. $6.8 billion and $3.8 billion

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

Source: The Oxford Olympics Study, 2016 | Photo: Wikimedia Commons

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