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ROBOTS INVADE FINANCE

BUDGETING FOR BIG PROJECTS

THE PATH TO TRUSTED STRATEGIC ADVISER

CFOs TO WATCH 2016

20 FINANCE CHIEFS FACING SIGNIFICANT CHALLENGES IN THE COMING YEAR


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September 2016
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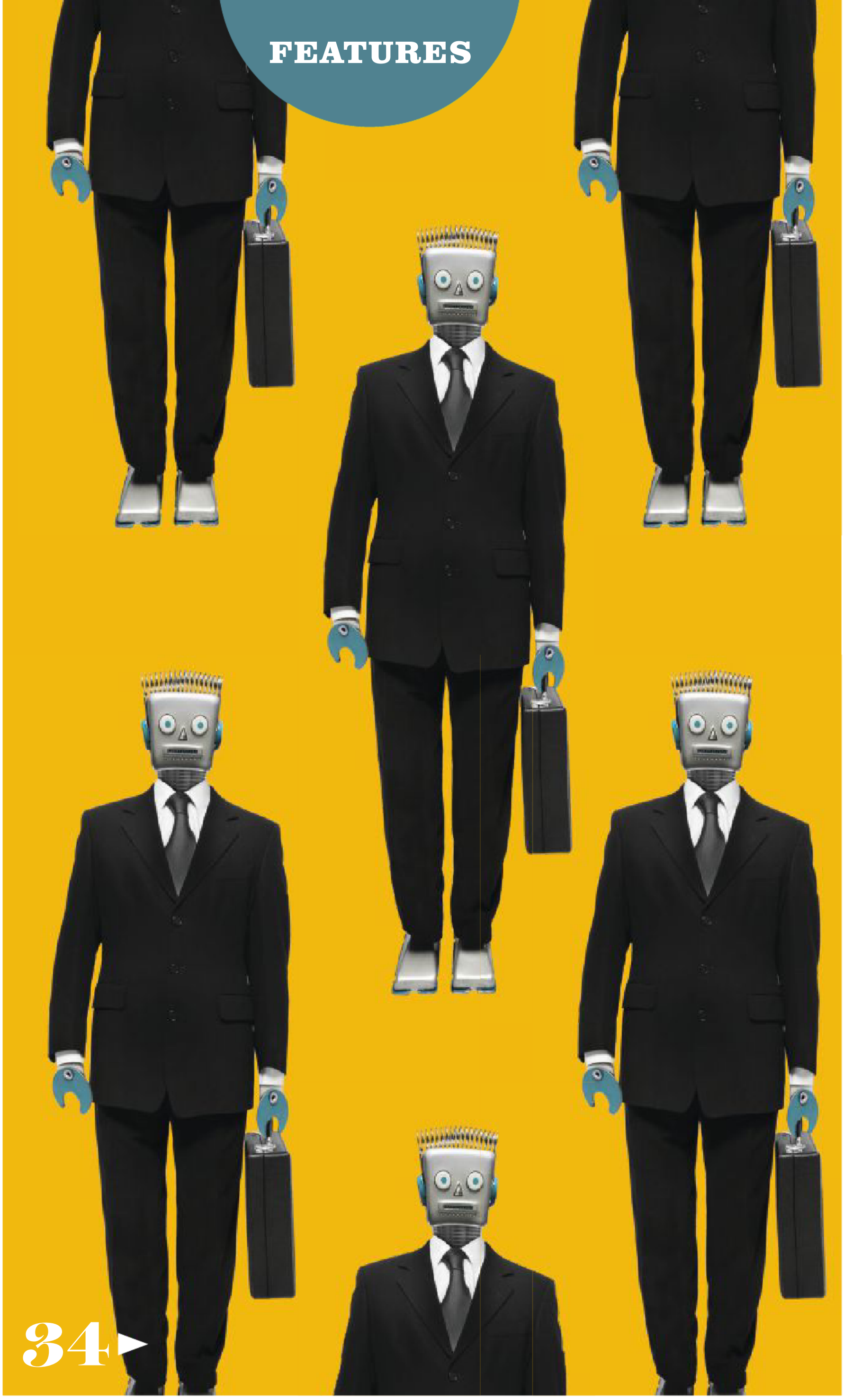

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Rising to The Challenge

The job of chief financial officer is tougher than ever. We profile 20 who have career-defining tests ahead.

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Robots, Robots Everywhere

Rather suddenly, virtual robots are bringing big change to corporate finance processes.

By David McCann

Cover: Getty Images. This page, from top left, Getty Images, Thinkstock

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Up Front

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FROM THE EDITOR

Robots To The Rescue

››A recent study found that the CFO position is becoming so responsibility-laden that it's almost impossible for one human being to perform it. As an EY executive said, "It's become a job that may be too big for any one individual to do well, given all the responsibilities and the incredible contrast between the day-to-day controllership functions and the very long-term, strategic, executive functions."

With compliance, controls, and costs consuming a finance chief's attention, strategic priorities get short shrift. Fortunately, new technologies are promising to change things. Specifically, companies are beginning to deploy virtual robots—software that enables automation across a spectrum of processes and works across different software platforms and systems, according to Genpact's Shantanu Ghosh. Full automation of procure-to-pay, order-to-cash, and record-to-report processes are good examples of what is formally called robotic process automation.

If all that sounds a bit confusing—or even outlandish—David McCann's feature on page 34, "Robots, Robots Everywhere," provides a thorough, easy to understand, reality-based primer on this essential subject. As his story explains, virtual robots could change the finance department as much as the spreadsheet did in the 1980s.

Of course, automation has its limits for the CFO. We have yet to find a software program that can determine where to allocate scarce capital when sales of a mature product are declining and shareholders are clamoring for buybacks and dividends.

Few top executives would want to cede those decisions to software, even if they could, because that's where the excitement is in finance. In our second annual CFOs to Watch feature ("Rising to the Challenge," page 23), we profile 20 finance chiefs who have multiple crucial decisions like that to make.

The CFOs to watch are top-notch finance people with a chance to change their companies' fortunes. We get the sense that they relish the test. Until robotic process automation proves it can revolutionize the finance department, these CFOs will be the real heroes.

Vincent Ryan
Editor-in-Chief

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EDITOR'S PICKS

STRATEGY

CFO's annual CFO Rising West Summit takes place in San Francisco on October 20-21. This year's theme is the evolving role of the strategic CFO. Speakers include the finance chiefs of Yahoo, EA, Toyota Financial Services, and Discovery Health. For more information, go to https://theinnovationenterprise.com/summits/cfo-rising-west-summit-san-francisco-2016.

LEADERSHIP

Are there too many executives at the very top of corporations? Writing in the Harvard Business Review, consultant Jacques Neatby says as companies add more officers, the CEO becomes more of a referee than a decision maker. Read more about the dangers of the "ballooning executive team" at https://hbr.org/2016/07/the-ballooning-executive-team.

Mark Bennington

THE BUZZ

➡ It was July 28, and we were looking for news briefs to post on CFO.com. Voila: a report arrived from the Employee Benefit Research Institute, providing data on the growing number of small companies that are discontinuing health benefits for employees. It was straightforward information, there wasn't a lot of it, and we didn't attempt to add analysis. It was a news brief.

But to *CFO*'s audience, **"Small Companies Are Dropping Health Benefits"** apparently was the most significant article of the month. It may have set our record for the lowest ratio of words written to comments posted.

Some readers simply wanted to know more. Did these employers see net cost savings? Did they increase employee compensation by the amount of savings?

Others took sides. "I think it is great that small business employers can now focus on running their business instead of being in the healthcare benefits business," one reader wrote. Countered another, "I suspect the decision to stop offering health benefits **had less to do with eliminating a management distraction and more with improving the bottom line.** It's a very rational decision that I don't necessarily disagree with, but let's be honest about the motives."

Upping the ante on reader discord, a subsequent poster commented, "I can tell you why we stopped offering benefits. It does have to do with the bottom line. We are a small medical business, and [thanks to the Affordable Care Act we have] declining reimbursements and increased expense. **No, we did not raise employees' pay by the amount we saved, nor did we line our fat pockets with that money.** We used it to survive and actually take home a normal paycheck. What it comes down to is, if you want a job, then deal with it. If you don't want a job, then sure, raise a stink about no benefits, because with them I'd be broke, and broke don't pay no bills."

Of course, that invited comebacks like this one: "That's tough. I'd say yours is not an attractive place to work. Hope you can retain the employees you have. Seems like a pretty grim situation."

And this one: "We pay 100% of employee-only coverage of health, dental, vision, and AD&D. We feel that taking away these worries from our employees allows them to focus on working and being loyal to the company. Yes, it costs the shareholders some bottom line, but the benefit is a workforce with little turnover."

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STATS OF THE MONTH

PRODUCTIVITY PROBLEM

-0.4%
Growth in quarterly output per worker in the United States, the largest decline in three years

1.3%
Annual rate of productivity growth from 2007 to 2015, compared with a long-term average of 2.2%

1.7%
Annual increase in hourly compensation for workers in nonfarm businesses

1.5%
Year-over-year rise in hours worked for workers in nonfarm businesses

Source: U.S. Bureau of Labor Statistics productivity and costs data for the second quarter of 2016

Topline

CASH MANAGEMENT

Corporate Cash Earning Almost Nothing

Companies are still reluctant to venture beyond very low-yielding investments.

Although stronger operating cash flows have corporate balance sheets bulging, companies are taking little to no risk with excess cash and therefore earning little or no return.

The Association for Financial Professionals' annual Liquidity Survey, conducted before the United Kingdom's vote to leave the European Union, found that companies are still holding vast amounts of cash in extremely low-interest bank deposits and clinging to the goals of principal preservation and liquidity.

According to the survey of 787 corporate finance practitioners, 55% of U.S. companies' excess cash is maintained in bank deposits. Another 9% is in prime money market funds, 7% in government money market funds, 4% in Eurodollar deposits, 4% in Treasury bills, and 4% in commercial paper.

"[Companies] have gotten comfortable with their banks, and there is no yield anywhere else," says Craig Martin, executive director of the AFP's corporate treasurers' council. "If there were a yield curve in the short term, between Fed funds and one-year, then I think the conversation between treasurers, CFOs, and boards of directors might be different."

Indeed, with the Federal funds target rate still at 0.25% to 0.5%, as of August money market funds were sporting annual yields of just 0.27% and two-year Treasuries were earning just 0.69%.

Treasurers could become even more conservative when new SEC rules on prime money market funds take effect in October 2016. Sixty-two percent of respondents will make changes in how they invest in prime funds as a result of the rules regarding floating net asset values and "gates" on investor redemptions.

Safety of principal continues to be the top short-term investment objective for 68% of organizations, compared with 65% in 2015, according to the AFP poll. Another 30% cite liquidity as their priority. Only 2% of survey respondents indicate the primary goal for their excess cash is yield.

"In all of the research we do, liquidity continues to be high on the list of things treasurers are paying attention to," says Martin. To prepare for the unexpected, "the best thing to do is to have good liquidity, know your sources of funding, and have a sound balance sheet and capital structure," he adds.

Companies are being cautious with cash even though more of it is coming in the door. Almost one-third of practitioners report that their organizations' cash holdings within the United States increased from May 2015 to May 2016. Driving the rise in excess cash levels the past 12 months were higher operating cash flow (cited by 64% of respondents), increased debt outstanding (24%), lower capital expenditures (16%), and retirement of debt (also 16%).

In addition, 25% predict their organizations will add to their cash cushions over the next 12 months (55% say excess cash amounts will be unchanged).

The aversion to risk and to earning any yield is also evident in the way CFOs and treasurers are choosing deposit partners. Ninety percent of survey respondents say their overall banking relationship is the primary driver in the placement of short-term investments. That's up from 85% last year and 72% in 2014.

Sixty-four percent of respondents say their firms continue to hold a bundle of cash outside U.S. borders. Most of those overseas cash holdings (71%) are in bank-type investments (including certificates of deposits and time deposits), AFP said. **VINCENT RYAN**

Same Strategy, Next Year

One-fourth of finance executives predict their organizations will increase their cash balances over the next 12 months. Here's why.

Increased operating cash flow	74%
Shortened/decreased working capital conversion cycle	24%
Acquired company or subsidiary and/or launched new operations	17%
Decreased capital expenditures	17%
Increased debt outstanding/accessed debt markets	13%

Source: Association for Financial Professionals 2016 Liquidity Survey

REGULATION

'Smaller Reporting Company' Rule Proposed

The U.S. Securities and Exchange Commission has suggested making it easier for registrants to qualify as "smaller reporting companies" subject to less stringent disclosure requirements.

Smaller reporting companies are eligible for "scaled disclosures," meaning they do not need to provide as much financial and governance information as larger companies. Under a proposed rule issued by the SEC in June, a company with less than $250 million of public float would qualify for scaled disclosures, up from the current $75 million threshold.

If a company does not have a public float, it would be allowed to provide scaled disclosures if its annual revenues are less than $100 million, as compared to the current threshold of less than $50 million in annual revenues.

"Raising the financial thresholds in the smaller reporting company definition is intended to promote capital formation and reduce compliance costs for smaller companies while maintaining important investor protections," SEC Chair Mary Jo White said.

Smaller companies can satisfy their reporting obligations by, among other things, providing an abbreviated business history and management discussion and analysis. Filings can omit a stock performance graph, market risk disclosures, executive compensation analysis, and executive pay ratio disclosure.

According to the SEC, its empirical analysis suggests that scaled disclosures "may generate a modest, but statistically significant, amount of cost savings in terms of the reduction in compliance costs for most of the newly eligible smaller reporting companies under the proposed amendments; a modest, but statistically significant, deterioration in some of the proxies used to assess the overall quality of information environment; and a muted effect on the growth of the registrant's capital investments, investments in research and development, and assets."

Under the proposed rule, once a company exceeds either of the thresholds, it will not qualify as a smaller reporting company again until its public float falls below $200 million or, if it has no public float, its annual revenues drop to less than $80 million. **MATTHEW HELLER**

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TAXES

Dems Demand Tax Break Clawback

Avowing a corporate tax agenda aimed at fighting outsourcing and keeping U.S. jobs at home, the Democratic Party Platform committee writes in the party's 2016 platform that the nation must "claw back tax breaks for companies that ship jobs overseas, using the proceeds to reinvest in communities and workers at home instead."

Besides seeing such clawbacks as a way of "fostering a manufacturing renaissance," the framers, who drew up the platform in July, contend that it would be a way of making "the wealthiest Americans and largest corporations ... pay their fair share of taxes."

Further, the Democrats promise to "end deferrals so that American corporations pay United States taxes immediately on foreign profits and can no longer escape paying their fair share of U.S. taxes by stashing profits abroad."

In a period of "massive income and wealth inequality like the present," Democrats, if elected, would "crack down on inversions and other methods companies use to dodge their tax responsibilities," according to the platform. (In an inversion, a U.S.-based multinational typically merges with an offshore partner and replaces its U.S.-based parent company with a new foreign holding company domiciled in a low-tax country.)

The party notes that the oil and gas, pharmaceuticals, and financial services industries have benefited from tax breaks at the expense of the public. Democrats are thus promising to "eliminate tax breaks for big oil and gas companies." Further, according to the platform, the biggest pharmaceutical companies "are making billions of dollars per year in profits at higher margins compared to other industries while many stash their profits in offshore tax havens."

In addition to sticks, the Democrats are offering carrots to companies that focus on domestic business. "We will make sure that our tax code rewards businesses that make investments and provide good-paying jobs here in the United States, not businesses that walk out on America," the platform says. **DAVID M. KATZ**

TECHNOLOGY

Wanted: Guidance on Cloud Income

The American Bar Association is asking the U.S. Internal Revenue Service to clarify how cloud transactions should be classified for tax purposes. Citing the growth in cloud computing, the ABA said there is "a pressing need for guidance from tax authorities."

"While traditional tax principles can be applied to cloud transactions, their current application is unclear," the association's tax section said in a document submitted to the IRS. "We suggest that [the Department of the Treasury and the IRS] issue additional guidance clarifying the application of such principles to cloud transactions."

The Organisation for Economic Co-operation and Development in 2014 addressed the challenges of taxing digital services and facilities, finding that it was unclear whether cloud transactions should be characterized as the provision of services or as rent or royalty income.

"Existing tax concepts are not, on their face, directly applicable to cloud computing," the ABA said, noting that cloud services may not be analogous to traditional commercial transactions.

While software-as-a-service, for example, is "similar to a 'typical' software license at a high level," the cloud services provider's "ability to exercise control over software, the ability to update and monitor software use, and the remote location of data storage may justify reconsideration," the ABA wrote.

The association recommended that the IRS "should generally characterize cloud transactions as services arrangements, with the exception of certain transactions that, based on the relevant facts and circumstances, would be treated as leasing transactions where physical equipment (i.e., servers) are dedicated to a user."

The cloud computing industry is expected to grow from an estimated $25 billion in spending in 2011 to $38 billion this year and $173 billion in 2026. **M.H.**

BANKING

Loan Standards Tighten

Are banks tiring of commercial borrowers? The July results of the Federal Reserve's survey of senior loan officers contained a mild surprise: some banks tightened their standards on commercial and industrial loans in the second quarter of 2016. According to the Fed, "modest fractions" of the 71 domestic banks surveyed tightened C&I lending standards for large and middle-market firms. Banks didn't necessarily worsen loan terms, however: "a modest percentage" of banks narrowed spreads of loan rates over the cost of funds, while "moderate fractions" of banks increased the premiums charged on riskier loans.

The domestic banks said they tightened either the standards or terms on C&I loans over the past three months because of a less favorable or more uncertain economic outlook, worsening of borrowers' industry-specific problems, and reduced tolerance for risk.

At the 23 U.S. branches and agencies of foreign banks, C&I lending standards remained unchanged for the most part. However, a small number of those banks said they raised the cost of credit lines and tightened collateralization requirements, and some increased premiums charged on riskier loans.

Commercial real estate (CRE) borrowers also came under pressure in the quarter. Domestic banks generally indicated that their lending standards for CRE loans of all types tightened during the second quarter, according to the Fed survey. In particular, a moderate net fraction of banks reported tightening standards for loans secured by nonfarm nonresidential properties, whereas significant net fractions of banks reported tightening standards for construction and land development loans and loans secured by multifamily residential properties.

Meanwhile, in the consumer arena, banks appear to be gaining an appetite for some loan types. A modest net fraction of banks indicated that they were more willing to make consumer installment loans during the second quarter compared with the first. On credit cards, some reported reducing minimum required credit scores. **V.R.**

REGULATION

Crackdown on Debt Collectors

The U.S. Consumer Financial Protection Bureau has proposed new rules for the debt collection industry that could "drastically overhaul" the market. The rules include limiting collectors' communications with debtors.

While the industry is already regulated by the Federal Trade Commission under the Fair Debt Collection Practices Act, the Consumer Financial Protection Bureau has penalized a number of large debt collectors in recent years. The agency receives more complaints about debt collection each month than any other area.

Under a proposal unveiled by the CFPB, regulation would be strengthened by requiring collectors to make no more than six attempts to contact debtors each week and to clearly disclose debt details. The proposed rules would also make it easier for the consumer to dispute the debt.

"This is about bringing better accuracy and accountability to a market that desperately needs it," CFPB Director Richard Cordray said.

The bureau's move follows efforts by states including New York and California to adopt stricter rules about the documentation required to collect on a debt.

The CFPB estimates that about one in three consumers—more than 70 million people—were contacted within the past year by a creditor or collector trying to collect a debt. Roughly 13% of consumers have a debt in third-party collection, with the average amount being $1,300. The most common complaints involve collectors seeking to collect debt from the wrong consumer or for the wrong amount, or trying to collect a debt that cannot legally be enforced.

Many consumer advocates contend that the CFPB should impose tougher measures, such as banning collectors from going after debt past the statute of limitations. **M.H.**

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Welcome To 'Risk Accounting'

Academics have codified a new accounting technique that could revolutionize enterprise risk management. By Peter Hughes

Conventional enterprise risk management systems are generally assessment based and, consequently, typically report results via an assessment metric often based on three colors: red, amber, and green. The managerial usefulness of such systems is limited for at least two reasons: first, "assessment" as opposed to "measurement" is inherently subjective and not easily audited; second, an assessment metric cannot be aggregated to support important management techniques such as trend analysis, benchmarking, ranking, and the comparison of actual usage against operating limits. To state the obvious, you can't aggregate and compare colors.

The evolving risk landscape in which firms operate has undergone dramatic change in little more than a generation due to several factors:

• advances in science and technology and an ever-growing dependency on globally interconnected electronic data and information networks;

• globalization and geopolitical uncertainties that lead to supply chain vulnerabilities; and

• the use of increasingly complex and sophisticated financial products to manage financial risks.

That has caused boards of directors, CFOs, and other C-suite executives to become increasingly concerned with risk and its potential to trigger material unexpected losses. As recent events such as the financial crisis demonstrate, such losses can severely impact or even wipe out a firm's capital.

Whereas accounting standards such as IFRS and GAAP ensure that companies present a fair view of their financial condition, there are no equivalent standards that apply to risk. In other words, a firm's stakeholders—investors, regulators, customers, and auditors—receive little or no information on the risks firms accept, absolutely or in comparison to others, to create shareholder value.

The misalignment between finance and risk reporting is what academics have set out to resolve through their codification of the new accounting technique referred to as "risk accounting." Risk accounting begins with the assertion that effective ERM must operate within a standardized system of risk measurement using a common risk metric that expresses all forms of risk. Accordingly, a unit of risk measurement unique to risk accounting has been created, the "risk unit," or "RU."

Analogous to financial accounting, where profits are created through the sale of products and services, risk accounting assumes that exposure to risk is similarly correlated with revenue generation. For management reporting, transactions associated with the sale of products and services are tagged with codes that uniquely identify products, customers, business lines, organizational components, legal entities, and locations. For risk reporting, these same transactions are tagged with additional codes that are used in a calculation of each transaction's risk-weighted value, that is, its exposure to risk in RUs.

The first step in risk accounting is to identify the primary risk types to which each industry is exposed. For example, in banking these are deemed to be operational, credit, market, liquidity, interest rate, and conduct risks.

Three sets of standardized tables provide the risk-weighted factors used in the calculation:

• **Product Risk Table.** Provides risk weights according to the risk characteristics of each marketed product, graded by criteria such as complexity, toxicity, rate of decomposition, method of distribution, and method of trading.

• **Value Table.** Used to convert revenue amounts, according to accounting records, into scaled value band weightings (VBWs).

• **Best Practice Scoring Templates.** Used to calculate the risk mitigation index (RMI) based on key risk indicators (KRIs) that reflect the operational status of each department and underlying process.

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These risk-weighted factors are then used to calculate three core metrics for each risk type triggered by the product in question:

- **Inherent Risk.** The risk-weighted transaction value, expressed in RUs, that represents its maximum possible loss.
- **Risk Mitigation Index (RMI).** A dynamic measure on a scale of 1 to 100 (where 100 is agreed-upon best practice) that represents, in percentage terms, the portion of Inherent Risk that is mitigated through the effective management and control of the firm's operating environment.
- **Residual Risk.** The portion of a transaction's Inherent Risk, also expressed in RUs, not covered by effective risk mitigation. This RU number represents the transaction's probability of loss.

The pairing of accounting and risk values in a single source of controlled and audited accounting data at the transaction level enables the production of combined finance and risk reports and the computation of enterprise-wide risk and return metrics. Feedback loops give managers real-time or near real-time information on risk mitigation initiatives, together with calculations of the associated improvement in RMIs and reduced residual RUs.

"A firm's stakeholders receive little or no information on the risks firms accept, absolutely or in comparison to others, to create shareholder value."

Given that risk accounting is an extension of management accounting, risk appetite can also be calibrated in RMIs and residual RUs and become an integral part of a company's budgeting and planning cycles, thereby constituting a true ERM system. The RMI is the de facto measure of risk culture as it blends risk attributes from across the enterprise.

A more detailed description of risk accounting is available in a research working paper, "Risk Accounting: The Risk Data Aggregation and Risk Reporting (BCBS 239) Foundation of Enterprise Risk Management (ERM) and Risk Governance." Whereas the models and examples included in the paper relate to banking, the method can be adapted for non-banks. CFO

Peter Hughes is an accountant and member of the advisory board of Durham University Business School's banking, risk, and intermediation research group.

Securities Class Actions Rise

As many as 6% of S&P 500 companies could be the target of such suits this year.

Plaintiffs filed 119 new federal securities class-action cases in the first half of 2016, a 17% increase over the second half of 2015, according to Securities Class Action Filings—2016 Midyear Assessment, a new report released by Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse. In addition, compared with historical averages, more S&P 500 companies were the subjects of filings.

The 119 total cases represent an increase of 17 cases from the second half of 2015 and 32 more than the first half of 2015. The total was also 27% higher than the half-yearly average of 94 filings between 1997 and 2015.

Federal filings of class actions involving mergers and acquisitions fueled the jump in class-action cases, as such filings increased to 24 in the first half of 2016, significantly higher than the half-yearly range of 5 to 9 filings in the period from 2012 to 2015.

"At the current pace, M&A-related filings in federal courts will double the annual numbers we have observed in the last four years," says John Gould, a senior vice president of Cornerstone Research.

In the first half of 2016, filings against S&P 500 companies were also more frequent than the historical average. The consumer non-cyclical sector, which comprises biotech, pharmaceutical, and health care companies, had the most filings, with 43. If the current pace of filings against S&P 500 companies continues, one in 16 companies (6%) would be the target of a lawsuit by year end, the highest annual rate since 2008, Cornerstone Research and Stanford predicted.

The report data also showed that plaintiffs bringing Section 11 cases, which involve untrue statements or omissions of material fact in securities registration statements, are more often suing in state courts rather than federal ones.

"Plaintiffs have obviously calculated that they are likely to achieve more plaintiff-friendly outcomes in state court than in federal court, and are using a range of jurisdictional maneuvers to try to steer an increasing number of cases away from the federal forum,'" said Joseph A. Grundfest, director of the Stanford Law School Securities Class Action Clearinghouse and a former SEC Commissioner.

Finally, on an annualized basis, filings against foreign issuers increased from 2015 levels. ▸ **VINCENT RYAN**

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Eight Keys to Being A Trusted Strategic Adviser

CEOs need a CFO who can help management confidently take new, calculated risks and strategize ways to grow the business. By Kathy Crusco

Competitive threats from new market entrants and established players are forcing CEOs to develop a greater appetite for risk. Specifically, according to a study done by KPMG in 2015, as many as one in three chief executives think they are not taking on enough risk as it relates to their strategies for growth.

In the report on the study of 1,200 CEOs, Mark A. Goodburn, global head of advisory at KPMG, says: "The question has clearly moved from 'How do I bring my costs down and not take too much risk?' to 'How do I expand into new geographies, new products and services, or deliver or enhance the value of existing products and services?' The winners will find the right balance between cost, risk, and growth."

With risk can come great reward, but it can't be approached with reckless abandon. Enter the CFO. Today's strategic CFO plays a vital role in being the conscience of the organization, balancing the risks and rewards inherent with various initiatives. To this end, the role of the CFO has evolved from number cruncher to that of a strategic partner working with the CEO to navigate the right course for growth.

That means the CFO role now encompasses greater depth and breadth than ever before. That includes knowing about product development and releases, sales growth strategies, customer satisfaction efforts, and many other functional challenges outside of finance.

While every business activity has an outcome that eventually can be boiled down to a number in a report, the CFO must be in lockstep with the

CEO, not only to provide advice, but also to act as the steering committee in charge of piloting corporate growth. Of course, a strategic CFO must also maintain a firm grasp of financial fundamentals and compliance issues, but this is now table stakes—the ability to qualify, quantify, and "right size" risk is the new yardstick by which today's CFOs are measured.

CFOs become strategic advisers to their CEOs by building trust and communicating effectively and often, making it a point to understand how each business unit functions to properly understand what changes to make to drive results. The process may not happen overnight, but there are some steps a CFO can take to move in that direction.

Dig Deep. The CFO must understand the business and key drivers, and have conversations with the CEO that focus on these topics. The CEO will come to respect and appreciate the fact that the CFO has a broad knowledge of the company as opposed to just debits and credits and how the numbers are flowing. That allows the CFO to be an independent, objective sounding board on what's happening in all parts of the business.

Build a Great Team. To be a strategic business partner to the CEO, a CFOs need to have great teams underneath him. Developing a great team and then delegating responsibility for reporting and day-to-day running of the finance department allows the CFO to focus on business transformation, growth areas, and investors. In essence, the CFO needs to make the shift from tactical expert to strategist.

Avoid Politics. The CFO can't have a political agenda and must portray objectivity, independence, and the ability to listen. So, while there will be different sides to every issue and to every conversation happening in the company, the CFO must be able to listen with an open mind and be willing to change opinions based on what is heard, all while keeping the company's goals in mind. That builds the CFO's reputation, showing the CEO and other business leaders that decisions are based on what is best for the organization.

Be Prepared to Course-Correct. There is more data to be analyzed than ever before, so it's critical for CFOs to clearly define key performance indicators (KPIs) and then track the key metrics against expected outcomes. CFOs should then go beyond providing raw data to give advice on when to course-correct if performance is lacking. Part of that involves establishing reason-

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able timelines (and associated metrics) for return on investment on business initiatives to provide unbiased measurements.

The World is Watching. Companies and their leaders are subject to ever-greater scrutiny by the media, social media audiences, and stakeholders. CFOs must be aware of customer and consumer behavior, and cognizant of public perceptions of all key decisions. They must consider not only what is financially possible but what, from a customer perspective, is socially acceptable.

The Cult of Personality. CEOs come in all shapes and types. To develop the right partnership, it's important to understand individuals and their hot buttons. How do they like to work, and what information do they want to know? What do they need to know, and how often do they want to talk? How do they like to have information presented? By learning the CEO's personal preferences, a CFO gains the understanding of how to best collaborate.

Always Be Transparent. The primary function of the CFO is to make sure that the CEO can see the company's true performance. Discussions about performance management disappear when numbers are regularly reported and measured. Providing transparent data is not enough, however; there also has to be some ability to convert the data into actions. The CFO must also help the CEO ensure the right processes and values are in place across the company while verifying that the data provided is accurate.

Know All Roles. Just understanding the KPIs that measure a group's performance isn't enough to provide added value. Meeting with leaders across divisions to understand both what drives and hinders success gives the CFO an extra layer of data to help make the best and most holistic decisions. Digital transformation has placed even more urgency around integrating functions. Collaboration between the CFO and business-level executives across the company can help determine how and where digital can help grow the company.

Kathy Crusco

"CFOs become strategic advisers to their CEOs by building trust and communicating effectively and often."

Ultimately, the CFO must become an agent of change for the organization by both providing insights across business units and executing on strategies that drive higher performance and better business results. The best CFOs will be adept at implementing all of the above to become the CEO's trusted strategic adviser. CFO

Kathy Crusco is executive vice president and CFO of Epicor.

Fewer IT Organizations Adding Headcount

But only 19% of them are planning to cut staffing levels, says Computer Economics

Economic uncertainty is affecting IT investment, particularly spending on new hires, according to a June survey of more than 200 IT executives in the United States and Canada by Irvine, Calif.-based Computer Economics.

Fewer than half (46%) of all companies in the firm's IT Spending and Staffing Benchmarks 2016/2017 study are planning to increase IT headcount, down from 50% in 2015. However, just 19% are planning to actually cut staffing levels.

Hiring likely isn't increasing at a faster rate because of macroeconomic factors and slow-growing economies, the firm said.

"Economic uncertainty makes it difficult for companies to be more aggressive in hiring new IT staff members," Computer Economics president Frank Scavo said in a release. "At the same time, virtualization and cloud services are making IT personnel more efficient, which softens the effect."

The mix of IT staffing is roughly the same as it was in past surveys, with the largest portion dedicated to application development and maintenance, representing about a quarter of staff. The next largest portion of staff is IT managers, representing 10% of IT personnel, and the third-largest group is help desk workers, at 9% of total staff.

While app developers and maintenance workers continue to grow in the IT department, server support headcount has steadily decreased in the last five years, from 12.1% of the total IT staff in 2012 to just 8% in 2016.

Computer Economics said the decline is due to several factors, including increasing use of virtualization and automation tools that improve data-center staff productivity, as well as the shifting of data-center workloads to the cloud. No other positions show a noticeable long-term trend up or down. **KATIE KUEHNER-HEBERT**

CFOs TO WATCH 2016

RISING TO THE CHALLENGE

The job of chief financial officer is tougher than ever. We profile 20 who have career-defining tests ahead.

In most lists of top finance chiefs, the criteria involve looking backward at what the executive has accomplished. At CFO, we take a different tack. Since 90% of a CFO's job involves looking forward, so do we. That's why our second annual CFOs to Watch comprises, even more than in 2015, finance chiefs that face enormous challenges in the next 12 months.

Although some star CFOs made the cut, there are others that toil behind the scenes, barely exposed to the mainstream media except on earnings calls. But these are executives responsible for billions of dollars in profits who steer the finance departments (and, increasingly, the strategy) of companies that are vital to the U.S. economy. How much debt these companies assume, whether they invest in research and development or return capital to shareholders, how aggressive these firms are in growing through acquisitions, and a multitude of other choices are largely the call of these CFOs.

This year, we found 20 extremely accomplished executives (they'd have to be in order to attain their positions) who have the unenviable jobs of rebooting companies after failed merger deals or charting new strategic courses to revitalize aging businesses, among other problems. A majority of them, in one way or another, are also tasked with finding opportunities for growth and efficiencies in rapidly changing industries. Plenty of other CFOs could have made our list based on those criteria. But for better or worse, these are the executives that, for the next year or more, have the toughest jobs in finance.

The profiles on the following pages were written by David M. Katz and David McCann, deputy editors of CFO, and Vincent Ryan, editor-in-chief.

Getty Images

JEFFREY S. BORNSTEIN

SVP & CFO, GE

A Full Plate

Speaking of GE finance chief Jeffrey S. Bornstein, Scott Davis, a managing director at Barclays Capital, said, "I think if he saw me in a dark alley, he might hit me over the head with a baseball bat."

Adds Davis in his assessment of Bornstein's attitude toward Barclays: "He's pretty hard-charging; he's not always nice to us, to put it bluntly." Not that Davis has been especially critical of Bornstein, per se. "But in the past we've had views that management was not executing at GE, that there were challenges at the operational level," the analyst recalls.

Davis and his colleagues, however, leveled those attacks while Bornstein was CFO of GE Capital. As such, Bornstein bears little responsibility for missteps made at the finance subsidiary's parent company. Still, recalling the credit woes GE Capital suffered during the financial crisis, Davis isn't letting Bornstein, who was finance chief of GE Capital from 2008 to 2013, off that easily.

"Let's face it, GE Capital had a lot of challenges, and he was CFO of the company, of that business, so you have to hold him certainly accountable for some of the mistakes," Davis adds.

But that was then, and 2016 is now. Bornstein is facing a daunting series of complicated initiatives as GE transforms itself into what it's calling a "digital industrial" company, and Davis feels that the CFO is more than up to the challenge. Among those initiatives is the integration of the financial reporting, accounting, and internal control systems of three power divisions of Alstom Energy, which GE acquired for $10 billion in November 2015.

Then there's the task of finishing off the sale of most of GE Capital in order "to focus on continued investment and growth in our industrial businesses," according to GE's March 31 10-Q. On top of that are a pension liability that will require about $2.1 billion in projected contributions in 2017 and a broad effort to cut corporate costs.

In the midst of all this, Bornstein has been spending about 20% of his time on strategy, development, and M&A related to Predix, the company's big play to get first-mover advantage on the industrial Internet. And there's little doubt that Bornstein will be spending as much or more of his time on the cloud-based operating system.

"The list is exhausting, the amount of things that Jeff is going to have to do. I do think he has the talent and the people around him to get it done," says Davis.


BORNSTEIN

"Jeff Bornstein comes across as a very genuine, no-nonsense, get-things-done," kind of CFO.

—SCOTT DAVIS, BARCLAYS CAPITAL

The biggest risk for Bornstein in all these activities is that they "need to be fairly flawless. GE is not a company right now, in the eyes of investors, that can afford to make a lot of mistakes," according to Davis.

"The biggest mess-up would be [problems in] the integration of Alstom or if [GE doesn't] make its cost and margin targets. "

But there's also the potential for big rewards. Davis regards Bornstein as "a legitimate candidate" to replace CEO Jeff Immelt when the CEO retires. At issue is whether the board would depart with GE tradition and choose a finance chief rather than an executive schooled in operations.

Nevertheless, "Jeff Bornstein comes across as a very genuine, no-nonsense, get-things-done," kind of CFO, according to the Barclays executive. "He holds people accountable."

DAVID M. KATZ

JOHN GALLINA

EVP & CFO, ANTHEM

Picking Up The Pieces

The Justice Department's July decision to oppose two of the largest acquisitions in health care in all likelihood meant that the proposed deals, Anthem's $54 billion takeover of Cigna and Aetna's $37 billion deal for Humana, were dead. The CFOs of all four health insurers involved in the proposed deals—John Gallina, Thomas McCarthy, Shawn Guertin, and Brian Kane, respectively—all now qualify as CFOs to watch.

Both Anthem and Aetna said they planned to challenge the DoJ when the federal lawsuits were announced. But if they walk away from the transactions or lose in court, after picking up the pieces each company will have much to decide in terms of big-picture strategy and maximizing shareholder value. If the deals had been allowed to proceed, each of the two combinations would have been almost as large as industry leader UnitedHealth Group.

Our selection of Gallina as the standard bearer for these health-care CFOs is somewhat arbitrary. But as the market's number-two player, Anthem may be the only one large enough to approach UHC's size by potentially acquiring one or more second-tier health insurers as an alternative strategy.

One looming headache for Gallina: under the terms of the Anthem-Cigna agreement, Anthem must pay a $1.85 billion termination fee if the deal goes belly up because of regulatory action. That's more than the total cash Anthem had on hand at the end of this year's second quarter.

These matters certainly will keep Gallina on his toes. There is no particular reason to expect that he won't be able to rise to the challenge, especially since he's been with the company since 1994. But he just ascended to the CFO chair on June 1, following the unexpected departure of Wayne DeVeydt.

The breadth of Gallina's experience likely will serve him well. He most recently was a divisional finance chief, after previously serving in roles including chief accounting officer, chief risk officer, senior vice president for internal audit, and CFO for comprehensive health services.

GALLINA

One looming headache for Gallina: under the terms of the Anthem-Cigna agreement, Anthem must pay a $1.85 billion termination fee if the deal goes belly up because of regulatory action.

Indeed, analyst Thomas Carroll of Stifel Nicolaus said at the time of Gallina's appointment that Anthem would be better off with him at the helm for the Cigna integration.

Now that the big acquisition is nearly off the table, Gallina still could find himself in integration mode, as the major health-care players are widely expected to seek other opportunities to bulk up.

But Gallina could actually find it a challenge to go up against Anthem's former target, Cigna, on M&A. Carroll wrote in July that Cigna, with "swift access to deployable capital of $12 billion," could be better-positioned to move toward an acquisition of its own. **DAVID McCANN**

WALLER

KATHY WALLER

EVP & CFO, Coca-Cola

Champion Of Diversity

A Coca-Cola lifer, having joined the company in 1987, Kathy Waller is a CFO to watch not so much because of weighty business challenges she faces (although there are certainly those) but because of the opportunity she has to serve as a role model.

As a woman and an African-American, Waller is a beacon for many who aspire to advance to executive positions despite being disproportionately under-represented within those ranks. That's not simply an honorary status based on her gender and race; Waller gets involved.

She heads up Coca-Cola's Women's Leadership Council, which develops strategies, initiatives, and metrics aimed at increasing the number of women in leadership roles at the company. Since the council was launched in 2007, the representation of women in senior leadership positions in Coca-Cola has increased from 23% to 30%, while the proportion of women at the immediate pipeline level has grown from 28% to 32%. And female participation in key assessment and development

Courtesy the companies

programs has shot up from 21% to 37%.

Waller also serves on the advisory board of Catalyst, a leading nonprofit organization with a mission to expand opportunities for women in business. And she's a member of the Junior League of Atlanta, an organization of women dedicated to developing the potential of women.

"Men are going to make sacrifices that are going to help out [both] men and women. It's going to help level the playing field quite a bit."

—KATHY WALLER
EVP & CFO, COCA-COLA

In an interview with *Rochester Review,* published by her alma mater, the University of Rochester, Waller said that the relative paucity of women in senior positions within American companies was not the fault of some "grand conspiracy."

She cited other reasons, one being that women don't have the same kind of access to casual settings where men load up on information and receive mentorship, like golf courses and bars.

"It's not necessarily that they aren't wanted or wouldn't be invited," she was quoted as saying. "Sometimes they have to go pick up the kids, or sometimes it's just not comfortable for women to go hang out in a bar with the guys. I don't believe men think of what they're doing in those settings as mentoring, but it is. And I think that's what women are missing—that network which is outside of the day-to-day work itself."

She also opined to the publication that men and women coming out of graduate schools have different mindsets. Women are more apt to say, "OK, I'll start at entry level, I'll work my way up, and I'll prove myself," whereas men are less likely to settle for entry-level positions, she said.

But she also saw reason for hope, noting that today younger men want to "be there for their families" as much as women do. "There's a huge generational difference," she told Rochester Review. "Men are going to make sacrifices that are going to help out [both] men and women. It's going to help level the playing field quite a bit." **D.M.**

LUCA MAESTRI

SVP & CFO, APPLE

Uncertain Times

Does it matter to Apple that Alphabet recently supplanted it as the world's most valuable company, if only briefly? Maybe, maybe not. But the slowdown in Apple's earnings growth and the shaky performance of its stock over the past year, which helped trigger its market-cap stumble, are of great concern.

Apple, of course, is a company that got where it is by consistently taking risks that ultimately paid off. More of the same will be required for it to remain atop the corporate heap. And Luca Maestri, Apple's finance chief since 2013, knows a thing or two about risk.

What would you call giving up the CFO post at one of the 20 largest U.S. companies to take a job as a controller, as Maestri did when he moved to Apple from Xerox three years ago, other than risky? Even though he was specifically hired to succeed Peter Oppenheimer, anything can happen with a new job. He was mid-career, just 49 at the time, and if the promotion to CFO hadn't transpired, Maestri's résumé would have taken quite a hit.


MAESTRI

Apple needs a new monster product. The iPad never became that—and in fact the tablet has passed its growth phase and is now indisputably in decline.

Today, with the iPhone market—responsible for more revenue in 2015 than all of Apple's other products combined—possibly nearing saturation, the company is at an inflection point. Of note, revenue fell by 27% in this year's second quarter, only the device maker's second down quarter in more than a decade.

Apple needs a new monster product. The iPad never became that—and in fact the tablet has passed its growth phase and is now indisputably in decline. The same thing happened with the iPod, and now it appears the iPhone is suffering the same fate, with sales in the second quarter falling 15%. Many observers are saying that almost everyone who wants a device has one and most sales going forward will be upgrades.

Maestri isn't going to come up with a monster product himself, of course, but as a major component of the executive team he's charged with making the right strategic decisions, especially those involving capital allocation and M&A. Is it time to put more of the company's $18 billion in cash to work?

Meanwhile, if Apple's share price continues to lag, Maestri may have an investor relations nightmare on his hands. However, most analysts are expecting a return to growth for Apple, in both revenue and share price, in 2017.

In fact, one of the most pro-Apple analysts, Piper Jaffrey's Gene Munster, told Bloomberg in mid-July that he was bullish on Apple even though investors seemed somewhat disappointed with reports about the iPhone 7, slated to be released in September.

"The biggest thing [investors are] underestimating is that people can't survive with phones that are three years old," Munster said. "I think there's this belief that upgrade cycles are going to extend to three years and beyond. That's not going to happen."

Whether high-profile Apple heads in the direction of rags or riches, Maestri's moves, like those of his boss Tim Cook, are under a microscope. **D. M.**

HARVEY M. SCHWARTZ

EVP & CFO, Goldman Sachs

Systemically Important

SCHWARTZ

If the years before the financial crisis were the height of excitement in U.S. investment banking, the years afterward, at least for risk-taking and outsized returns, have been the height of boredom. Goldman Sachs, in particular, doesn't do nearly as well when banking is boring.

In its second-quarter earnings report, Goldman reported lower revenue from fixed-income trading, a drop in investment-banking revenue of 11%, and a 55% fall in fees from initial public offerings and stock sales. No wonder the banking company's stock was trading at a P/E ratio of 15.6 in early August, when the industry average was 18.9.

At a time when it's business model, and indeed its identity, are in doubt, Goldman seems to have the right person as CFO, however: Harvey M. Schwartz, who succeeded industry stalwart David Viniar in 2012.

Not only does Schwartz have an investment banking and sales background—at Citicorp, he structured derivatives for clients in the petroleum and mining industries—but he was also a member of Goldman's risk committee during the heat of the financial crisis. The latter is serving him well as Goldman navigates a tight banking regulatory regime. The bank's value at risk—an estimate of how much a set of investments might lose on a typical day in the quarter—was $62 million in the second quarter, down from $72 million in the first quarter and the lowest level it's been in years.

Not that Schwartz is averse to making money. Goldman might be cutting costs (removing 5% of staff in three months, which the firm expects will save about $700 million), but it also dipping its toes into a new business: unsecured consumer lending. In April, Goldman acquired $16 billion in online deposits from GE Capital. Schwartz said Goldman is launching the lending product this autumn. "We're keenly aware of the fact that this is a new business opportunity for us, and importantly, a new client base," Schwartz said in July. "And so one of the things we did was reach out to thousands of consumers to really understand what they want and their borrowing priorities."

"We're keenly aware of the fact that [unsecured consumer lending] is a new business opportunity for us, and importantly, a new client base," says Schwartz.

In another recent move, one that hearkens back to pre-

Courtesy Apple, Daniel Stoll/Rutgers

financial crisis days, Goldman is marketing a private equity fund of about $8 billion, for which it can only contribute a small amount of its own capital. So while the fund won't produce the abundant profits private equity earned for banks a decade ago, it's a sign that Goldman hasn't totally pulled in its horns.

The investment banking giant is far from being in dire straits. Revenue from its fixed income, currency, and commodities trading unit was $1.93 billion, 20% higher than in the second quarter a year ago. But Schwartz seemed hard pressed on the Goldman earnings call to present evidence that there's any light at the end of the tunnel. Indeed, the bank's investment banking transaction backlog decreased in the second quarter compared with both the end of the first quarter of 2016 and a year earlier.

For being the finance chief of a highly visible bank that has a bumpy road ahead of it, Schwartz is a CFO to keep an eye on. **VINCENT RYAN**

JOHN RAINEY

SVP & CFO, PAYPAL

Learning To Fly

While many CFOs have defected to small tech startups the past two years, John Rainey took a different path by joining PayPal one year ago. The former finance chief of United Continental arrived at PayPal a few weeks after it had been spun off from Ebay, in a daring move to migrate from the rather staid airline industry to the rapidly evolving world of payments.

Rainey, 45, said he was excited to be joining a company that was "leading the transformation of money." For PayPal's part, it wanted a finance chief with experience running a large, complex organization.

Rainey certainly looks up to the task, but that doesn't mean he can keep PayPal on top of its game. PayPal has a solid position in the digital payments space because, as Rainey pointed out, it is "technology and device and operating system agnostic." And PayPal has not been shy about strengthening that position through deals like the purchase of Xoom, an online international money transfer company bought shortly before the spinoff transaction. PayPal also boasts a person-to-person social payments platform in Venmo, a key area for payments growth.

But PayPal is going to need all the assets it can get, facing intense competition from Apple Pay and other smartphone- and web-based payments systems. Apple recently announced, for example, that it would allow Apple Pay users to make web payments, a segment right in PayPal's wheelhouse.

RAINEY

> **Analysts think that PayPal has an opportunity to drive efficiencies and increase profit margins with Rainey in the finance chief's seat.**

What are Rainey's marching orders that make him a CFO to watch? Out in the market, PayPal faces something of an identity problem, analysts say, in that customers don't understand its size and scope in the payments world. In addition, payment vendors of all stripes face a consumer adoption issue in the important growth area of mobile: 65% of consumers are still wondering what the benefits are to using mobile payments, according to a Federal Reserve study.

Still, the company added 4 million new users in the second quarter, for 11% year-over-year growth, though transactions per active account (29.4 on an annualized basis) were below management's ultimate target.

Inside PayPal, Rainey must instill discipline in a company with decentralized operations. Gaining efficiency and reining in costs top the list. At a Keefe Bruyette Woods investor conference in July, Rainey talked about the need to clean up the fragmented purchasing process in PayPal's procurement department, for example. Rainey also wants to reduce the company's service costs by allowing customer representatives to work from home, something he did at United.

Analysts think PayPal has an opportunity to drive efficiencies and increase profit margins with Rainey in the finance chief's seat. The company is pushing hard to avoid losing momentum: in the second quarter, it landed a big partnership with Visa which will essentially make the card giant the preferred payment option for PayPal customers, according to Aite Group. The partnership will also expand acceptance of PayPal's digital wallet at physical retail locations that accept Visa contactless transactions.

But, as many experts pointed out, PayPal, whose tradition was enabling customers to bypass the debit- and credit-card networks, will now be paying transaction fees to Visa.

Achieving all of the above will be key to Rainey's ultimate problem: maintaining a stock price that was, as of mid August, at a high price-to-earnings ratio of 34.4. If PayPal doesn't continue to fire on all cylinders, keeping Wall Street happy won't be easy. **V.R.**

SID SANKARAN

EVP & CFO, AIG

Steward Of The Balance Sheet

Nearly eight years after the start of the financial crisis, AIG is still trying to shed the huge amounts of unprofitable financial and insurance risk it's taken on over the years. So it's understandable that when the property-casualty insurance giant announced a management shakeup in December 2015, it tapped its chief risk officer, Sid Sankaran, to be the new CFO.


SANKARAN

"A core role of the CFO is driving the capital allocation process and acting as the steward of the balance sheet," says Sankaran.

Indeed, in a late July interview with *CFO,* Sankaran's methodical approach to risk was on display. Very much like a risk manager, he methodically analyzed the company's approach to the macroeconomic risks it faces, including those stemming from the interest-rate environment, the competitive pricing climate for commercial insurance, and geopolitical hazards like the Brexit vote.

In terms of interest-rate risk, "we plan to multiple interest rate environments," he explains. "And I think you always have to plan to the current estimate of the yield curve. But we also look at scenarios where rates stay low longer and we also look at scenarios where they rise."

Regarding low insurance prices, which Sankaran attributes to a glut of risk capital in the market, "our focus has been on risk selection and business mix and making sure we have the right quality of business and the right returns," he says, noting that "growing the entire portfolio [of insurance products] in aggregate might not be the best thing."

Sankaran keeps close watch on global political risks in the wake of the United Kingdom's vote to exit the European Union. The decades-long trend toward globalization appears to be "fading," the finance chief observes, and AIG, as an international insurance carrier, needs to be "cognizant that some of the trends that have played out significantly may turn out differently in the next 5 to 10 years from the way that they have in the last 20."

Sankaran's tenure as CFO began amid a heated, well-reported struggle between the company's CEO, Peter Hancock, and hedge fund investment managers Carl Icahn and John Paulson. Both activists proposed splitting up the multi-line insurer into three independent property-casualty, life, and mortgage insurance companies. They reasoned that such a reorganization would help cut the onerous costs and capital requirements associated with being designated a company that is "too big to fail." Icahn, in an October 2015 letter to Hancock, in fact, called AIG "too big to succeed."

In February 2016, however, AIG's management struck a compromise with the activists, giving each a seat on the board. Barely two weeks before, the company had also adopted an ambitious new shareholder-friendly strategy, committing itself to return at least $25 billion through buybacks and dividends.

Further, the board approved an IPO of up to 19.9% of the mortgage insurer, United Guaranty, "as a first step towards a full separation." (It wound up selling the unit to Arch Capital.)

That's left Sankaran with some big responsibilities over the coming months. In terms of helping the company manage to return such a whopping amount of capi-

Courtesy the companies

tal to shareholders while maintaining a sound equilibrium between debt and equity, he says, "a core role of the CFO is driving the capital allocation process and acting as the steward of the balance sheet."

To provide part of the $25 billion without overly diminishing its core assets, the company has set up a legacy portfolio of about 20% of its capital that it has identified as being targeted precisely for capital return to shareholders. "That legacy portfolio, combined with the sustainable earnings power of our company, we believe, will allow us to execute on that target while maintaining that balance sheet strength we're proud of building up," Sankaran says. **D.M.K.**

JEFFREY C. CAMPBELL

EVP & CFO, AMERICAN EXPRESS

In Need Of A Spark

During American Express's 2016 second-quarter earnings call, analysts could be forgiven for having a tough time grasping where the company's growth would be coming from in the back half of the year and in 2017.

On the one hand, Amex had lost its longstanding credit card relationship with Costco. On the other, it was getting an immediate cash boost from selling off its Costco receivables and shedding related costs.

On the one hand, under the new arrangement Amex was giving up access to huge numbers of customers on sales within Costco. On the other, it would be investing heavily in a "growth initiative" aimed at picking up new business from those old Costco customers on non-Costco-related sales.

Acknowledging the difficulty in clarifying what all these conflicting signals might mean, Amex CFO Jeffrey Campbell patiently tried to explain. The difficulty in making the company's quarterly financials clear, Campbell said, was that they "included a number of discrete items, creating some complexity in our results."

Yet Amex's second-quarter net income was up 37% versus the same quarter of 2015, mainly as a result of the gain from the Costco credit portfolio sale. The good news also included a $1.1 billion pre-tax gain for the sale of the Costco cobrand portfolio.

On the downside, Campbell, the only member of top management on hand to deliver the earnings report and handle questions, reported a continued slowdown in Costco-related volumes leading up to the date of the sale. There was also a $232 million restructuring charge related to the company's ongoing cost reductions and increased investment spending.

So where was the beef? Campbell said during the call that Amex's recent loan growth stemmed from efforts to sign up former Costco cobrand card members for other Amex products. "We expect to capture at least 20% of the out-of-store spending of the former Costco cobrand card members as a result of our acquisition efforts prior to the sale," the CFO said.

But Donald Fandetti, a Citigroup Global Markets broker, called for a clarification: had Amex received an actual financial boost in the quarter from those earlier efforts, or was most of the loan growth merely a result of the "run rate"—simply an extrapolation of the loan growth in earlier quarters?

Although Campbell answered that Amex had seen actual second-quarter loan growth—growth that confirmed the previous run rate and would keep it going in future—he added a puzzling qualification. That growth would be subject to "complex dynamics," the CFO added.

Fandetti asked Campbell to elaborate. Part of the finance chief's answer was that competition in the credit card business overall has been fierce and could be get-

CAMPBELL

"You have many other competitors (in the credit card business) who have launched either new marketing efforts or new products that perhaps are targeted at some of the same types of card members," says Campbell.

ting fiercer. "You have many other competitors who have launched either new marketing efforts or new products that perhaps are targeted at some of the same types of card members," he said.

Further, the move away from Costco is shifting Amex's relationship with its customers and the geography of its customer base. "And then if you think about the broader external environment, you have tremendous uncertainty around interest rates," Campbell said. "We'll have to see."

Unfortunately, a wait-and-see attitude concerning Amex's growth may only make investors more impatient. Global card spending increased just 3% year-over-year in the second quarter, and provisions for loan losses actually fell.

But American Express "is using cost cutting and share buybacks to post good earnings numbers," Kyle Sanders, an Edward Jones analyst, told TheStreet.com. "There's not really any catalyst to spark this business, and it's hard to get excited about it at this point." Can Campbell find a way to help generate excitement about (and revenue growth for) American Express? **D.M.K.**

AMY HOOD

EVP & CFO, Microsoft

Stabilizing Force

When she was tapped to be Microsoft's finance chief three years ago, Amy Hood was viewed as the CFO who would stabilize the computing giant. She would help manage Microsoft's transition into a devices and services company and increase shareholder value, in part by better managing costs.

The verdict so far: she has been successful, but only partly, and some of her tallest hurdles lie ahead. Shareholder value has definitely been a field of victory. Microsoft's stock price, below $35 three years ago, was about $57.50 per share in mid August.

The company's cloud-based computing platforms, which Hood is helping steer, performed robustly on the topline in the second quarter. But, overall, the transition from legacy licensed-based systems to subscription products is still happening too slow to not dent earnings: Microsoft recorded $85.32 billion in total annual revenue in fiscal 2016, down 8.8% from fiscal 2015.

Sales for Microsoft's latest operating system, Windows 10, continue to be stagnant: for the year, revenue from the More Personal Computing segment, which includes Windows, fell 6.3% to $40.5 billion. In addition, in July the company announced it would not meet its self-imposed goal of having Windows 10 on one billion devices by June 2018.

One other thorny problem for Hood is what to do about eroding margins. Margins on cloud services, which are sold by subscription, are slimmer than those for business software licenses. Microsoft's gross margins fell in the second quarter, and Hood says she expects margins to shrink this fiscal year as well.


HOOD

Is bringing together "the world's leading professional cloud with the world's leading professional network" going to be the game changer Microsoft needs?

In July, though, Microsoft pulled off something of an M&A coup by buying LinkedIn for about $26 billion, at a price significantly below LinkedIn's 52-week high. Is bringing together "the world's leading professional cloud with the world's leading professional network" going to be the game changer Microsoft needs?

Hood and her colleagues are projecting conservatively, stressing that the primary goal of the tie-up is to accelerate top-line growth across LinkedIn's core businesses as well as Office 365 and Dynamics, Microsoft's customer relationship management system. Microsoft is also predicting a long runway before the deal enhances the bottom line: LinkedIn won't be accretive to non-GAAP earnings per share until fiscal year 2019.

Given Microsoft's history with acquisitions, there is good reason for prudence: other than its 2011 purchase of Skype, its second largest after LinkedIn, Microsoft's large takeovers have been a disaster. Deals to buy aQuantive (for $6.3 billion) and Nokia's handset business (for $7.9 bil-

Courtesy the companies

lion) both resulted in write-downs that erased virtually the entire value of the acquired assets.

As a CFO who, by all accounts, is operationally focused, Hood will have a huge hand in whether the LinkedIn deal makes Microsoft a more socially relevant, hipper version of its old self, and sets it back on a growth path again. If Hood can pull that off, she will certainly be able to lay claim to putting the aging computing power on firmer footing. **V.R.**

PAUL S. HERENDEEN

EVP & CFO, VALEANT PHARMACEUTICALS

Crisis Manager

Just over a year into his tenure, CFO Robert Rosiello had a lot of cleaning up to do at troubled Valeant Pharmaceuticals. Forbes recognized as much in March with its headline, “The Most Thankless Executive Job in America: Chief Financial Officer of Valeant Pharmaceuticals.”

But just as suddenly, the problems are no longer Rosiello’s, as he was ousted as finance chief as of August 22 (although he stays on as executive vice president of corporate development and strategy). The new CFO is Paul S. Herendeen, who had been serving as CFO of Zoetis, a provider of medicine and vaccinations for pets and livestock. Herendeen also has 16 years of experience as CFO of Warner Chilcott and MedPointe. But even he may not be ready for what awaits.

Since Valeant recently completed an $11 billion acquisition (of Salix Pharmaceuticals), you might expect the biggest item on the new CFO’s plate would be integrating the entities. Not in this case. Following is a partial rundown of the headaches Herendeen must deal with.

For starters, the company has a staggering debt load of about $31 billion. Next, in early August the company still had a restatement project on its hands. Valeant acknowledged in February that its financials for 2014 and the first quarter of 2015 could no longer be relied upon. That was an after-effect of its ill-conceived relationship with Philidor, a virtually unknown specialty pharmacy company that was accused of altering doctors’ prescriptions in order to sell more of Valeant’s high-priced drugs. The accounting issue is about improper revenue recognition. Valeant accounted too early for $58 million in revenue from sales through Philidor, the company has acknowledged. The miscues occurred before Valeant purchased an option to buy Philidor for $100 million.

There is a public-image fallout from a federal investigation begun last autumn into Valeant’s pricing practices, which also drew intense heat from lawmakers.

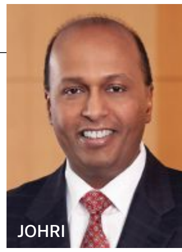

HERENDEEN

Even though Valeant has cut its ties with Philidor, the snafu caused a long delay in Valeant’s filing of its 2015 financials, which fortunately happened in time to avoid triggering defaults on its debt. Then there is the public-image fallout from a federal investigation begun last autumn into Valeant’s pricing practices, which also drew intense heat from lawmakers. By October the list prices of several of its already-pricey drugs had shot up by 8 to 30 times what they’d been listed at less than two years earlier.

Valeant announced in February that it was under investigation by the Securities and Exchange Commission, although it did not say whether it concerned the pricing matter, the revenue recognition issue, or something else. Investor relations is another troublesome area. After reaching a giddy high of $262.52 on August 5, 2015, the company’s shares were trading in the $30 range in mid August—a cataclysmic plunge.

In announcing the CFO switch, CEO Joseph C. Papa called Herendeen “an accomplished and well respected financial executive” whose “prior experience as a public company CFO, strong operational focus, and disciplined approach to financial management make him the ideal choice to lead our finance function.”

While Papa praised Rosiello, a 30-year executive at McKinsey, for helping guide the company through a tough time, it certainly was necessary to replace him with a professional CFO like Herendeen. But even the most-experienced CFO would find the Valeant cleanup job daunting. **D.M. & V.R.**



10 TO KEEP AN EYE ON

These CFOs face some hard strategic questions that their companies' fortunes hinge on.

BRIAN GLADDEN
EVP & CFO, Mondelez International

Just as he did in his last days at Dell, Gladden now must deal with flagging growth at Mondelez. The global snack maker has reported falling revenue for 11 straight quarters. Facing Brexit-induced currency headwinds, its outlook doesn't appear any brighter. Gladden's hopes of becoming a CEO at some company, someday, may be frustrated yet again.

BRAD HALVERSON
Group President & CFO, Caterpillar

It tests a CFO's fortitude when market realities that can't be controlled conspire against his company. For Halverson, who joined Caterpillar in 1988, it's a bitter pill seeing sales and earnings declining at double-digit rates thanks to slashed investment in key industries that the company serves, including construction, mining, and energy. Halverson has his work cut out for him.

SABRINA SIMMONS
EVP & CFO, Gap

Following the lead of CEO Art Peck, Simmons will have to be swift and decisive to keep up with the clothing industry's recent sales volatility. Reacting to a 5% first-quarter drop in revenue, the company is closing 53 of its Old Navy stores in Japan in an effort to put its resources to the best geographic use. For Simmons's part, she's likely to be focused on controlling what's most controllable in unpredictable times: costs.

JON MOELLER
CFO, Procter & Gamble

Moeller has spent his entire career—28 years and counting—at the consumer products giant. He might not say its current state of affairs is a high point, and it's probably not much consolation that the company's troubles aren't unique. As with many mature companies, growth is stagnant. Does he need to take P&G in a new direction?

MICHAEL CHAE
Senior Managing Director & CFO, Blackstone

Chae took over as Blackstone's finance chief a year ago when Laurence Tosi improbably jumped to Airbnb. Tosi will be a tough act to follow. Blackstone is the world's largest alternative investment firm—with more than a third of a trillion dollars of assets under management, as well as a thriving financial advisory services business for mergers and acquisitions, restructurings, and private placements. Chae is charged with protecting and allocating Blackstone's own assets.

KEN GOLDMAN
CFO,Yahoo

What will Goldman, among Silicon Valley's most influential executives, do after Verizon completes its acquisition of Yahoo? Might he join the new public company that will be created to hold Yahoo's investments in Alibaba and Yahoo Japan, which aren't part of the Verizon deal? Join yet another technology firm? Retire, despite not having shown the slightest interest in that idea? Or take up with a private equity firm, à la former Ebay finance chief Bob Swan?

AKHIL JOHRI
SVP & CFO, United Technologies

After nixing Honeywell's merger proposal, which would have created a $97 billion industrial powerhouse, Johri is at once looking around for other deals and trying to help reinvigorate the company's slumping sales and stock price. Meanwhile, UT's Pratt & Whitney subsidiary is taking plenty of flak for having spent $10 billion over the past decade developing a turbofan jet engine, so picking the right projects for capital allocation may be a higher priority than ever for Johri.

MARK MCCOLLUM
EVP & CFO, Halliburton

Displaying rare flexibility, McCollum recently returned as CFO after a stint as chief integration officer during Halliburton's failed attempt to acquire Baker Hughes. Slammed by declining energy prices, the company has slashed nearly one-third of its jobs since 2014. Depending on the outcome of the November election, McCollum's agility could come in handy in dealing with one of the country's biggest environmental issues. Halliburton, after all, is the world's biggest provider of hydraulic fracturing, or "fracking," services.

KEN MILLER
EVP & CFO, Juniper Networks

It's gut-check time for Juniper, which badly trails Cisco Systems and is threatened by upstart competitors. Miller, with the company since 1999, was promoted to CFO in February, when predecessor Robyn Denholm left the company. The networking industry has been in a malaise recently and, as of early August, Juniper had generated shareholder return of negative 18% for 2016, far worse than its peers.

ANTHONY NOTO
CFO, Twitter

Noto is the only person we designated as a CFO to Watch in 2015 who's back for an encore—and with good reason. Among popular social media platforms with buzz, there's no question Twitter has lost ground to services like Instagram and Snapchat. To provide reasonable shareholder value, the only course may be an acquisition by a deep-pocketed Google or Facebook. Noto likely will be spending a lot of his time in the coming year evaluating potential takeover offers.

Courtesy the companies


EVE

ROBOTS, ROBOTS RYWHERE

Rather suddenly, virtual robots are bringing big change to corporate finance processes.

BY DAVID McCANN

In fairly short order, robots have begun taking over in the corporate world. Don't be alarmed. This is nothing like the feared "singularity," that prophesied (if dubious) moment when humans become smarter than machines and then, to prove it, commence wiping us out.

But robots are indeed infiltrating finance departments, some other functions, and operational areas in a number of industries. For the most part, robots are being deployed to automate repeatable, standardized, or logical tasks historically handled by people. In finance and accounting, think procure-to-pay, order-to-cash, and record-to-report processes. Enterprise-wide, the number of potential use cases seems almost limitless, although most of the potential is so far untapped.

Collectively, these technologies are referred to as "robotic process automation" (RPA), although they aren't enabled by electromechanical machines that have arms and legs. They are virtual

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robots; in other words, software that is programmed to mimic the keystrokes humans make in completing a process. (At least, that's a definition of what might be called "basic RPA"; many experts include more advanced technologies, discussed below, under a bigger RPA umbrella.)

What distinguishes the robots is that "they can work 24/7, they are very accurate, they do exactly what you tell them to do, and they don't complain," says David Wright, Deloitte's finance robotic process lead in the United Kingdom. In other words, they don't have human flaws. And with the use of RPA expanding exponentially, the potential workforce implications—depending on who you talk to, anything from reductions on a scale that could wreak havoc on the global economy to a broad transference of head count to more strategic, value-add positions—are a matter of some debate.

While RPA is largely based on technological capabilities that have been around for some time (like screen scraping, work flow, and rules engines), it didn't begin penetrating companies in a significant way until recently. "This has really started to accelerate just in the past 18 months," says Cliff Justice, principal, innovative and enterprise solutions, for KPMG. "But it's already in at least the pilot stage in maybe half of the Fortune 500 companies."

Virtually all RPA observers expect the trend to continue surging. RPA vendors, not surprisingly, agree. "We are at the very beginning of a major disruption in the accounting world that will be as big for the profession as Excel was," says Steve Palomino, director of financial transformation at Redwood Software. "Robotics will become an industry standard."

Although RPA is in its early stages, acknowledges Dinesh Venugopal, president for digital and strategic customers at Indian business process outsourcing (BPO) firm Mphasis, "customers with BPO-like processes that are coming up for re-bid are all asking about it."

Value Proposition

RPA software is not complex compared with other enterprise technologies. Nor is it particularly expensive, despite its relative newness. "In the past couple of years we've seen quite an uptake in companies wanting not big, transformative process reform, but very tactical reform to get a rapid ROI with a very low-risk solution," says Craig Le Clair, a vice president and principal analyst at Forrester Research.

"I term it a non-invasive solution," he continues. "You don't have to do any data-integration projects or have a lot of cross-department meetings. [The technology] really is just about understanding the specific clicks that a human is making and substituting a software routine, a bot, to eliminate a lot of non-value-added steps."

Similarly, Wright says he tells clients that "this isn't rocket science. Seeing a demo is like being in a finance shared services center, looking over somebody's shoulder and seeing keystrokes being made and transactions being executed."

Midsize companies generally haven't yet made much use of the technology, but they could, according to Mihir Shukla, CEO of RPA vendor Automation Anywhere. "It's simple and cost-effective, and they will see the same ROI as an enterprise customer on a smaller scale," he says.

How much ROI are we talking about? Enough that the practice of saving on costs by offshoring business processes may quickly become obsolete. An offshore, full-time employee averages about 35% of the cost of an onshore FTE, according to a Deloitte analysis. But a robot would typically be less than a third of the cost of the offshore FTE, or about 10% of the onshore employee's cost.

Venugopal says Mphasis is quoting prices for RPA that will save customers from 25% to 40% on outsourced processes. But traditional BPO providers like Mphasis are in a tough spot, notes Le Clair. "Their [method] over the years has been to substitute labor for technology, because labor is what they have an abundance of," the Forrester analyst says. "But while a number of partnerships have been announced between the BPO firms and the RPA product companies, more than half of the implementations are being done by companies on shore within their own data centers."

BUILDING A DIGITAL ARMY

There may be as many as 2,000 startup companies trying to marry robotic process automation with machine learning and artificial intelligence in a bid to fundamentally change the way we work.

But currently, a much smaller cadre of companies is dominating the field, including those providing basic RPA and those developing more advanced approaches. The lines between those categories are significantly blurred, but consider the following players to be worth investigating:

- Arago
- Automation Anywhere
- Blue Prism
- IBM
- IPsoft
- Kryon Systems
- Nice Systems
- OpenSpan/ Pegasystems
- Tata Consultancy
- UiPath
- Wipro
- WorkFusion

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Use Cases

So far, financial services has embraced RPA more than any other industry, followed by health care, utilities, and telecommunications—what Forrester calls the "hubs," says Le Clair. The common denominators among those industries are a large volume of "swivel-chair work" (i.e., data entry and switching among various applications), the use of centralized shared services, and heavy regulation.

But the research firm is also seeing growth in what it calls "the edges": manufacturing, supply chain, warehousing, and even oil. "We believe that in the next three to four years, the hubs and the edges will come together, disrupting the way modern enterprises work," Le Clair says.

In financial services, think of all the processes required to, for example, approve and fund a home mortgage, from processing the application to the background check, credit check, property assessment, and approval. "Imagine how fast these processes have to happen and how accurate they must be for the new online mortgage companies that are processing applications within 24 hours," says Shukla.

For finance and accounting at financial services and other types of companies, in addition to the processes mentioned above (order-to-cash, procure-to-pay, and record-to-report), RPA is being used for accounts payable, vendor statement reporting, and travel-and-expense processing, among other tasks, notes Le Clair.

Drilling down to more-specific uses, one common application of RPA for accountants is journal reconciliations, says Palomino of Redwood Software. Others include unapplied cash, where money in a bank account hasn't yet been tracked to a specific customer payment; intercompany transactions, or those between company divisions or subsidiaries; and creating consolidated reports, which typically involves manual processes for pulling information together, and reformatting and distributing it.

But the tasks companies have deployed RPA for so far merely scratch the surface of its potential, according to Le Clair. "There's greater usage of RPA, but I would say it has a low penetration today," he says. "There are thousands and thousands of processes that could benefit." Forrester plots technologies in terms of their maturity; there are five phases, and RPA is still in the first phase, called the creation phase.

It's worth noting that you don't need dedicated technologies to accomplish the various tasks that RPA addresses. "Similar to spreadsheets, robotic software tends to be both use-case-agnostic and application-agnostic," says Wright. "You can use spreadsheets for financial transactions, monitoring the recruitment pipeline, or planning a wedding. In the same way, you can use [RPA] across numerous functions."

Getting Smarter

As promising as basic RPA is, the most interesting business applications for robotic technologies increasingly will be more sophisticated. These applications will apply machine learning, artificial intelligence, cognitive computing, or some combination of them.

> **We are at the very beginning of a major disruption in the accounting world that will be as big for the profession as Excel was.** Steve Palomino, Redwood Software

Among the most advanced RPA-related tools with cognitive capabilities currently on the market, and certainly the best known, is IBM's Watson. It's not an RPA program itself, but rather a platform on which smart RPA capabilities can be built. The big key is the technology's ability to sort enormous amounts of data—including unstructured data such as emails, which are typically text-heavy. By some estimates, unstructured data, which historically resisted deep searching and analysis, accounts for as much as 80% of all data in the world.

"If you've built bots on Watson, now you'll be able to infer, reason, and interpret natural language, and the context of that language, and really automate more decisions that in non-intelligent bots would get escalated to humans," says KPMG's Justice. "Watson will gather the evidence available and make a probabilistic determination." Notably, procurement organizations are using Watson to help search for alternative, lower-cost vendors.

Such technology can greatly improve invoice processing, for example. Often, an invoice must be read for context. It might have data in the wrong field, or lack information needed to determine whether it meets contract requirements or procurement rules. It might require a three-way match, verifying with the business, the vendor, and the procurement organization that the correct products or services were delivered. A cognitive technology based on machine learning and AI can do all that.

And cognitive bots get smarter over time. They can monitor how humans interact with the system, and as more data on those actions is collected, the machine gains confidence that it can process exceptions or handle other issues, notes Justice. Credit card fraud detection is a perfect example of machine learning that's in common use, with bots getting smarter and smarter at detecting when cards are being used suspiciously, says Venugopal.

Three years ago, companies' online chat bots weren't very impressive. "Now they're being built on programs like Amazon's Alexa, which is still very new but has a deep, machine learning capability," Justice says.

Call centers are also perfect candidates for improvements based on machine learning. A company starts by encoding standard operating procedures, and then today's technologies track voice interaction with customers and convert it to machine language.

Also, the platforms behind personal digital assistants Siri (Apple) and Cortana (Microsoft) have been open-sourced, allowing the development of advanced RPA capabilities based on speech-recognition technology.

Advanced RPA could even play a major role in closing the books. According to a Forrester report, at financial services firm UBS, 2,000 people are involved in the closing process. The company told Forrester that it believes it can fully automate the process within five years.

These advancements are not as much of a technological miracle as they may seem. The key is developing the curated knowledge base that such tools will draw from. "The algorithms are fairly well known, and they're going to become commoditized," says Le Clair. "What you need are domain experts to develop the right model for how humans interact with the machine so it can take advantage of human knowledge. We're just at the point where we're starting to see the knowledge bases and domain expertise needed to take this to the next level of being very real and practical."

At the same time, there is a danger, according to a Forrester report released in June, that company leaders will get too caught up in the automation whirlwind and overautomate, thereby degrading the customer experience. "Those who think that 'everyone is automating everything, so we should drive as much cost out of our business as possible' will drive customers away," the report said.

Down with People?

"A common denominator of RPA approaches is decoupling routine service delivery from labor arbitrage," says Tom Reuner, research vice president, intelligent automation, at HfS Research. Translation: in an RPA-centric business environment, companies won't have to think anymore about whether to offshore back-office processes to take advantage of cheaper labor. That's because labor needs will be drastically reduced, and running a bot will cost the same—that is, not very much—everywhere.

And it's not only offshore jobs that will go away. Forrester estimates that RPA and machine learning will cause the number of U.S. "cubicle workers" to decrease by 16%, or 12 million workers, by 2025. KPMG suggests the worldwide total could be as much as 100 million jobs.

However, Forrester said, the 16% of U.S. workers displaced will be partially offset by the creation of new jobs as a result of these technologies, equivalent to 9% of the current total cubicle jobs, for a net decrease of 7%. "Not transformative, but still a fair number," says Le Clair.

But Wright suggests that there are alternatives to the "now we can cut heads" point of view. "Rather than remove people, some organizations will keep the headcount they have but take in a lot of extra work," he says. For example, he told of a company that was providing a certain reporting service to one unit in the business. When robots came along, the company decided it would now be cost effective to provide the service to the entire business.

Shukla of Automation Anywhere offered an even rosier outlook for back-office workers. "The workforce will change and skills requirements will shift," he says. "Our customers tell us they're seeing sighs of relief from employees, who hate the mundane tasks they have had to do over and over. Imagine human employees metaphorically working next to software bots. When the humans have something that must be done repeatedly, they hand it off to a bot."

A new digital workforce that makes the finance department more productive and handles tasks staffers would rather not? It sounds like an idea most finance departments would heartily embrace. CFO

Man vs. Machine

How prepared are you to bring humans and technology together to solve issues arising from smart-machine technologies?*

Prepared (defined set of principles/best practices for both human and tech support)	7%
Partially prepared (tech operations, applications, support are understood; human/organizational aspects are not)	32%
Partially prepared (human/organizational aspects are understood; tech operations, applications, support are not)	12%
Somewhat prepared (internal teams have been organized to study human and tech issues)	24%
Poorly prepared (limited understanding of the human and technology implications)	25%

*Asked of 130 automation technologists
Source: Forrester Research, Q2 2016 Global Automation Technology Survey

Budgeting for The Next Big Thing

New products or investment opportunities can blow a hole in well-planned budgets. Here's how companies adapt. **By David M. Katz**

A company may have a chance to buy a piece of prime real estate at a bargain-basement price. Or, suddenly, it finds it can run a manufacturing plant much more cheaply because a new energy technology has become available. Or the CFO senses that interest rates have hit bottom, and the firm has a now-or-never chance to lock in low rates for years. ¶ Whatever the opportunity might be, rigidly observed annual budgets can be of little help to a finance chief who must make a fast decision about allocating capital when the unexpected crops up in the middle of a fiscal year.

Take, for example, Jeff Bornstein, the finance chief of General Electric (and one of our CFOs to Watch in this issue, on page 23). Along with other members of the company's senior management, he's leading an effort to succeed in a largely uncharted field—the "industrial internet," a new term that GE itself is credited with having coined.

In developing Predix, the software platform GE is touting as its launching pad into this arena, the company, of necessity, has only a skeletal plan to guide it this year. "This space moves so quickly. We came into the year with an outline. We knew where we wanted to be at the end the year. We had a definition of what we thought success looked like," says Bornstein.

Ultimately, budgeting for Predix had to be a work in progress. "It's a live thing. It's not a budget you print on a piece of paper and put in a filing cabinet," Bornstein says.

Mike Murray, the CFO of Napa Recycling & Waste Services, feels the same way about annual budgets. Approaching his budget on a monthly basis gives him the precision to adjust his plans to fluctuations in oil prices, the need for new equipment, and other contingencies. "The annual budget is a dead document, in my opinion," Murray says.

Indeed, as the pace of change accelerates, finance chiefs increasingly find themselves in the position of having to redraw their best-laid plans. Never is that more the case than when a major corporate effort arises—an entry into a new market, for example, or an enterprise resource planning system installation.

To learn about the effects of such major efforts on budgeting, planning, and forecasting processes, *CFO* interviewed three finance chiefs grappling with transformations of their com panies and industries. Here are their stories.

Into the Unknown

A little more than a year has passed since GE began transforming itself from an infrastructure and financial services giant into a full-blown industrial internet company. Accordingly, the firm is putting a lot of its eggs into Predix, a cloud-based operating system aimed at helping companies gather and analyze their internal data to get maximum performance out of their industrial assets.

The company's aspirations for the platform are high. If Predix establishes itself as "one of the two or three operating systems for the world's industrial internet, which includes markets and customers and companies that we don't directly do business with, then the optionality on that is enormous," CFO Bornstein says.

Yet because the effort is largely a journey into the unknown, detailed long-range planning is a challenge. At the beginning of 2015, "we started with a definition of what winning would look like for the digital industrial effort at the end of 2016," explains Bornstein.

That definition of winning translated into specific outputs. "We wanted a certain number of people developing, a certain number of deployments of Predix, a certain number of customers operating on the platform. We wanted

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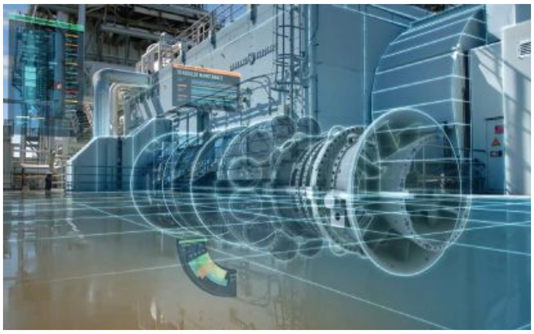
a certain number of petabytes of data going through our algorithms," the finance chief recalls.

Every quarter, senior management sits down with each of its businesses, including Predix, and does what it calls a "blueprint review." The three-hour reviews involve assessments of whether the business is on target for the current year's plan. "That's how we pivot and reevaluate," Bornstein notes. "We decide whether we're on course or not, and whether or not we need to change the strategy."

The finance chief explains that if a new M&A transaction or other capital allocation opportunity for the business presents itself, attendees are asked: "How does it change the way you think about your business or the company in its totality?"

The review sessions aren't the only times when plans are assessed. "As we move throughout the year, we're constantly reevaluating whether or not that blueprint still makes sense," he adds.

More broadly, the blueprints are evaluated in the context of GE's entire portfolio of operations. Every July, Bornstein and other senior executives perform a detailed review of the portfolio for the GE board. As part of the review, they present a three-to-five-year financial profile of the company, including its capital allocation strategy over that period.



In developing Predix, the cloud-based platform GE is touting as the launching pad for its industrial internet initiative, the company has only a skeletal plan to guide it this year.

Further, management details "where we think the company is going, where we should be investing, where we think the returns are," according to Bornstein, and "where we ought to maybe reshape the portfolio."

Recycling the Budget

Mike Murray, CFO of Napa Recycling, remembers the bad old days of working under the tight grip of an annual budget. "It was very onerous," he says of the yearly process over two decades ago at the huge environmental corporation that would later be called Waste Management.

At the time, Murray was working as a district controller at the company. Speaking of the budget, he recalls, "that thing would just sit on the shelf. All you would do is talk about it at every monthly meeting, but you weren't able to adjust it."

If Waste Management, which later acquired Murray's current employer, "wanted to buy two trucks, [we] needed to know that a year in advance." he says. "If we wanted to buy a third truck, we wouldn't be able to buy it" that year because it wasn't in the budget.

Although Napa Recycling still retains an annual budget cycle, the company has long since adopted a 24-month rolling forecast to make it more adaptable to changing conditions during the year. Every quarter, the company's managers compare the budget's assumptions to a fresh forecast and adjust the budget accordingly.

The current budgeting and forecasting system is "[much] more flexible" than the previous system, Murray says. "It allows us to see what changes are happening in the current quarter, and we can roll those forward if we think they're going to continue. It really helps us manage our company a lot better."

A big advantage is that Napa can see far beyond the current year and use that forecast to allocate capital needed more immediately. For example, if a truck is in poor shape, Murray can decide to buy a new one even if it wasn't provided for in the annual budget. That's because he can see how the company might be able to recapture the revenue to pay for the truck over, say, the next 10 years.

By looking closely at the budget each month, the firm's finance team can also react effectively to volatile commodities markets. For instance, Chinese companies buy a substantial

> **"The annual budget is a dead document, in my opinion."**
> ›› **Mike Murray, CFO, Napa Recycling and Waste Services**

amount of cardboard from Napa Recycling and other players in the U.S. packaging industry. Typically, cardboard prices spike in July through September in response to China's need to fashion packaging for running shoes and the like in anticipation of the Christmas rush. "The trick is [to determine] where the recycling business is going," says Murray. "We're constantly at the whim of what China is paying for material."

Further, the forward-looking nature of the process has enabled the recycler to see in advance the benefits of major projects that may have seemed too costly to launch under a rigidly enforced annual budgeting system. In January, Napa, a company with $40 million in annual revenue, was thus able to open a processing plant that converts green waste (nitrogen-rich waste culled from gardens, parks, homes, and businesses) to compressed natural gas. In turn, the company uses the low-carbon, environmentally friendly gas to generate electricity to run its 48 garbage-collection trucks.

The forward-looking nature of Napa Recycling's budget process enabled the company to envision the benefits of electrical fueling of its trucks.

At least temporarily, the project made for complicated budget negotiations with the city of Napa, Calif., which compensates Napa Recycling for its work. Murray says that he and his team had to conduct a lot of research on relative power costs and usage in drawing up their project plan. Once they did that, however, they could show "that their cost of maintenance went down significantly."

True, changing the ability of its trucks and machines to run on electricity rather than on diesel fuel has cost Napa Recycling $2.5 million. But the project has included elements of automation that have enabled the firm to cut labor costs—which, along with capital expenditures, is one of its two major budget outlays. "Before ... we were using a lot of labor to move material around. We now have an automated line that takes it from start to finish," Murray says. "We look at initiatives to save us money and to save on ratepayers' money [in the form of] garbage collection rates."

Shifting Focus

Besides spurring big changes in a company's information technology and financial reporting, the movement from managing data on premises to handling it in the cloud can disrupt how a company budgets, plans, and forecasts. That's even been the case at a company like Centage, a budgeting and planning software provider, for whom budgeting is second nature. But when the company began entertaining the prospect of migrating its flagship Budget Maestro product to the cloud, it "forced us to take a long hard look at the business," says CFO John Orlando.

At the start of 2015, when the 75-employee firm first considered making the transition, Orlando and his colleagues began to closely scrutinize what it might mean in terms of potential markets, pricing, and, especially, the churn of on-premises customers. "We want to make sure we're retaining customers at a fairly robust pace," says Orlando. "That makes it easier to stay in the business—when you're not having to work so hard to continually get new business."

Presumably, the subscription-based contracts used in selling services in the cloud can boost customer retentions. Yet that can also make the process of putting together a balanced income statement a scramble. "Transitioning from an on-premises to a cloud business is a bit tricky because when you sell something in an on-premises business, it becomes net sales immediately," Orlando points out. "In a cloud business, what you sell ends up being deferred" over the course of a 12-, 24-, or 36-month contract. "It's a totally different ballgame in terms of putting your P&L together," the finance chief adds.

That overabundance of deferred revenue has, in fact, shifted the focus of the company's planning efforts away from the income statement. Centage, for instance, might have a one-year contract with a customer for $120,000 worth of services. But during the course of the year, only $12,000 might be recorded as sales for each month. In that case, after the first month, the remaining $108,000 resides on the balance sheet and not the income statement, Orlando says, noting that "it becomes even more complicated on the two-year and three-year deals."

Booking sales on a subscription basis rather than getting paid immediately was a brand-new system for Centage's management to learn. "So we changed our thinking when we put our plan together. We're much more focused on balance sheet and cash flow than we ever were before," the finance chief says.

Is the company's cash flow suffering because of the move to the cloud? That would be true if the company were billing for its subscriptions on a monthly basis, according to the CFO. "But what we're doing is trying to get everything on a prepaid basis," Orlando says. "So from that aspect, cash is coming in much quicker than if we were expecting a check every single month."

"We changed our thinking when we put our plan together. We're much more focused on the balance sheet and cash flow."

›› John Orlando, CFO, Centage

As it has at other firms, it seems, the big change at Centage has brought with it a more adaptive way to budget and plan to meet the company's most pressing challenges. CFO

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

Follow the Money

CFOs from different regions of the world have different plans for their excess cash.

By David W. Owens

Many companies around the world are gearing up for a spending spree—unless they happen to be located in Japan.

That is one of the conclusions from the results of the Duke University/*CFO* Magazine Business Outlook survey conducted in June.

The survey gauged the second-quarter economic and business outlooks of more than 1,200 finance and other corporate leaders from companies of all sizes. The survey covers selected countries from all regions of the world: North America, Latin America, Europe, Asia, and Africa.

In most of the regions, a plurality of respondents say that their companies will begin to consume some of their cash reserves over the next 12 months. (See Figure 1.) In the United States and Europe, about four in ten respondents agree that their firms are likely to begin deploying their cash reserves in the coming year. That sentiment is shared by 50% of the respondents in China and 56% of the corporate executives in Latin America.

The lone exception is Japan, where only 13% of the executives surveyed think their companies will spend some of their cash reserves. More than half (52%) indicate that their companies will be hanging on to their cash, and the rest (36%) remain uncertain what the future will hold.

Where are companies' current cash levels? Respondents from Latin America (42%) and China (43%) were the most likely to say that their companies have less cash and cash equivalents on their balance sheets today than a year ago. (See Figure 2.) With these respondents also the most likely to say they expect to continue to deploy their cash reserves, the spending of reserves is, for the most part, a continuing trend.

Executives from the United States and Europe were most likely to report that their companies are staying the course, compared with a year ago. That may be indicative of the relative economic stability in those regions compared with Latin America and Asia.

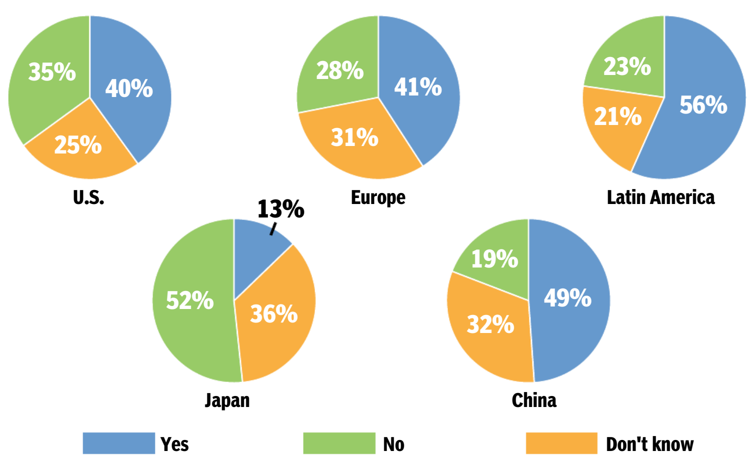
The responses of Japanese firms suggest that they are continuing their conservative approach to cash management. Nearly six in ten respondents from Japan (59%) say that their companies are holding more cash and marketable securities today than they held a year ago. That number is approximately 20 percentage points higher than seen anywhere else in the world.

40%

Percentage of U.S. executives who say their firms will begin to deploy their excess cash reserves in the next 12 months.

FIGURE 1

Is it likely that your firm will begin to deploy its cash reserves during the next 12 months?



SPENDING TO GROW

For the most part, finance executives expect to use their cash to bolster capital spending and investment. That is the top choice for the use of cash reserves by half or more of the respondents from the U.S., Europe, and China. (See Figure 3.) As they cope with a stubbornly sluggish world economy, these companies may now believe their cash is better used to spur growth than to stockpile as a buffer against a new recession.

In China and the United States, acquisitions are favored as a path to further growth. In China, in particular, 50% of executives expect to use their cash reserves to fund their acquisition strategies. And that nation's respondents additionally are targeting organic growth-inducing activities such as R&D, marketing, and advertising. Those plans may reflect a renewed determination to overcome the slowdown in economic activity that China has recently begun to experience.

In Europe, companies are more likely to return cash to shareholders in the form of dividends and share repurchases (41%). But about one-quarter of the respondents there (26%) still have a need to use cash to cover operating losses, as the region continues to struggle in the aftermath of the economic downturn. (Note: This quarter's survey concluded just before the United Kingdom voted to exit the European Union.)

Companies in Latin America have a similar need, with 30% of the respondents from the region saying they will allocate cash to cover operating losses. The top choice in Latin America, however, is the use of cash reserves to pay down debt or lines of credit (50%), which likely has accumulated as the region's economies have struggled with political turmoil and recession.

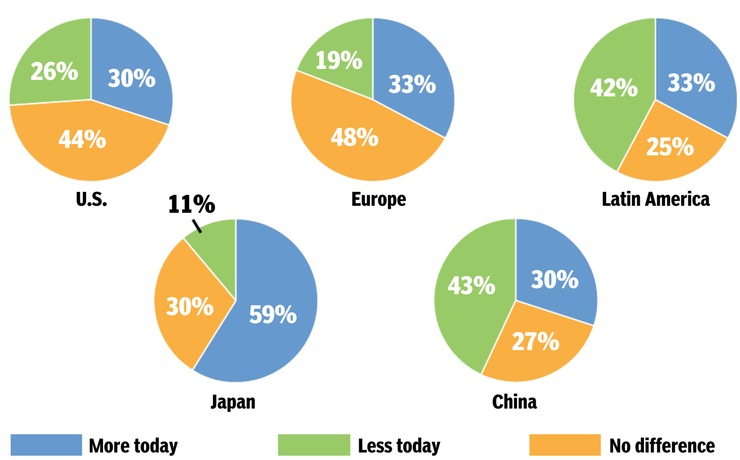
FIGURE 3

If you plan on spending accumulated cash reserves, on what will they be deployed?

Rank	U.S.	Europe	Latin America	China
1	Capital spending or investment (54%)	Capital spending or investment (59%)	Pay down debt/ line of credit (50%)	Capital spending or investment (50%)
2	Pay down debt/ line of credit (30%)	Dividends or share repurchases (41%)	Capital spending or investment (39%)	Acquisitions (50%)
3	Acquisitions (30%)	Cover operating losses (26%)	Cover operating losses (30%)	Research and development (44%)
4	Increase hiring (19%)	Acquisitions (22%)	Purchase raw materials (20%)	Marketing and advertising (39%)

FIGURE 2

Is your firm holding more or less cash and marketable securities today, compared to one year ago?



CAUTION IN JAPAN

Companies in Japan are the contrarians in this quarter's survey. As successive governments continue to churn out new policies in their attempts to lift the economy out of stagnation, executives deem it wise to stay highly liquid.

Half of the respondents in Japan say they do not need cash reserves as a source of funds. Since nearly 60% of this quarter's respondents from Japan indicate that they have been building up their cash reserves over the past year, their reluctance to use them is a sign of continuing conservatism.

Other reasons the Japanese respondents give for hanging on to their cash include keeping it as a liquidity buffer in case credit markets tighten and saving it as dry powder for future investment opportunities. They also cite a lack of attractive opportunities in the current market. All of those reasons suggest that many executives in Japan continue to have doubts about the efficacy of shifting economic policies in their government. CFO

Tonic For Retirement Ills

Balancing benefits costs and outcomes is critical to enterprise success. **By Chris Schmidt**

Finance executives' efforts to manage benefits risks and costs, while trying to enhance benefits outcomes, will be critical to their companies' ability to succeed in the future.

This is the key finding of a recent CFO Research survey of 180 senior finance executives at U.S. companies with defined benefit (DB) retirement plans. (Many respondents also have defined contribution [DC] plans as well.) The survey, sponsored by Prudential, gauged finance executives' current thinking on a range of retirement and benefits issues.

Five strategies were highlighted by the survey: enabling financial "wellness" of employees via innovative offerings; increasing contributions to close DB funding gaps; transferring pension risk through annuity purchases; helping employees better manage their retirement planning; and outsourcing benefits administration.

84%

Percentage of finance executives who say it's important to ensure their companies' employees are educated on key tenets of financial wellness

FINANCIAL WELLNESS

The survey found that finance executives view employee "financial wellness" as an important component of corporate performance, as well as a sound human resource management strategy. Respondents agree that good benefits programs are valuable for their businesses. More than six in ten respondents (63%) say that employee satisfaction with benefits is important for their company's success, and 65% believe that employee benefits are critical to attracting and retaining workers.

Finance executives believe that the financial security of employees is an important concern for the company, as well as for the employees themselves. More than eight out of ten respondents (82%) believe that their companies reap rewards from having workforces that are financially secure. Nearly as many (78%) also believe that employers should assist employees in achieving financial wellness during their working years.

Finance executives consider higher employee satisfaction (59%) and increased retention (53%) as the most important advantage of a focus on financial wellness. These convictions may help explain the fact that 72% of respondents agree that the financial wellness of employees is a focus for their organizations, and even more (84%) say that it is important to ensure that their employees are educated on key tenets of financial wellness.

CLOSING THE DB GAP

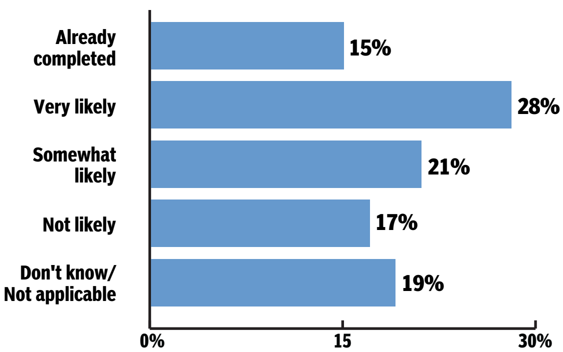
Finance executives from companies with DB plans reveal a continuing worry about funding those plans. Accordingly, many companies are increasing contributions to close their funding gaps, moving plans closer to full funding.

Nearly two-thirds (64%) of respondents report either that their companies have already increased contributions (15%) or that they are likely to do so within two years (49%).

A fully funded plan reduces financial risk to the company and enables the consideration of different investment strategies available to maintain full funding. It can also lay the groundwork for the next stages of DB risk management, such as transferring pension obligations to a third-party insurer.

FIGURE 1

How likely is your company to increase contributions to close its DB plan funding gap over the next two years?



Longevity risk continues to garner increased attention. The survey shows that most companies are preparing to account for an increase in life expectancies in their calculations. About six in ten respondents (61%) say either that they have reviewed participant mortality experience within the past 12 months (46%) or are planning to do so within the next 12 months (15%).

PENSION RISK TRANSFER

As finance executives consider the ultimate disposition of their companies' DB plans, risk transfer in the form of annuity purchases has become a solution that more companies are deploying.

More than one in seven (15%) respondents report that their companies have already executed liability transfer transactions, and nearly one-quarter (23%) say they would be "very likely" to purchase an annuity within the next two years. Another 24% say that they are "somewhat likely" to do so.

The rising interest in liability transfer serves as motivation for some companies to close their DB funding gaps—that is, the gap between projected liabilities and the level of assets required to cover those liabilities. The more fully a plan is funded, the easier it becomes for an employer to manage its DB plan risk, and the more options it has open to it—including, in some cases, liability transfer.

Nearly four in ten respondents (38%) acknowledge that liability transfer could be helpful in enabling them to focus more on their core business, rather than on pension plan management.

HELP IN ACHIEVING SECURE RETIREMENT

Finance executives continue to look for ways that their companies can help employees better manage their own retirement planning. The survey shows that finance executives anticipate having to manage an increasingly aging workforce. Longer life spans mean that employees will need to make their retirement savings stretch even farther. More than half of the finance executives surveyed (57%) believe their companies' employees already will be delaying retirement due to inadequate savings.

One executive echoed this sentiment when writing that her company needed to address gaps in its portfolio of DC plan investments "that affect long-time employees reaching retirement age." In fact, nearly half of the survey respondents (49%) say that the concern over market volatility drives the need for offering more conservative investments in DC plans.

Overall, survey results reveal a growing interest in DC plan features that help individual employees save an appropriate amount while ensuring those savings last during retirement. These features include adopting matching contribution formulas that encourage employees to save at higher rates, utilizing automatic contribution escalation policies, and making guaranteed lifetime income products available.

OUTSOURCING BENEFITS ADMINISTRATION

The survey also suggests that, as companies look for ways to focus more on the strategic value of benefits planning and less on the time-consuming administrative aspects, they are more likely to consider the advantages of outsourcing some parts of benefits administration.

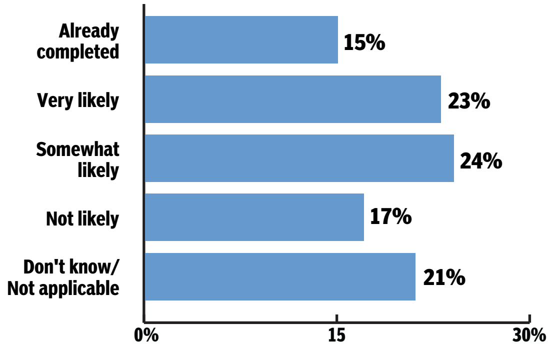
At the same time, the cost of benefits programs continues to rise steeply—especially for health and medical benefits. Controlling the cost of medical benefits for active employees is the top benefits-related priority for finance executives in the survey, selected by 35% of respondents. In second place is minimizing benefit cost increases overall (25%). Notably, nearly one-fifth of the respondents (19%) say that complying with local, state, and federal regulations in their benefits programs is a top priority.

Seeking to free themselves from the burden and cost of benefits administration and regulatory reporting, many companies are turning to outsourcing for a variety of benefits programs. Respondents express the strongest interest in outsourcing management of Affordable Care Act (ACA) compliance. Nearly half (46%) say that either they have already outsourced reporting and regulatory compliance for the ACA to their insurance carriers or to other vendors (26%), or that they are at least considering it (20%).

Interest in outsourcing extends beyond the management of new ACA requirements. Four in ten respondents (40%) also are either outsourcing, or considering outsourcing, administration of requirements for the Americans with Disabilities Act (ADA). Approximately the same number of companies (27%) in the survey are already outsourcing ADA compliance as are outsourcing ACA reporting. CFO

FIGURE 2

Within the next two years, how likely is your company to purchase an annuity for a portion of DB plan participants?



THE QUIZ

Pay at the Pinnacle

As evidenced by the new CEO Pay Ratio Rule, to take effect in 2018, regulators are taking executive compensation seriously—even if investors don't care much, judging by the results of shareholder "say on pay" votes, which routinely approve of CEO comp packages. Still, how much the boss earns does influence the bottom line. Take our quiz to test your knowledge of CEO pay in 2015.

1 According to proxy statements filed for fiscal-year 2015, CEOs of U.S. public companies had greater median total compensation than did CEOs of non-U.S. companies that filed proxies. How much greater?

A. 65%
B. 22%
C. 281%
D. 140%

2 What country outside the United States had the greatest median CEO compensation?

A. Germany
B. Japan
C. United Kingdom
D. France

3 The CEO of which company was *not* among the 10 most highly paid Fortune Global CEOs?

A. Comcast
B. Chevron
C. CVS Health
D. McKesson

4 Among the 15 most highly compensated Fortune Global CEOs, how many were women?

A. 3
B. 5
C. 2
D. 0

5 Among those 15 CEOs, how many were from a non-U.S. company?

A. 6
B. 4
C. 1
D. 3

6 What was the most commonly used performance metric in calculating CEO incentive compensation?

A. Earnings per share growth
B. Return on invested capital
C. Return on equity
D. Total shareholder return

7 Who was the highest-paid CEO at a U.S. public company?

A. Leslie Mooves, CBS
B. Dara Khosrowshahi, Expedia
C. Robert Iger, Walt Disney
D. Howard Schultz, Starbucks

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

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