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BANKING SURVEY: TRUST ISSUES

ARE STATE TAX BREAKS OVERRATED?

STORM SURGE

Planning for the damage and disruption extreme weather causes

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November 2017
Volume 33, No. 9

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IN THIS ISSUE

November 2017
Volume 33, No. 9

Jamie Miller, GE's new CFO

Up Front

By the Numbers

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FROM THE EDITOR

Courting Companies

Stonecrest, Georgia, incorporated in 2016 and has a population of 50,000. What it also has is a burning desire to be the home of Amazon's second headquarters. The town thrust itself into the running in October when the city council voted to de-annex 345 acres and call it the city of Amazon. This is contingent, of course, on the ecommerce giant choosing it as the site of "HQ2."

Stonecrest is only a 24-minute car ride from Atlanta, so perhaps its pitch is realistic. But it also illustrates the silliness that Amazon's $5 billion request for proposal has launched. Amazon has received 238 overtures from cities and regions in North America. And the desperation to attract huge job creators is not unique to the Amazon situation. Plenty of cities offered generous tax incentives and other enticements to woo General Electric. (Boston won.)

This frenzy is great for corporations. Many of the tax credits on offer are refundable, meaning they can reduce a company's tax liability to below zero. Cash incentives are also part of some deals. But are companies smart to enter into these entanglements? And what about the cities and states willing to spend all that money and energy on a single employer?

The danger in these deals is that they fall short of their goals. With cost-cutter John Flannery taking the helm, GE has postponed the finish date of its Fort Point campus in Boston to 2019. Many of the job hires won't happen until 2021. Fortunes can change in four years, especially to an industrial conglomerate with an unclear future. When companies fail to meet their promises, political backlashes are certain.

The irony is that smart companies will choose a location based on its supply of a highly skilled workforce. (See "Location Lures," page 28.) So, it makes more sense for a city or state to invest funds in worker training programs and higher education. To attract the highly skilled, it also needs efficient mass transit and well-funded cultural institutions, among other quality-of-life markers. The returns will be a lot more tangible, and in the long run less risky than a major subsidy to one company.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

FINANCE
Argyle Executive Forum's Chicago event for finance chiefs is coming up. The **2017 Chief Financial Officer Leadership Forum** takes place on November 29. Hear from the CFOs of Welspun Group and Integrity Payment Systems and the head of financial planning at KFC. See the full speaker list on the Argyle website.

TECHNOLOGY
Not sure your corporate transformation project is making a difference? In **"Change Management is Becoming Increasingly Data-Driven. Companies Aren't Ready,"** the director of Change Logic and his co-authors describe some technology tools for getting real-time employee feedback and identifying the reactions of stakeholders. Read the full article on the Harvard Business Review website.

CAREERS
How much luck is involved in becoming chief financial officer of a large company? According to Robert H. Frank, an economist at Cornell University, so-called "self-made" people overestimate their responsibility for their own success. Read Frank's article, "Why Luck is the Silent Partner of Success" on the Knowledge@Wharton website.

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Mark Bennington


TAX

In “What Are Auditors Looking For This Year?” Robert Rostan, CFO of financial-education firm Training The Street, offered a good synopsis of current auditing issues.

“This is an excellent article on the challenges facing the audit profession in the near future,” commented one audience member. **“Audit environments have certainly changed, as have associated risks. Total independence is needed,** more than ever, to report on these risks. [They] are extending beyond the bounds of the company’s primary focus, which is fenced in by audit committees and chief executives.”

While the article discussed the changes that external auditors are looking for, companies should not place “more than reasonable faith in the effectiveness of internal organizations, as a result of internal interests, bonds, and ties,” the commenter added.

In “Capital Gets a Reset,” three Bain & Company consultants noted that despite a steadily declining cost of capital, companies are spending less on capital investments and R&D. “This suggests that **in the future, strategy is going to be less about capital and more about other things**—for example, talent or management bandwidth,” a reader offered.

“Hooray for the ACA?” (page 12) reports on a survey in which only about one-third of health benefits professionals said they favored a full repeal and replacement of the Affordable Care Act. The respondents did, though, dislike several aspects of the ACA, including the required shared-responsibility reporting, which 95% of them wanted to be simplified.

When we wrote about this on CFO.com, one audience member wrote (apparently to drive home the point that such reporting is allegedly a waste of time and resources) that **“health benefits professionals are quasi-regulators—without complicated regulations, they are out of business.** And still, a vast majority of them don’t agree with the reporting requirement!”

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STATS OF THE MONTH

13.9%
Year-to-date return for the S&P 500*

25.43
S&P 500 price-to-earnings ratio, the highest level since 2009

2.74
Median price-to-book value of S&P 500

$28.98
Estimated S&P 500 earnings per share for Q3 2017

22%
Projected growth in S&P 500 earnings over the next 15 months

*All data as of October 10, 2017.
Source: S&P Dow Jones Indices

TOPLINE

STRATEGY

GE Switches CFOs, Turns to Cost Cutting

The industrial giant replaces veteran CFO Jeffrey Bornstein and pulls back on a major cloud platform investment. By David M. Katz

In an interview with *CFO* in June 2016, the words Jeffrey S. Bornstein used to describe the prospects of Predix, General Electric's industrial Internet platform, were bullish, to say the least. If GE succeeded in making Predix one of the two or three leading players in the field, "then the returns [would] get ridiculous," Bornstein said. "There are infinite returns, essentially."

In line with those expectations, former CEO Jeff Immelt had opened his checkbook wide, investing $1 billion in the cloud-based operating system in 2016. About 10,000 web developers and programmers had already been hired for the effort, with the company shooting for a total of 20,000. The company also made a flurry of acquisitions in November 2016, buying two startups in the artificial intelligence space (Bit Stew Systems and Wise.io) as well as ServiceMax, a provider of apps for inventory management and workforce scheduling.

For his part, Bornstein said that GE's future would likely be intertwined with Predix's, and that 20% of his job as finance chief was related to the project. "I've been very involved in the detailed architecture of the technology stack that we're building around Predix," he told *CFO,* adding that he also played a role in "evaluating the suite of offerings of the micro services embedded in Predix that allow people to develop industrial solutions on it."

Analysts viewed Bornstein as a legitimate heir apparent to Immelt. But GE's stock fell 3.7% in the 12 months following Bornstein's remarks, while the S&P 500 jumped 15.9%, according to Bloomberg. So, in June 2017 the company announced Immelt's retirement. Bornstein and John Flannery, a reputedly adept cost cutter, became the finalists for Immelt's job.

Jamie Miller, GE's new CFO

Bornstein lost. In early October, GE announced that Jamie Miller, who had been the CFO of GE Transportation, would replace him as the company's CFO. Bornstein, who'd been appointed vice chairman in June, will continue in that role through the end of 2017.

The fall of Bornstein, who had been with the company for 28 years, seemed to track a demise in Predix's status. GE is now seeking to cut the unit's costs and boost its profits, and is reportedly mulling selling an equity stake in the platform, Reuters reported.

Indeed, prior dreams of the conglomerate's becoming a "digital industrial" powerhouse seem to be dimming in favor of shareholder pressures to stick to its knitting. To be sure, the company still "fully embrace[s] the digital industrial transformation, and we believe in its potential to change the world,"

This page, from left: Thinkstock, Rob Lever/Getty Images

Flannery wrote in a September 15 piece on LinkedIn.

But the new CEO wrote that the company would "broaden and strengthen" GE's partner relationships to support Predix, suggesting that it wouldn't focus as heavily on building the technology in-house. Further, Flannery's strategy will stress the company's traditional verticals. "We will leverage what we do best in energy, oil and gas, aviation, health care, rail, and mining, and draw on our core assets and equipment to deliver the best value and execution," he wrote.

Not that Bornstein was without experience at the helm of a sinking ship. Before becoming CFO of the entire company in 2013, he was finance chief at GE Capital during the financial crisis and its aftermath. Since 2015, the parent company has been slashing the once high-flying finance unit's assets to a bare minimum.

Miller's finance experience, though, should stand her in good stead in a cost-sensitive environment. Before joining GE in 2008 as controller and chief accounting officer, she was controller at Wellpoint (now Anthem) for a year. In that slot, she led investor relations, controllership, financial planning and analysis, and tax.

Prior to that, she was a partner at PricewaterhouseCoopers, leading the firm's financial services practice in Chicago. Miller also served as corporate controller and chief accounting officer of Genworth Financial.

If GE succeeded in making Predix a top three player in the field, "the returns [would] get ridiculous."

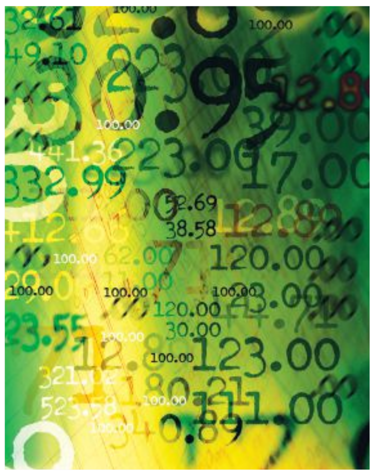
—Jeffrey S. Bornstein, former CFO of GE

In 2013, Miller was named GE's chief information officer, steering its global IT strategy, services, and operations. After two and a half years in that role, she was tapped to lead the company's transportation unit in 2015. And those infinite returns Bornstein spoke of? They will have to wait awhile. CFO

ACCOUNTING

Hiding in Plain Sight

Freewheeling rules on 'other comprehensive income' invite earnings management.



Companies may be managing earnings by shifting potential income-statement losses to the other comprehensive income (OCI) part of their balance sheets, say a new study's authors. Georgia Tech accounting professor Charles Mulford and graduate student Anna Babinets infer from their findings "that companies are engaging in selective earnings management by reporting losses in OCI and excluding them from net income." One finding on which they base their assumption is that "losses are more likely to be reported on the statement of other comprehensive income than gains [are]."

Further, the losses reported under OCI soared in the three years they studied. The percentage of S&P 100 companies reporting a loss under OCI shot up from 46% in 2013 to 81% and 85% in 2014 and 2015, respectively.

The study doesn't prove that more and more companies are intentionally attempting to boost earnings by actually shifting losses. But it does reveal the mounting tendency for companies to report OCI and the big bang that OCI assets produce when they are cashed in.

Broadly, OCI represents gains and losses generated outside of a company's normal operations. They bypass net income on the income statement but cause changes in stockholders' equity. Unrealized investment losses and negative foreign currency adjustments were the main drivers of OCI losses in the study.

The researchers say the findings "affirm a general tendency" for companies to leave material losses 'on paper' and out of earnings, so they "can paint their performance in a more positive light." In addition, after gains or losses are realized (moved onto the income statement), "they often [have] a material impact on earnings," they said.

The loose standards for reporting OCI might be a factor enabling firms to spruce up their earnings, the researchers suggest. Managers are afforded leeway in deciding what elements of gain or loss are included in net income or OCI. By timing the recognition of gains and losses in net income, they can report net income "at a higher level than would be obtained if all [OCI] income gains and losses were recorded in net income as they occurred." | DAVID M. KATZ

This page, from top: courtesy GE, Thinkstock

REGULATION

SEC Quells Pay Ratio Fears

New guidance on the CEO pay ratio rule from the Securities and Exchange Commission brings significant relief to companies concerned about the high costs of compliance.

Many companies, especially multinationals, have complained that gathering workforce compensation information will be unduly burdensome.

"On an aggregate basis, for purposes of financial statements, companies know what their employee costs are," says Steve Seelig, executive compensation counsel for Willis Towers Watson. "But they may not have a direct line of sight to how people are paid in foreign jurisdictions."

The SEC guidance, issued in September, alleviates much of that concern. It gives companies wide discretion to use "reasonable estimates, assumptions, and methodologies" in making pay ratio calculations. The SEC also specifically endorses the use of statistical sampling. In fact, the guidance states that "required disclosure may be based on a registrant's reasonable belief" and acknowledges that given the discretion extended to registrants, disclosures "may involve a degree of imprecision."

Under the guidance, a pay ratio disclosure could also actually be significantly imprecise without inviting an SEC enforcement action. The guidance states that the commission will not pursue such actions against a company

"unless the disclosure was made or reaffirmed without a reasonable basis or was provided other than in good faith." It also notes that companies may rely on data in their human resources information systems in making the calculation.

The pay ratio rule is slated to take effect for fiscal years of SEC registrants beginning after December 31, 2017, so the first disclosures will be made in early 2018. | DAVID McCANN

CASH MANAGEMENT

Banks Lack Interest

From December 2015 through June 2017, the Federal Reserve raised the short-term benchmark interest rate four times. But the interest rates that banks are paying depositors have barely budged. This has occurred even though yields on short-term marketable securities, such as commercial paper, have risen in tandem with the federal funds rate's cumulative 1% increase, says Lance Pan, director of investment research for Capital Advisors Group.

In a research note, Pan investigates why deposits generally lag the market when rates are rising, and this lagging effect is more pronounced than in the past. His evidence: Among jumbo deposits (greater than $100,000), the money market rate rose only 1 basis point, to 0.12%, from December 2015 to August 2017.

There are many contributors to persistently low deposit rates, says Pan, including:

Abundant bank reserves. The Federal Reserve's asset purchases following the financial crisis resulted in a huge increase in bank reserves, providing "sufficient liquidity in the banking system and [lessening] the need for banks to pay higher rates on deposits," says Pan.

Restrictive banking regulations. With higher capital adequacy and balance-sheet liquidity requirements, "banks need to optimize the use of deposits for high-margin lending and capital markets activities to justify the costs of holding deposits on their balance sheets," writes Pan.

Money market fund reform. "In past cycles, yield on MMFs tended to trend higher with federal funds, which would in turn lead to some asset migration from bank deposits," points out Pan. However, MMF regulatory reforms "have greatly reduced institutional cash investors' appetite for prime funds, and the absence of competition from prime funds has allowed the banks to keep returns low despite rate increases." | VINCENT RYAN

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BENEFITS

Hooray for the ACA?

During the first few years after the Affordable Care Act's 2010 passage, most companies were none too happy about new costs for taxes mandated by the law and for complying with its many requirements. But now, a group that's inherently interested in managing health-care costs—the people companies pay to run their benefits programs—are fine, on the whole, with keeping the ACA. Only about a third of 300 health benefits professionals surveyed by Mercer in mid-September said they favored a full repeal and replacement (see chart).

Work to find an alternative to the ACA, or at least push through significant amendments, will continue in Congress in 2018. However, prospects for an outright repeal and full replacement will be shaky. Sixty votes in the Senate will be required, rather than the 51 that were needed to pass health-care legislation as part of the federal budget reconciliation process.

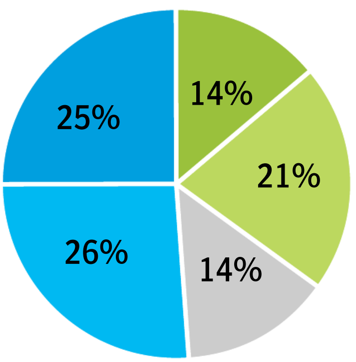
While the benefits managers were cool toward the idea of dumping the ACA, they did remain steadfast in their opposition to certain aspects of it. For example, 95% said they favored simplifying the required "shared-responsibility" reporting of the medical coverage offered to employees.

Additionally, concern over the 40% excise tax on high-cost health plans, slated to take effect in 2020, remains rampant. Virtually every respondent has already taken actions designed to minimize their exposure to the tax. However, such efforts are doomed to be only temporarily effective unless the provision is amended.

That's because the cost thresholds above which the tax will kick in are scheduled to escalate every year by only the consumer price index growth rate plus 1%. Medical-cost inflation, however, has exceeded that pace for years and is expected to continue doing so. So, most companies would likely be on the hook for the tax within a few years. | D.M.

Health Care Status Quo

What is your opinion on a full repeal and replacement of the Affordable Care Act?



Source: Mercer survey of 300 health benefits professionals, September 13–22, 2017

CAPITAL MARKETS

Buybacks Show Restraint

Are issuers propping up their lofty share prices by pouring an ungodly amount of cash into share repurchases? Not S&P 500 companies, at least not in the second quarter, according to data from S&P Dow Jones Indices. In fact, most of the S&P 500 also failed to meaningfully boost earnings per share through the level of stock repurchases they undertook in the April-to-June period.

Second-quarter share buybacks by S&P 500 companies fell 9.8% compared with the first quarter, says the organization. The $120.1 billion total was a 5.8% decline from a year ago and the lowest amount since 2014. While S&P 500 companies have record amounts of cash to repurchase stock, high prices may be scaring some off.

The combination of lower buyback expenditures and higher share prices meant buybacks were also lower on a share-count basis, resulting in a "weaker tailwind" for EPS, notes Howard Silverblatt, senior index analyst at S&P Dow Jones Indices.

As a rule, Silverblatt says, issuers need to reduce their share counts by 4% to meaningfully impact EPS. Only 66 of the S&P 500 companies cut their share count by that amount in the second quarter; a year ago, more than one-fifth of all S&P 500 issuers did so.

"[Wall Street] is interpreting the decline in discretionary buybacks ... as a positive sign; while there is less support for EPS growth, companies are showing an ability to meet their EPS targets without [buybacks]," says Silverblatt. | V.R.

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If You Owned a U.S. Dollar LIBOR-Based Instrument Between August 2007 and May 2010

You May Be Eligible for a Payment from a $130 Million Settlement

There is a Settlement with Citibank that impacts individuals and institutions that entered into over-the-counter financial derivative and non-derivative instruments directly with Citibank, Barclays, or a Non-Settling Defendant that received payments tied to U.S. Dollar LIBOR. Citibank, Barclays, and the Non-Settling Defendants (Credit Suisse, Bank of America, JPMorgan, HSBC, Lloyds, WestLB, UBS, RBS, Deutsche Bank, Rabobank, Norinchukin, Bank of Tokyo-Mitsubishi UFJ, HBOS, SocGen, and RBC) are U.S. Dollar LIBOR Panel Banks. The instruments include certain interest rate swaps, forward rate agreements, asset swaps, collateralized debt obligations, credit default swaps, inflation swaps, total return swaps, options, and floating rate notes.

The litigation claims that the banks manipulated the U.S. Dollar LIBOR rate during the financial crisis, artificially lowering the rate for their own profit, which resulted in purchasers receiving less interest payments for their U.S. Dollar LIBOR-based instruments from the banks as they should have. Plaintiffs assert antitrust, breach of contract, and unjust enrichment claims. Citibank denies all claims of wrongdoing.

Am I included?

You are included in the Settlement if you (individual or entity): Directly purchased certain U.S. Dollar LIBOR-based instruments from Citibank, Barclays, or any Non-Settling Defendant (or their subsidiaries or affiliates) in the United States; and owned the instruments at any time between August 2007 and May 2010.

What does the Settlement provide?

The Settlement will create a $130 million Settlement Fund that will be used to pay eligible Class Members who submit valid claims. Additionally, Citibank will cooperate with the Plaintiffs in their ongoing litigation against the Non-Settling Defendants.

How can I get a payment?

You must submit a Proof of Claim to get a payment. You can submit a Proof of Claim online or by mail. The deadline to submit a Proof of Claim is **March 29, 2018**. You are entitled to receive a payment if you have a qualifying transaction with Citibank, Barclays or a Non-Settling Defendant. At this time, it is unknown how much each Class Member who submits a valid claim will receive.

What are my rights?

Even if you do nothing, you will lose your right to sue Citibank for the alleged conduct and will be bound by the Court's decisions concerning the Settlement. This Settlement will not result in a release of your claims against any Non-Settling Defendant, and the litigation against Non-Settling Defendants is ongoing. If you want to keep your right to sue Citibank, you must exclude yourself from the Settlement Class by **January 2, 2018**. If you stay in the Settlement Class, you may object to the Settlement by **January 2, 2018**.

The Court will hold a hearing on **January 23, 2018** to consider whether to approve the Settlement and approve Class Counsel's request of attorneys' fees of up to one-third of the Settlement Fund, plus reimbursement of costs and expenses. You or your own lawyer may appear and speak at the hearing at your own expense.

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Be Cautious About 'Sweating Your Assets'

Even though letting assets depreciate can make certain metrics look better, it isn't enough to sustain growth. By Gregory V. Milano

Although there are countless operating initiatives we can pursue to create value, they all can be characterized in one of three ways. First, we can make investments that deliver a return over the life of an investment above the required return on capital. Second, we can improve the profitability of existing activities by some combination of price and cost management. Third, we can improve asset productivity and deliver more profit or cash flow per dollar of assets.

This last method is interesting, and often effective. But it can get us into trouble if we are not careful. The commonly used term for asset productivity is "asset turnover," measured as dollars of revenue per dollar of assets.

Awhile back I began inverting this ratio and calling it "asset intensity." Just as we can look at costs as a percentage of revenue, we can view assets as a percentage of revenue, which makes them more comparable to costs. Whether we are talking about cost to revenue or asset intensity, up is generally bad and down is good.

Consider a management team that improves its $120 million production plant. The plant produces nine million units a year that are sold for $10 each, which yields $90 million of revenue. The current asset intensity is 1.33x, which is the $120 million of assets divided by the $90 million revenue.

Note that asset intensity by itself doesn't tell us much. If this business has a very high cash profit margin, asset intensity of 1.33x might be particularly attractive. On the other hand, if

the company is faced with razor-thin margins, 1.33x might be too asset intensive. Another way to think about this is that high asset intensity isn't a problem as long as margins are high enough. Similarly, low margins are not a problem as long as asset intensity is low enough.

Imagine that the company's production engineers realize they have a bottleneck in production that is constraining volume. The majority of the plant is capable of greater volume, but one process cannot handle any more. So, the volume produced by the whole plant is limited. They propose some new equipment and process-flow changes that will require $5 million of capital but are expected to increase volume by a million units per year. What will happen to asset intensity?

The assets will rise from $120 million to $125 million. If they yield one million more units at $10 each, then revenue will rise by $10 million, to $100 million. The new asset intensity will decline from 1.33x to 1.25x ($125 million divided by $100 million). Thus, while it used to take $1.33 of assets to produce a dollar of revenue, it now takes only $1.25 of assets.

If we assume the returns generated by the business were adequate beforehand and margins held constant, then the returns would be even more adequate after this asset intensity decline. So, it's good.

What if the company stops investing, and its production, pricing, and assets stay the same? In accounting, assets are depreciated to recognize the cost of an asset over its life. What if a few years later revenue was still $100 million, but the assets had depreciated down to $100 million? Now, asset intensity will have fallen to 1.00x, down from 1.25x. Is that good?

Although it seems that performance has improved, that is an accounting fiction. When companies "sweat their assets," they are typically reinvesting

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less than their depreciation, so their net property, plant, and equipment (PP&E) balance is falling. The decline in net PP&E is not the result of any transaction or cash flow, just the accounting depreciation. Measures such as asset intensity, asset turnover, return on capital, and economic profit all look better. But nothing really happened.

One way to check if a company is sweating assets is to examine the ratio of net PP&E to gross PP&E, or simply the net-to-gross ratio of corporate assets. When companies are investing heavily in the future, their net-to-gross asset ratio tends to rise as there are proportionately more new assets. When companies are investing very little and sweating assets, the net-to-gross ratio tends to decline as assets age with very little replacement and investment.

To test what impact the changes in net-to-gross ratio might have, we conducted a study of total shareholder return (TSR), which includes share price appreciation and dividends paid in relation to changes in the net-to-gross ratio. We studied 483 nonfinancial, non–real estate members of the current Russell 1000 index and created four groups, or quartiles, based on the companies' changes in the net-to-gross ratio between 2006 and 2016.

The group of companies that increased their net-to-gross asset ratios the most had median TSRs of 13% per year or 307% cumulatively over the 10 years. Those companies increased their net-to-gross ratio by at least 4% over the 10 years.

The companies with significantly declining net-to-gross ratios didn't fare as well, recording a median TSR of only 6.8% per year, or 124% cumulatively. Those "sweaters" saw a decline in their net-to-gross ratio of at least 12% over the period. It is clear that those investing enough to increase their net-to-gross ratio had substantially better median TSR than those that were merely sweating assets.

When companies "sweat their assets," they are typically reinvesting less than their depreciation.

There are three important messages here. First, true operating-asset efficiency improvements can be very good for the company and its shareholders. Second, if apparent improvements in asset efficiency are stemming only from declines in the net-to-gross ratio, then it is probably not good for shareholders. And third, to avoid this problem, companies can use gross assets instead of net assets for asset productivity, return, and economic profit measures. The signals are much better. CFO

Gregory V. Milano is the founder and CEO of Fortuna Advisors, a value-based strategic advisory firm.

SEC Begins Disclosure Simplification

The commission is trying to ease some disclosure rules for issuers.

The U.S. Securities and Exchange Commission recently moved a step closer to lightening the compliance burden on public companies by simplifying disclosure requirements.

The Fixing America's Surface Transportation (FAST) Act of December 2015 directed the SEC to modernize and simplify the requirements of Regulation S-K. In October, the commission endorsed a staff proposal that would, among other things, allow companies to omit some references to risk factors and hyperlink to information in the SEC's EDGAR database.

"The FAST Act has given the commission the opportunity to update our rules, simplify our forms, and utilize technology to make disclosure more accessible," SEC Chairman Jay Clayton said. "An effective disclosure regime provides investors with the information necessary to make informed investment choices without imposing unnecessary burdens of time and money on issuers, and today's action embodies that goal," he added. Commissioner Kara Stein, the only Democrat on the three-person SEC panel, also came out in favor of the proposal, saying it would "make some modest and marginal changes to our disclosure framework."

The SEC is seeking to reduce the costs and burdens on companies, improve the readability of disclosure documents, and discourage repetition and disclosure of immaterial information.

The proposal would eliminate the risk factor examples listed in the disclosure requirement; revise the description of property to emphasize the materiality threshold; and change management's discussion and analysis to allow for flexibility in discussing historical periods. The commission also would require data tagging for items on the cover page of certain filings and the use of hyperlinks for information that is incorporated by reference and available on EDGAR.

The public has 60 days to comment on the proposed rules. | MATTHEW HELLER

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HUMAN CAPITAL

Mondelez Grooms The Next Generation

The snacks company invests in training that develops real-world corporate finance skills. By David McCann

Operational transformations, the sale of a coffee business, steep cost cutting, determined pricing discipline, an almost-deal to acquire Hershey, talk of being acquired by Kraft Heinz, and, this year, a series of top-executive departures: for Mondelez International, the last few years have been a wild ride. Amid all the tumult, however, the $26 billion snacks company hasn't forgotten the need to develop its people with internal employee-education efforts. Among those efforts, F1, a multifaceted program designed to open up broader career opportunities for finance professionals and bolster retention, stands out.

The centerpiece of F1 is Financial Acumen Skills Training, a 12-week educational experience for high-potential junior and senior finance managers. FAST is built around a computerized business simulation in which teams of participants compete with one another to turn around a fictitious, failing company and set it on a path to growth and profits.

A key goal of the training is to encourage collaboration among the company's finance managers, who are distributed across more than 160 countries. Teams, which are purposely constructed with geographically far-flung members, communicate via teleconference and virtual networks. "It's tough," says CFO Brian Gladden. "They have to get together late at night or early in the morning, which is what I also have to do to deal with a global business."

FAST is operated by TRI, a finance education company that has worked with many of America's biggest corporations to accelerate finance teams' development. But in some ways, the program at Mondelez is unique, says Paul Bueker, a TRI consultant and a former leader of General Electric's acclaimed Financial Management Program.

"[Mondelez's] finance leaders are much more involved than those at other companies," says Bueker, who has handled dozens of such simulations for TRI clients. "This is not an outsource situation, where TRI comes in and runs a program. Since we started talking to Mondelez in 2015, they've wanted to own the program. They also provide a coach for each team, and nobody else does that. They are very hands-on."

Gladden was a longtime GE executive and later the finance chief of Dell (where he also worked with TRI) at the time the computer giant was taken private in 2013. At Mondelez, where he arrived in early 2014, he says he "demands" that senior finance leaders be engaged in providing mentorship and coaching for FAST teams. In fact, it's a component of their annual performance discussions.

"When we made a commitment as a leadership team to reinvest in talent," Gladden tells *CFO*, "I said, 'Look, it has to start with us. The best development programs always have senior leaders right in the middle of them.' We're making sure the teams understand that we have a commitment to their development and careers for the long term."

Scenarios and Simulations

Mondelez—whose brands include Oreo, Chips Ahoy!, BelVita, Toblerone, Trident, Dentyne, Clorets, and Halls, among others—held its first FAST program in late 2015 and kicked off its fourth on October 2. Each one includes 36 participants divided into two sub-

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groups: College 1, whose participants are at the analyst level, and College 2, populated by more-experienced managers. Both have three six-member teams; at the end of the competition there are two winners, one from College 1 and one from College 2.

Each team takes on the role of an incoming management team, replacing one that failed, for one of three companies competing against each other in the medical-device field. "You never want it to be the [client] company's actual industry, because then the participants have all kinds of preconceived notions," says Bueker. "You want them to have a blank slate and to think about it outside their normal comfort zones."

The teams are given about 40 pages of financial and operational information. All three begin in the same financial position using the same model. The program, which requires several weekly hours of participants' time, spans six fiscal quarters of the fictional companies. Teams start in the second half of a fiscal year, analyzing results and planning the next year. They then put their plans into action over the next four quarters.

Each team has many decisions to make, such as what products to develop and at what pace. They also have to determine the allocation of resources to sales, marketing, hiring, quality control, and research. The simulation program factors in all of the decisions to keep a running tab of financial results for the fictional companies. There are no arbitrary outcomes; all are determined only by the companies' actions. Any action can affect not only the company taking it, but its competitors as well.

For example, one team may decide to increase price to extract value for a product enhancement it just invested in, while another team introduces a similar feature at the same time but does not change price. Maybe the third team forgoes the enhancement and instead drops its price to become the market's no-frills product supplier. Based on these decisions, the model determines the companies' resulting market shares.

"The best development programs always have senior leaders right in the middle of them."

—Brian Gladden, CFO, Mondelez

Through role-play, teams learn to deal with uncertainty and how to react to market, operational, external, and other real-life opportunities and challenges that Bueker introduces each quarter. Bueker also takes on the roles of various stakeholders—customers and suppliers, for example—with whom teams can interact. Teams must plan carefully, as they are allowed only a limited number of conversations with stakeholders each quarter.

"The emphasis is on team dynamics and in-depth problem solving," says Barbara Stohlmann, HR business lead for global finance at Mondelez. "We want people to experience the idea of a fully integrated business plan, connecting with peers around the globe and making a virtual environment work."

While the simulation takes place in a different industry, it works in some elements that are specific to Mondelez. For example, given the company's geographic dispersion, it buys materials and snack ingredients in many different currencies. So Bueker throws in a challenge to the participants: their fictional company is thinking about outsourcing from a new supplier, and there are candidates in multiple countries.

Remote Talent

The winning teams are determined by a weighted average of four financial metrics: total revenue (40%); net income (35%); cash flow (15%); and absolute variance (10%), or the difference between a projected budget and actual costs. The winners present to Gladden via videoconference, detailing their strategies and decisions—which can be a big deal, for both the participants and the CFO.

"There are specific individuals—who I wouldn't have known about otherwise—who have impressed me so much that they've gotten opportunities they wouldn't otherwise have had," Gladden says. "Some unbelievable talent may be sitting in pretty remote locations that we sell into. We don't always get exposure to them."

While College 2 is made up of Mondelez finance professionals with more experience than those in College 1, the results of the two groups tend not to differ, Bueker notes. That gives Gladden hope that people can be moved faster through the organization. "If the junior [staffers] are just as capable in this kind of program, then I think they're capable of doing bigger jobs sooner," he says. CFO

Editor's Choice

KEEPING A HAND IN

The number of U.S. chief executive officers leaving their positions rose in September, to 101, up 5% from August, according to Challenger, Gray & Christmas. But many CEOs are staying on with their companies in some capacity. In addition, only about one-quarter of CEOs that have exited companies this year have retired.

Courtesy Mondelez; Thinkstock

How to Buy Cyber Insurance

Deciding how much cyber insurance to buy is no trivial matter, and the responsibility rests with the CFO. By Greg Reber

Businesses around the globe are making cyber risk among their highest priorities. Insuring companies against data breaches is becoming an enormous industry, even as its promising role and impact in security operations continues to unfold. While North American policyholders dominate the market, the insurance markets in Europe and Asia are expected to grow swiftly over the next five years due to new laws and significant increases in cyber attacks.

While the average cost of a data breach declined by 10% from $4 million in 2016 to $3.62 million in 2017 worldwide, the United States experienced a 5% increase in cost, according to an IBM Security and Ponemon Institute study.

Health care was the most expensive industry for data breaches for the seventh consecutive year, costing health-care organizations $380 per record, more than 2.5 times the global average of $141 per record across industries. The high likelihood of experiencing a significant breach (in any industry) is especially disturbing: IBM assessed that the organizations in its data breach cost study had a 28% likelihood of experiencing a material breach (10,000 records or more) in the next 24 months.

Deciding how much cyber insurance to buy is no trivial matter, and the responsibility rests directly with the board of directors and the CFO. Directors and executives should have the highest-level view of cyber risk across the organization, and are best positioned to align insurance coverage with business objectives, asset vulnerability, third-party risk exposure, and external factors. Not all breaches are limited to data exposure: ransomware, advanced persistent threat, and distributed denial of service attacks can also disrupt operations.

How much does a company stand to lose from a supply chain shutdown, website outage, or loss of service? Data points from breach investigations help frame the discussion around risks and associated costs. Following a variety of high-profile breaches helps ensure that projected coverage requirements match up with reality. Be sure to follow older cases for deeper insight into the full expense compared with insurance payout, since related costs and losses are often incurred for years afterward as a result of customer and market response as well as legal and regulatory enforcement.

In late 2013, retailer Target suffered a very public breach that resulted in the 2014 resignation of its CEO, who had been with the company for 35 years. Target had purchased $100 million in cyber insurance, with a $10 million deductible. At last count, Target reported that the breach costs totaled nearly $300 million, with some lawsuits still open.

Home Depot announced in 2014 that between April and September of that year cyber criminals stole an estimated 56 million debit and credit card numbers, the largest such breach to date. The company had procured $105 million in cyber insurance and reported breach-related expenses of $161 million, including a consumer-driven class action settlement of $20 million.

Those cases illustrate the need for thoughtful discussion when deciding how much breach insurance to buy. Breach fallout costs depend on many factors, are not entirely predictable, and can rise quickly as a result of an attack's cascading effects. Case in point: the post-breach evisceration of Yahoo's pending deal with Verizon.

The Fine Print

Companies need to review their security posture and threat environment on a regular basis and implement mechanisms for unceasing improvement. The technology behind cybersecurity

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threats and countermeasures is on a sharp growth curve, while the targets, motives, and schemes of hackers shift unpredictably. Directors and executives may find it useful to assess risk levels and projected costs for multiple potential scenarios before cyber insurance amounts are decided upon.

Most policy premiums are currently based on self-assessments. The more accurate the information provided on a company's application, the more protected it will be. Since most policies stipulate obligations the insured must meet in order to qualify for full coverage, executives need to read the fine print and seek expert advice.

It's also essential to review policy details regularly to ensure they match prevailing threats and reflect the evolution of crimeware and criminal exploits on the dark web. Cyber insurance carriers continually adjust their offerings based on risk exposure and litigation outcomes.

Companies should also assess the state of their IT security very carefully. If a company claims to be following specific protocols, but a post-breach investigation finds they were poorly implemented, circumvented, or insufficiently monitored, the insurer may deny or reduce coverage. Of course, companies must also notify their insurance providers immediately about significant changes to the enterprise's security infrastructure or practices.

As the industry matures, cyber insurance policies will become more standardized. For now, it's an evolving product in a dynamic market that CFOs and boards need to keep an eye on. Meanwhile, CFOs need to realize that checking off compliance requirements, writing policies, and purchasing security software isn't sufficient. CFOs need to make sure risk assessments are thorough and up-to-date, corporate policies are communicated and enforced, and security technology is properly configured, patched, and monitored. CFO

Breach fallout costs depend on multiple factors, and are not entirely predictable.

Greg Reber is the founder and CEO of AsTech Consulting, an information security consulting firm.

Political Risk Returns

Risk levels are rising in a number of countries.

Political risk is on the rise in some countries, with Aon declaring that government-related risks worsened in a number of nations in the third quarter. The global insurer "downgraded" the political risk ratings of four countries, which it does when it sees a pronounced increase in the level of political risk. The third quarter also marked the first time "in some time" that, based on Aon's assessments, the number of countries experiencing a significant increase in political risk outnumbered those experiencing a decrease.

The four countries that Aon "downgraded" in its quarterly report were Togo, Chad, the Solomon Islands, and Barbados. In the accompanying report, the insurer also spotlighted mounting risks in Iran and North Korea even though those countries' ratings remained unchanged.

Among the nations with heightened levels of political risk, Aon raised the political risk levels of Togo and the Solomon Islands to "high" from "medium-high," thanks to an increase in political violence. The risk level in Chad went from "high" to "very high," due to "continued weakening of oil revenues," and the political risk outlook for the Caribbean country of Barbados went from "medium-low" to "medium," due to a poor fiscal outlook.

In other areas spotlighted by Aon, the insurer said the White House's new stance on the Iran nuclear deal has injected an element of uncertainty into a country where political risk was already high.

While abandoning the Iran deal, called the Joint Comprehensive Plan of Action, remains a risk rather than a likely outcome, Aon said, "the uncertainty surrounding policy implementation and the divergence between [the United States] and other countries' foreign policy toward Iran undermine the investment outlook."

In North Korea, another nation with which the White House is taking a contentious stance, Aon said the "intensifications" in economic sanctions on businesses trading, combined with military drills, "have augmented the risk of strategic accidents and escalations." It noted that businesses may suffer from increases in insurance costs in the country.

Finally, Aon noted that political risk is beginning to rise again in Latin America and the Caribbean, in part due to weak economic growth and low investment.

Aon said the remainder of 2017 and 2018 "will bring a series of extensive elections across most of the region's economies, which will limit the implementation of government reforms in the near-term." | VINCENT RYAN

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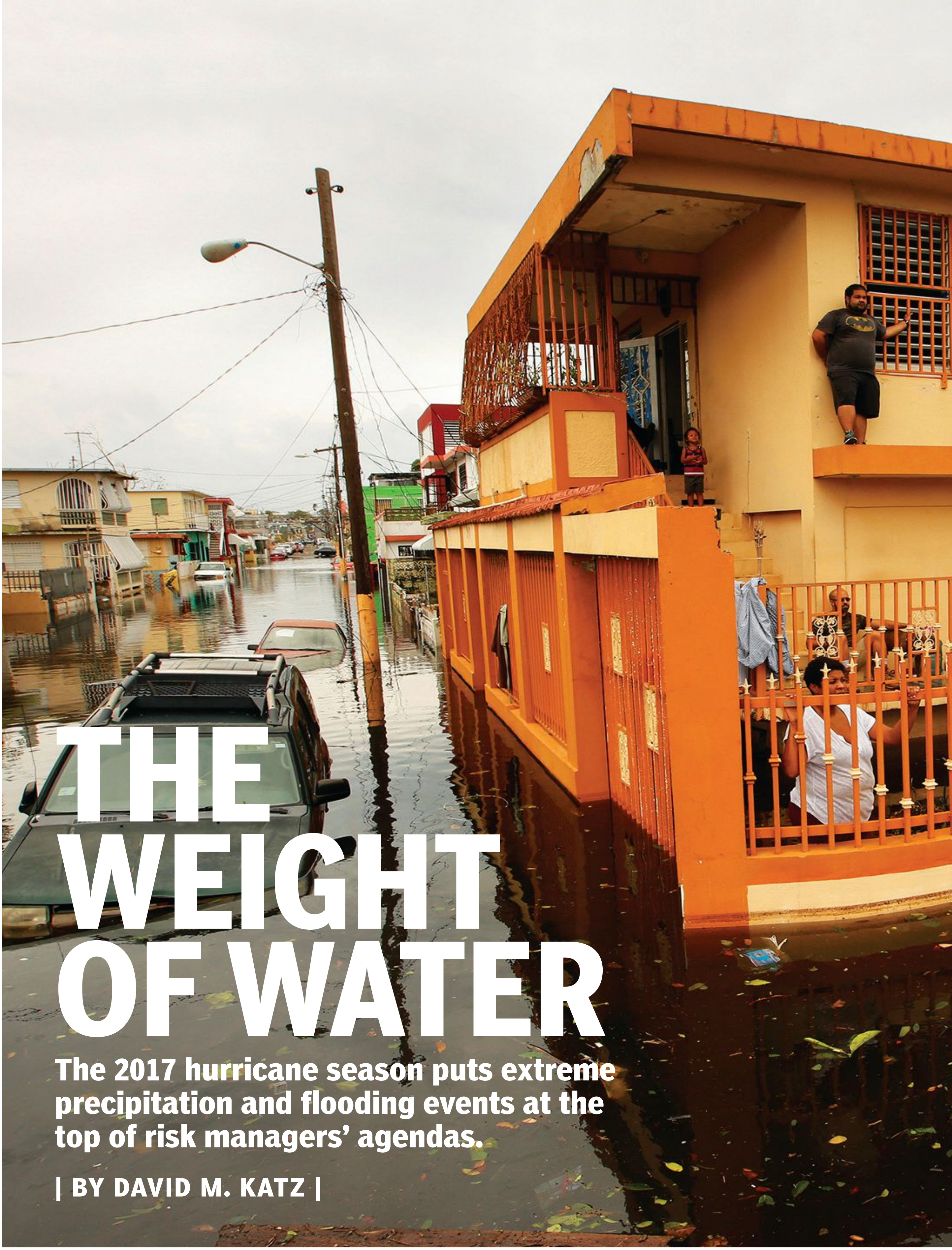

THE WEIGHT OF WATER

The 2017 hurricane season puts extreme precipitation and flooding events at the top of risk managers' agendas.

| BY DAVID M. KATZ |

The United States suffered from hugely destructive hurricanes before August 2017. As recently as 2012, Superstorm Sandy placed large swaths of New York City under water, and the devastating effects of Hurricane Katrina in 2005 still haunt New Orleans. In 1992 the massive wreckage caused by Hurricane Andrew spurred Florida to upgrade its ability to avert comparable damage from Hurricane Irma last September.

: Three weeks after Hurricane Maria struck Puerto Rico, about 85% of its 3.5 million residents still lacked electricity and 40% were without running water.

Carolyn Cole/Los Angeles Times/Getty Images

To many, however, there was something different about this year. Maybe it was the awareness that the Gulf of Mexico's waters were “freakishly warm” this summer, as the *Chicago Tribune* reported in March, and that such warming could indeed intensify storms originating in those waters. Or that a tropical storm reached Ireland, farther east than any Category 3 hurricane on record.

Or perhaps it was seeing the destruction of Puerto Rico's infrastructure by Hurricane Maria, which battered the island nation with winds of 155 miles per hour. Here, if proof were needed, was evidence of how weather could incapacitate a global supply chain, as reports surfaced of the impact on the manufacture of pharmaceuticals, which comprise 72% of the territory's exports.

Or maybe it was the increasingly apparent financial weakness of the United States' National Flood Insurance Program, which is sinking deeper into debt, just as the risk of extreme precipitation and flooding seem to be rising.

All of those factors have played a role in a sense of renewed urgency around extreme weather-related risks. According to data scientists who model such exposures, the big change of focus this year has been on the unique effect that inland flooding, rather than high winds or coastal sea-surge, can have on the life of a major city and its citizens, as well as on corporate balance sheets.

WATER, WATER EVERYWHERE

What image is most on the minds of CFOs, scientists, and strategists as they search for risk management lessons from 2017's storm season? The heavy waters of Hurricane Harvey inundating the streets of Houston.

For example, to Pete Dailey, a vice president in charge of modeling inland flooding at Risk Management Solutions, which forecasts weather for insurance companies and risk managers, the effects of Hurricane Harvey could represent “a paradigm shift” in the risk perspective on major storms. With its Category 4 wind speeds, Harvey, the wettest tropical cyclone on record in the United States, was “a major hurricane, ... Yet what are we talking about?” asks Dailey. “We're not talking about the wind. We're not talking about the storm surge along the coast, [or] the coastal flooding. What we're talking about is flooding in a metro area well away from the coastline.”

To view a hurricane “as an inland flood event is really unconventional, not something that people think about. So when an event like Harvey happens it sort of shifts the thinking,” Dailey says.

When most executives assess risks associated with inland flooding, they focus on so-called “fluvial” events that stem from the overflowing of river basins, he explains. In contrast, much of the damage stemming from Harvey was caused by “pluvial flooding,” in which rain pools in low-lying surface areas.

That kind of flooding, especially in urban areas, means that the water remains for a longer time, creating more lasting effects on businesses and economies. “In comparison to a storm surge, which can last for two or three days, a rain deluge can be around for two to three weeks until the water starts to recede,” says Brian Alster, global head of compliance and supply at Dun & Bradstreet.

Case in point: While Farmer Bros., a Houston-based national coffee roaster and distributor, suffered only “nominal damage” to its local plant, the company's future sales could be hurt by the effects suffered by its customers, according to CFO and treasurer David Robson. Although the plant was up and running three-and-a-half days after Hurricane Harvey hit, there was a “longer tail [of flooding problems] on individual streets within the Greater Houston area, where the roads were just impassible,” Robson said in early October, about a month after the storm had run its course.

In the company's fourth-quarter earnings call in late September, the CFO predicted that effects of Hurricane Harvey and, to a lesser extent, Hurricane Irma would cut the company's net sales by about 2%. Such revenue hits would stem not so much from problems with the company's Houston facilities but from “water damage to [Farmer Bros.'s] end customers,” which include convenience stores, restaurants, and hotels. Because of such damage, “they're just not doing business as usual,” Robson says.

Houston's economy could lose as much as $60 billion of its gross domestic product output in the next year as a result of Hurricane Harvey's floods, according to the Centre

Hurricane Harvey: The First 30 Days

19 trillion gallons of rain

$608 million in advance flood insurance payments

80,000 homes flooded with 18 or more inches of water

$367 million in low-interest Small Business Administration loans

Source: FEMA

“In comparison to a storm surge, which can last for two or three days, a rain deluge can be around for two to three weeks until the water starts to recede.”

—**Brian Alster**, global head of compliance and supply, Dun & Bradstreet

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Extreme Costs

Six of the top 10 flooding events in the United States since 1978 have occurred in the last decade.

	Paid losses (in $ mil)*
1. Hurricane Katrina (2005)	$16,320
2. Superstorm Sandy (2012)	8,596
3. Hurricane Ike (2008)	2,699
4. Louisiana severe storms and flooding (2016)	2,407
5. Hurricane Ivan (2004)	1,612
6. Hurricane Irene (2011)	1,343
7. Tropical Storm Allison (2001)	1,105
8. Hurricane Matthew (2016)	619
9. Louisiana flood (1995)	585
10. Tropical Storm Isaac (2012)	$558

Note: Includes events that occurred between 1978 and May 31, 2016
*Based on National Flood Insurance Program payouts
Source: Insurance Information Institute

for Risk Studies at the Cambridge Judge Business School in the United Kingdom.

VOLATILE CONDITIONS

Do corporations with facilities near bodies of water face increased risk of extreme flooding in the coming years? While it may be hard at this point for scientists to tie a specific storm to global warming, extreme precipitation events could indeed be on the rise.

"Basic physics tells us that as the climate warms, the water cycle becomes more volatile," said professor Kerry Emmanuel of the Massachusetts Institute of Technology, in a whitepaper from FM Global. "Absent large changes in atmospheric circulations (e.g., wind velocity and patterns), this volatility means that places that are usually very dry, like Southern California, will likely get drier. And places where it rains a lot, like the Pacific Northwest and the Southeast United States, will probably experience more rain."

To prepare for those potential extremes, of course, companies need good information about flood risks. But some of that information is lacking. After Harvey, a report by the inspector general of the Federal Emergency Management Agency found that FEMA had failed to map changing flood risks in U.S. communities in a timely manner. The disaster preparedness agency has more than 240 mapping projects on hold, the report found, meaning only 42% of FEMA's flood risk database is current.

"Without accurate floodplain identification and mapping processes, management, and oversight, FEMA cannot provide members of the public with a reliable rendering of their true flood vulnerability or ensure that [National Flood Insurance Program] rates reflect the real risk of flooding," the report said.

If companies can't accurately assess the risk of flooding for their locations and therefore don't prepare, their bottom lines are at risk, Jeffrey A. Burchill, the former CFO of FM Global, wrote on CFO.com in August 2016, not long after the Louisiana flooding that dumped 7.1 trillion gallons of water on the region.

"Extreme wet or dry conditions can affect profit-generating buildings, machinery, data centers, transportation networks, supply chains, people, and sales," Burchill noted. "And though sales and revenue might be insured during a business interruption, market share, shareholder value, reputation, and customer confidence will not be."

Burchill wasn't overstating the possible effects: In 2011's monsoon season, floods in Thailand caused a global shortage of hard disk drives. Analysts said the floods were the primary reason that Seagate Technology recaptured the worldwide lead in hard disk drive shipments. "Because Seagate's disk drive manufacturing plant in Thailand was located on high ground, and was less adversely affected by the floods, it was able to continue supplying hard drives when its competitors could not," he wrote.

BEING PREPARED

The value of resiliency in the face of flooding is difficult to underestimate. Hurricane Harvey confirmed to some organizations in the Houston area that their contingency plans were up to the challenge of mitigating the risk. Robson, the Farmer Bros. finance chief, says that the company was able to keep distributing coffee nationally at normal levels

"To view a hurricane as an inland flood event is really unconventional. So when an event like Harvey happens it sort of shifts the thinking."

—Pete Dailey, VP in charge of modeling inland flooding, RMS

for the short time the Houston plant was down by taking a number of steps before the storm actually struck the city.

Part of the company's contingency plan is to hold an extra few weeks' worth of coffee beans at its plants in Dallas-Ft. Worth and Portland, Oregon, as well as in Houston. "We've mitigated that risk to a significant degree," Robson says. "We weren't impacted by the inability to bring product in."

More worrisome was the company's ability to supply

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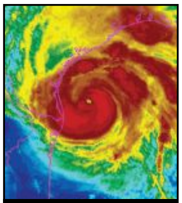
coffee to its customers. Once Farmer Bros. judged that the storm could have a major effect on its business, it decided to pay for a significant amount of overtime by its Houston employees. It also arranged for early, pre-storm shipments of its products to customers outside the area.

That strategy, however, could make up for only a few days of storm-related downtime at the Houston plant. Much more significant was the company's "luxury," as Robson calls it, of being able to boost production at another of its plants. "When the storm hit, Portland began upping its production ... to ship all over the United States," the CFO says.

At CenterPoint Energy, a Houston-based public utility holding company, 950,000 customers experienced power outages as a result of Harvey's floodwaters, said William Rogers, the company's CFO, at a September investor conference. The outages were the result of the need to switch customer service from one substation to another, since 16 out of CenterPoint's 200 substations were flooded.



THE WEIGHT OF WATER

"At the end of any given day, we may have had 60,000 customers that were out of power for that day, and that was the result of either their premises being flooded or not being able to get to them [because of] the flood," Rogers said.

But CenterPoint did find that it had an ace up its sleeve: it was able to restore power to customers more quickly because of an investment in digital meters in 2009. The investment was not a risk management imperative but a com-

What Insurers Cover

Contingent interruption coverage and wind/flood allocations can help a business maximize reimbursement for hurricane-related losses.

BY SHAUN CROSNER

As thousands of companies prepare to pursue insurance coverage for their property damage and business-income losses from the 2017 hurricanes, many CFOs and finance managers have been tasked with preparing and submitting first-party property insurance claims.

Commercial property policies typically insure against "all risks" of physical loss or damage to real property, except to the extent an exclusion or other limitation applies. This means that companies often are entitled to broad coverage for hurricane-related loss or damage to structures, machinery, stock, and other property.

Property policies also typically provide coverage for "business interruption" or "lost profits" attributable to damage to or at the insured's facility. However, such damage is not always a prerequisite to coverage.

Even in the absence of direct damage to or at an insured's facility, many policies also cover lost profits either attributable to the insured's inability to access its facility or to damage suffered by suppliers and customers. The latter coverage, often referred to as "contingent business interruption," may be available to insureds even if they have no presence in the states impacted by Harvey, Irma, and Maria.

In the wake of hurricane damage, CFOs and risk managers have to consider whether it is necessary to perform a so-called wind/flood allocation.

First-party property policies often treat "wind" losses differently than "flood" losses. Some property policies provide broad coverage for wind losses but purport to limit or exclude coverage for certain flood losses. In other cases, property policies purport to impose different deductibles—that is, one for wind and another (typically larger) one for flood—that must be satisfied before the insurer begins to pay.

These provisions can significantly impact an insured's total recovery—which can include damage from both wind and flood. Accordingly, insureds must consider whether it is necessary to perform a wind/flood allocation (typically done by experts) to determine how much of their total damage and loss is attributable to wind and how much is attributable to flood.

Not surprisingly, wind/flood allocations can become more complicated as time passes. Therefore, early in the process, CFOs and risk managers should carefully review their policies and consider whether it's advantageous to perform a wind/flood allocation and attempt to segregate their wind and flood losses.

| ***Shaun Crosner*** *is a partner at Pasich LLP, a law firm focused on the representation of insureds in complex insurance coverage matters.*

Wikimedia Commons

petitive one, according to Rogers. The "smart meters" have enabled the utility to supply power to its retail customers more efficiently than years ago, when the company relied on customers calling in to report power outages, he adds.

During Harvey, the advantage was pronounced. "If you can identify where and when the loss is, you know how to reroute electricity. And fewer customers are out of power for a shorter period of time," Rogers says.

The hurricane will have only a "modest" negative impact on CenterPoint's finances, in part because as a utility, it can recoup future operating and maintenance costs from ratepayers. Nevertheless, the unusually intense flood damage brought up questions about how CenterPoint (and other utilities) can protect the nation's power grid during storms, especially in urban areas.

"Resiliency means that we want to improve long term and protect the grid against all adverse situations and natural disasters."

—Kenneth Mercado, SVP, CenterPoint Energy

In cities, power stations are largely built underground, because that's the most efficient way to deliver electricity in densely built areas, according to Kenneth Mercado, senior vice president of CenterPoint Energy's electric utility business. That design also protects power stations from high winds, compared with the damage that might occur if the stations were built above ground. But placing facilities above ground sets up a different dilemma. "After a wind event, everybody asks, 'Why don't you put all your utilities underground?'" Mercado says.

The power executive says he wishes the solution were simple. "The answer is that we have to balance how much we can put underground with how much we put above ground," he explains. "During Harvey, our underground facilities created more problems than our overhead facilities" because flooding caused underground circuits to short out.

As a result, Harvey's flooding affected the company's thinking for the future. "Resiliency means that we want to improve long term and protect the grid against all adverse situations and natural disasters," Mercado says. "Where we might be able to raise facilities [above ground]—that will be on our plan for the future."

FINANCIAL PROTECTION

Besides risk assessment, risk mitigation, and resiliency, in the wake of this season's storms corporate finance executives and risk managers are likely to be thinking harder about the availability of insurance to cover flood risks. And that's the case even in organizations that don't have facilities in coastal areas or near floodplains.

For example, Kilroy Realty, a publicly traded real estate investment trust based in Los Angeles, develops most of its properties in California, where earthquake risk dwarfs flood hazards. But it also does a considerable amount of business in the state of Washington and elsewhere in the Pacific Northwest. In fact, the REIT is extremely limited in the amount of insurance it's able to buy to cover a property located near Lake Washington because of the structure's extensive flood risks, according to Scott Ritto, vice president of risk management.

In comparison to all of its other property insurance policies, under which Kilroy need only incur a $25,000 deductible, the REIT must absorb a $500,000 deductible on that property because a tributary of the lake runs nearby. To cover that big deductible, the company is thinking about buying a relatively cheap National Flood Insurance Program policy, Ritto says.

But there's a considerable risk involved in counting on the NFIP. Authorized by the federal government to continue only through December 2017, the NFIP "likely will not generate sufficient revenues to repay the billions of dollars borrowed from the Department of the Treasury ... to cover claims from the 2005 and 2012 hurricanes or potential claims related to future catastrophic losses," according to a September report by the U.S. Governmental Accountability Office.

"Since the program offers rates that do not fully reflect the risk of flooding, NFIP's overall rate-setting structure was not designed to be actuarially sound in the aggregate, nor was it intended to generate sufficient funds to fully cover all losses," according to the GAO report. With the losses the program is facing as a result of Harvey, Irma, and Maria, in tandem with the low premiums it charges, Ritto worries, "Who knows whether the NFIP will continue?"

Regardless of whether CFOs believe in climate change, or their companies are lucky enough to be able to afford flood insurance, they should be planning for extreme weather events, especially if they have built or planned structures in affected regions, according to the FM Global whitepaper.

Risk managers should "make sure they review the resilience of their buildings or new locations to withstand the impact of an extremely high rainfall event and area flooding," said professor Minghua Zhang of Stony Brook University. That includes examining a buildings' ability to withstand flooding, as well as evaluating processes to manage surface water, roof drainage, and water supply.

If anyone wins in a catastrophe, according to Burchill, it's resilient companies, and resilience requires preparation. But the biggest lesson of 2017 may be this: an assessment of the risks of extreme weather events clearly belongs in any long-range corporate plan. CFO

David M. Katz is a deputy editor at CFO.

Flickr


ONE HUNDRED DOLLARS

LOCATION LURES

State and city tax breaks abound, but they shouldn't be the only consideration when locating a business.

There seems to be no limit these days to what U.S. states and cities will do to lure businesses to their communities. Incentives recently dangled in front of companies include the $3 billion in tax breaks—amounting to $15,000 to $19,000 per job annually—that Wisconsin's governor has offered Foxconn to build a flat-screen plant in the Badger State. Suitors competing to be the host of a $5 billion second headquarters for Amazon have created elaborate videos, enlisted the help of CEOs of other major companies, and of course, offered huge tax incentives to attract the attention of the e-commerce giant.

"Different jurisdictions throughout the country are in the middle of an intense competition to lure businesses to their locales by offering generous financial incentives such as tax breaks," says Paul Laudicina, a partner and chairman of consulting firm A.T. Kearney's global business policy council. "The current competition to win Amazon's second head-

BY BOB VIOLINO

Getty Images

quarters is a compelling example."

Finance chiefs, though, need to stay level-headed no matter how alluring the incentives may be—and, as with any major business decision, conduct their due diligence. For businesses that don't tread warily, the grass truly may not be greener on the other side.

"The bottom-line financial incentives municipalities offer will be easy to compare," says Scott Martinez, a former attorney for the city of Denver who is now a partner at the law firm Snell & Wilmer. "The best CFOs will reach deeper to the city's economic vitality and livability for its workers.... Does the city have access to quality health care, a housing market employees can afford, a commitment to infrastructure and education?"

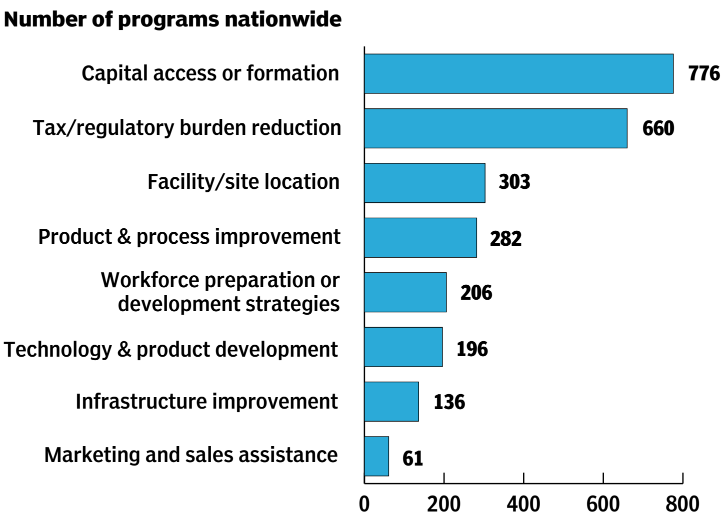
WEIGHING INCENTIVES

Tax relief is among the most widely used and effective tools that jurisdictions employ to lure companies, according to Laudicina. But as evidenced by the experiences of companies such as Amazon, General Electric, Aetna, and Caterpillar, global businesses are also attracted to large cities with a plethora of top talent, an abundance of research institutions, and good infrastructure.

"The most ideal incentives are those that make doing business simpler and less expensive," says Bert Young, CFO of Impartner, a provider of channel management technology. For most technology companies, the largest expense is payroll, so any incentives that reduce employee taxes, im-

Sweetening the Pot

U.S. states are offering numerous types of incentives to companies that relocate or start up businesses.



Source: The Council for Community and Economic Research's State of State Business Incentives Report, 2015

"We need to relocate to an area we know has a large enough talent pool to support our continued expansion." — Bert Young, CFO, Impartner

prove benefit costs, or offset real estate costs are helpful, he says. Among the vital things to look for is a city's commitment to arts and culture, Martinez addds.

"Cities tend to invest in arts and culture after their commitments to health, infrastructure, and education have already been met," he explains. "When you see a region with a commitment to funding an enlightened and entertaining cultural scene, it is an indicator that it's meeting the other obligations workers in a livable city would expect."

Paul Gevertzman, a partner at accounting firm Anchin, Block & Anchin, is an expert on tax incentive programs and chairs the firm's tax credits & incentives group. He recalls that one business client rejected an incentive-laden offer to move to New Jersey because "it was concerned that the workforce wouldn't move with it."

"It doesn't always make sense to chase the best offer," he says. "That client made the decision that it wasn't all dollars and cents and concluded it would be better off staying where it was."

Each of these investment incentive deals "is a unique animal, so there are no hard-and-fast rules to follow," Laudicina says. "In general, however, CFOs should weigh the financial incentives being offered with broader considerations about whether their workforce and infrastructure needs will be easily met in the locality."

Considerations about skills and workforce should most certainly be part of any decision, notes Alfredo De Zayas, a principal at accounting firm Morrison, Brown, Argiz & Farra. "In today's economy of knowledge-based products and services, a company's ability to hire, train, and retain highly talented [professionals] is crucial for business growth and sustainability," he says.

Cities that expect to lure businesses must be able to provide a steady flow of talent. Martinez cites the case of a corporate client that was seeking to relocate a large satellite office. The company, he says, partnered with a large city's economic development department and a university to fast-track apprenticeships and provide employment tax relief for apprentices.

One of the biggest concerns for growing technology companies is not having a large enough pool of qualified candidates to hire for hard-to-fill positions, Impartner CFO Young explains. "Software engineers and sales and customer support professionals are key to the growth and success of the business," he says. "We need to relocate to an area we know has a large enough talent pool to support our continued expansion."

CASH IN HAND

Even as they are looking to maintain a skilled workforce, companies want to keep the cost of doing business as low as possible, De Zayas says. When relocating a company to another state or city, he explains, finance officers need to think about deals in which financial incentives include not only breaks on taxes, but also grants for research and development, training, and education; bonuses awarded to the most innovative employees; cash incentives to fund projects; and subsidies for housing, moving expenses, and other costs.

"Companies should emphasize upfront cash incentives

Prime Spot

Amazon provokes a bidding war by inviting cities to compete to be its second home.

With states and municipalities thirsty for jobs-creating denizens, Amazon's very public request for proposal (RFP) incited a stampede. U.S. cities have been falling over themselves trying to entice Amazon to build its "second headquarters," dubbed "HQ2," in their corner of North America.

Given the benefits Amazon claims to have brought to downtown Seattle since it moved there (see right), to some cities it may seem perfectly rational to offer billions of dollars of perks. Amazon promises to add 50,000 new jobs to the local economy in which HQ2 will be built, and it claims the employees will have an average salary exceeding $100,000. Amazon will also spend $5 billion on construction, although that will be over about 15 years and, according to Amazon's RFP, back-loaded.

Still, municipalities and states have jumped in with both feet. Some offers leaked before the RFP response deadline of October 19, displaying all manner of largesse. New Jersey is offering up to $7 billion in state and local tax rebates to draw Amazon to Newark, with Governor Chris Christie tacking on $2 billion to what the legislature approved. California, on the other hand, is proposing $200 million in tax credits and $100 million in worker training funds. Property tax abatements are on the Golden State's offer sheet also. And Worcester, Mass., an hour west of Boston, is prepared to give Amazon a 100% personal property tax exemption for 20 years.

Amazon states it will favor metropolitan areas with more than 1 million people, proximity to an international airport, and access to good mass transit. That will immediately whittle down the prospects.

Whatever location Amazon chooses, it may secure the biggest tax incentive package ever. And the victorious state or city? The hope is that it doesn't suffer the "winner's curse," having, in the hysteria over becoming home to a technology icon, paid too much for too little tangible benefit. | **VINCENT RYAN**

Amazon's Location Wish List ...

In its search for the right place to locate what it calls "HQ2," Amazon made public some of its requirements:

- **A metropolitan area with more than one million people**
- **A stable and business-friendly environment**
- **Close proximity to an international airport**
- **Access to mass transit**
- **An urban or suburban location with the potential to attract and retain strong technical talent**

... And What It Promises in Return

Amazon claims its move to Seattle in 2010 resulted in the following direct and indirect economic benefits to the area:

- **233,000 annual hotel nights by visiting employees and guests**
- **$43 million paid into the city's public transportation system as employees' transportation benefit**
- **53,000 additional jobs created in the city as a result of Amazon's direct investments**
- **$38 billion in additional investments in the local economy as a result of Amazon's direct investments**

Source: Amazon.com

Courtesy Amazon

from the government," De Zayas says. "During the investment phase of moving to a different state, companies will be incurring a lot of costs and expenses and not [booking] enough revenues. Thus, cash incentives are [more] preferable during the early stages—the first few years—than state and local tax credits. Tax credits are useful once the company becomes profitable."

The financial health of a city is another consideration. "You want to make sure that those cities have the funds and financial health to come through on their financial commitments to the company," De Zayas notes. "The company's decision-makers need to think about the state's infrastructure, economy, quality of life, technology, education, business friendliness, access to capital, and cost of living."

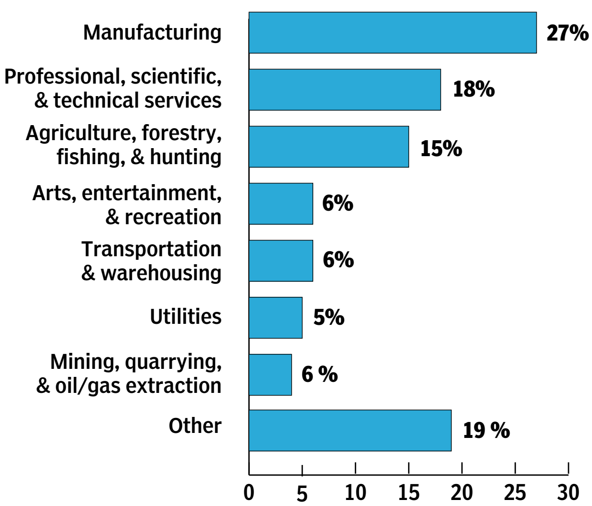
SHIFTING SENTIMENT

No matter how diligent CFOs may be, though, there is one variable they certainly can't control. As professional sports franchises have found in trying to move their team to a new location, political winds can change overnight. Governments may change their policies or back out of commitments.

"Politics is always risky," says Snell & Wilmer's Martinez. "The only thing we know for certain is that there will be another election with new candidates. Forward-thinking companies get to know their politicians and their potential successors early on and discuss how the incentives impact their business, their employees, and the people in the city."

Who's Being Wooed?

The manufacturing industry is the most targeted by state incentive programs.



Source: The Council for Community and Economic Research's State of State Business Incentives Report, 2015

"I have clients who were promised benefits and who did all they were supposed to do, but the legislature didn't allocate the funds and the state didn't pay."
— Paul Gevertzman, partner, Anchin, Block & Anchin

He adds: "The art of politics is personal. A personal relationship between company management and the person filling a political seat is the difference between having a conversation about the importance of an incentive and finding your company's incentives on the chopping block."

An example of an unexpected turn because of politics comes from the Business Employment Incentive Program in New Jersey, Gevertzman says. "I have clients who were promised benefits and who did all they were supposed to do, but the legislature didn't allocate the funds and the state didn't pay." After three or four years of not receiving the money, the companies converted from grants to tax credits paid out over a period of years. "So, it took five years to get what [they] were offered three years ago," Gevertzman says.

Changes in government administrations can always lead to changes in policy, which is a risk for businesses, Laudicina says. "And in our populist-charged political environment, tax concessions to companies may be an easy target," he adds.

To mitigate the risk of new politicians changing previous commitments, companies should build broad, cross-party support in both state legislatures and city councils to ensure the continuation of pro-business policies, Laudicina explains. "And they should act as good corporate citizens in the community once their business is set up," he says.

Companies that take discretionary incentives to relocate but then leave [the new area] after a few years can face political backlash in the form of clawback provisions. "That's part of the political situation, leading to more and more accountability for these programs," Gevertzman says. He predicts that state and city governments will be demanding on a regular basis that companies show they did what they promised to do.

Chicago, Boston, and Albuquerque, among other cities, have clawback provisions, Laudicina says. At the federal level, President Donald Trump has threatened retaliatory action against companies that have accepted tax incentives and later moved jobs abroad.

But there's little doubt states and cities will continue to leave no stone unturned in their courtship of companies. As Gevertzman says, "States are really hungry for money—and that's going to get worse." CFO

Bob Violino is a freelance writer based in Massapequa Park, N.Y.

Let the Fun Begin

Technology is eliminating grunt work and boosting the value of financial planning and analysis. **By Keith Button**

For those involved in financial planning and analysis, the bad news is that the work can be boring much of the time. The good news: It's quickly getting more interesting. ¶ As with many corporate processes, technology is driving fundamental changes in FP&A. Thanks to a new generation of tools, the drudgery factor is lessening and practitioners are spending more of their time doing actual planning and analysis. And that's a fortunate development, not just for FP&A professionals, but also for the companies they work for. In almost every industry, today's souped-up business environment drives a concomitant need for heightened strategic input.

FP&A encompasses a plethora of strategic activities, from budgeting and forecasting to management reporting, business-decision guidance, and specialized tasks in areas like risk management. Unfortunately, as much of 70% of the work still consists of acquiring, verifying, and reconciling data, according to Brian Kalish, an FP&A consultant.

How fast is the change for the better happening? Perhaps not fast enough to satisfy finance departments, but Kalish says that on average finance chiefs are talking about doubling the amount of strategic work for FP&A staffs within five years. "All of that [rote activity] is going to be automated," Kalish says. "Any activity that doesn't improve by a human touching it is going to go away."

That will provide an opportunity for more companies to follow those that have moved away from old-style, static annual planning and migrated toward continuous planning. "CFOs are [increasingly] able to see what's going on in their businesses and their world in real time, and make adjustments [quickly]," Kalish says. "If a CFO can see opportunities faster than others because of the tools he has, or see where problems are going to happen so he can [address them or] get out of the business faster, that's what it's all about."

For example, new FP&A tools allow CFOs to produce what-if balance sheets for multiple scenarios so they can anticipate 6 to 12 months out whether they might miss benchmarks required by debt covenants, says Alan Hart, principal consultant with Pacific Shine Group. But the new automation also goes far beyond that.

As much as 70% of FP&A work still consists of acquiring, verifying, and reconciling data.

In-House or Outsource?

A few years back, many companies, especially large global ones, were increasingly outsourcing transactional FP&A functions. Now those tasks are more often handled with new planning and analysis software that can do the work less expensively and more accurately, notes Punit Bhatia, a Deloitte partner and leader of its business process outsourcing (BPO) practice.

Some Deloitte clients are even finding that the latest FP&A technology can produce more-accurate forecasts than their business-unit managers can, Bhatia says. Indeed, he notes, outsourcing providers are cannibalizing their own businesses by offering their clients robotics software and the related services for setting it up, keeping it going, and jumping in to handle exceptions that the robots can't.

BPO firms traditionally have had human capital–centric service models, but today they have no choice but to raise their games with automation, as that's what companies are looking for. The argument for outsourcing now is that a BPO firm may provide a service for hundreds of companies and also have the latest technologies. Therefore, it may be more efficient than a single company can be, Bhatia says.

But companies are unlikely to outsource their most strategically important planning activities and analyses. "It's quite rare for a client to say, 'I'm going to try outsourcing for the first

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time, and go with FP&A as the first wave.' They'll try it with the more transactional stuff first," Bhatia notes.

For those lower-level tasks that generate the data needed for planning and analysis work, many CFOs and business-unit finance leaders at large companies prefer to tap their internal shared-services organizations. In that scenario, finance has more control over the work and can more easily intervene to fix problems.

The Holy Grail

The big three software vendors in the enterprise planning space—Oracle, SAP, and IBM—have been steadily pumping out new FP&A tools for a few years, as have assorted smaller vendors. Much of this automation is cloud-based and affordable.

"All of a sudden you're able to move to that holy grail, the single version of the truth," Kalish says. "Seeing your actuals in real time, and having built the analytics around it, really helps you identify what data you need to convert into useful information, which then transforms into knowledge, which gives you the ability to make decisions."

There's a night-and-day difference between the FP&A technology available today and that of a few years ago, agrees Gary Rihani, CFO of Lakeview Cheese, a processor and distributor with $100 million in annual revenue.

Rihani is researching enterprise resource planning (ERP) systems, something he also did for his previous employer, Ace Metal Crafts, which completed an ERP installation in 2014. The FP&A options available in new ERP systems are much more robust and easy to navigate, and the interfaces are more user-friendly and attractive, Rihani notes. "The functionality was there before," he says, "but it would take a lot longer to get where you wanted to go than it does now." Rihani expects the improved tools to help him pull up operating figures on a daily or real-time basis to better identify bottlenecks in production or spot cost issues.

Courtesy Kalish Consulting

"Let the people running the business come to you with questions. Don't let them ask you to run every report under the sun."
—Brian Kalish, Kalish Consulting

And once a company has the right tools in place, not only FP&A professionals will be able to devote more time to strategic, value-add activities. "There are lots of little victories for CFOs," says Kalish. "For example, they don't have to spend time arguing about what this or that number means, or if the number is right, or whether everybody is comfortable with the numbers."

Sticking to the Mission

If a task can be moved out of FP&A—to automation, to an outsourcing provider, or to another unit within the company—then it probably shouldn't be considered an FP&A function, according to Kalish. For the most part, that includes any task associated with closing the books, reconciling transactions between business units, or dealing with budget variances.

CFOs should also make sure that generating reports is well down the hierarchy of tasks for FP&A, which better serves the company as a provider of analysis. A drawback of the new tools is that they foster the ability to report information a thousand different ways, and they create a temptation to run reports that demonstrate that ability, notes Kalish.

It's better to instead provide access to FP&A tools to internal business partners, letting them know they can slice and dice information any way they want. "Let the people running the business come to you with questions," Kalish counsels. "Don't let them ask you to run every report under the sun."

Steve Larek, CFO for Clare Holdings, recently implemented a new ERP system for one of the company's businesses, a Chicago-based beer distributorship. A key issue was making sure the finance staff was up to speed on the skills and competencies needed to use the system's FP&A tools—but he then found that he had to restrain them from overusing their new analytical capabilities.

"You can't let the team that's responsible for deploying and using that kind of new product get too far away from the mission," says Larek. "They may like to produce things and play with their new toys."

He had a similar issue

Buy Tech, Be Efficient

The more companies spend on FP&A technology, the less time practitioners have to spend doing "grunt work."

FTE days spent* collecting and manipulating budget data

Tech investment as % of total budget	Mean FTE days	Median FTE days
Less than 10%	384.16	60
10%-19%	153.75	30
20%-49%	62.29	14

* By full time–equivalent employees

Source: Association of Finance Professionals, 2016 survey of 255 FP&A professionals

recently with the finance team for Clare's Caribbean food-distribution business, but in that case the goal was reorganizing and training them to better use their existing analytical tools. "The big thing was making sure they didn't spend too much time and effort refining numbers," Larek says. "They have to take action that steers the next round of analytical effort to come up with answers."

Specifically, he says, he pushed for the team to understand that achieving 98% accuracy within an hour is far more valuable than achieving 100% accuracy within a day or two. The training effort paid off in the aftermath of the two huge September hurricanes, Irma and Maria, that devastated the region. The team pulled together a new consolidated forecast for the business through year-end in two-and-a-half days, which Larek says astounded the company's bankers.

"That business is as fluid and as dynamic right now as it's ever going to be," he notes. "It's been rocked to its foundations, and we need data fast."

What's Next?

In the future, CFOs should expect to find more FP&A applications that take better advantage of the massive amounts of virtually free data that have become available from many sources, Kalish says. It wasn't long ago, he points out, that crunching big data was either physically impossible—finance couldn't get the information—or prohibitively expensive.

Finance chiefs should also look for applications with machine-learning capabilities—where the software gets "smarter" as it observes humans operating it—and even artificial intelligence features. FP&A software vendors are also likely to provide more specific tools that fit the needs of individual companies and that will integrate with other finance systems and software.

"It's hard to imagine there's going to be an FP&A product that covers everything you need soup to nuts," says Kalish. "Instead, the market is going to provide a lot of specialized tools and then build bridges between them." CFO

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

Take the 'F' Out of FP&A?

A purely financial focus leads to damaging short-termism, KPMG says.

Try this on for size: Companies shouldn't even be involved in FP&A. So says KPMG Advisory, which argues in a September report that FP&A should be replaced with BP&A—"business planning and analysis." The idea is to downplay finance's focus on short-term results and shift toward strategies aimed at a longer-run future.

"Financial planning is focused on budgeting and forecasting within a fiscal year, with an emphasis on meeting the quarterly or year-to-go target," KPMG writes. "Functional teams aim to cut costs rather than anticipate upcoming business issues.... Reports, tools, and information are often outdated and not aligned to key business drivers."

In contrast, "a business planning approach incorporates activities from functions that are crucial to moving the business forward—such as sales, marketing, and operational planning—all aligned with the company's strategic vision." Rather than targeting a pure financial valuation, the company integrates key functional areas that directly influence business results.

To be sure, CFOs are looking for new ways to drive growth through their company's business strategy and its performance-planning and management processes, KPMG allows. "When they examine the financial plan, however, all too often they discover that it reflects the numbers executives want to achieve without considering the reality of the changing business landscape," the report says. "Leaders and staff become resigned to a plan they think they have to achieve but see no way of doing so."

That mindset can lead to many challenges, like business leaders making short-term decisions so the numbers work temporarily but in the process creating bigger long-term problems.

A desire to avoid that kind of issue is what's driving leading companies to take a broader, more integrated approach to business planning. There are obstacles to making such a shift, to be sure. But it's worth the effort, as business planning is far more effective than cost management, KPMG says. | DAVID McCANN

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The 2017 *CFO* Commercial Banking Survey

A Question of Trust

After yet another scandal, businesses are placing more emphasis on the trustworthiness of financial institutions.

BY VINCENT RYAN

When one of an industry's largest, reputable providers is found to have deceived—indeed, scammed—its customers, the whole industry suffers.

Commercial banking has had character issues in the wake of the financial crisis, but in 2017 the issue of trust arose once more with the Wells Fargo fake account scandal. The bank's salespeople opened as many as 3.5 million fake bank and credit card accounts, slapping customers with unnecessary fees. The scandal, which goes back years, aroused skepticism about banks and whether they could be trusted: once again, a financial institution had showed disdain for those it purported to serve.

It's not surprising, then, to see the after-effects of the scandal seeping into the results of the fourth annual *CFO* Commercial Banking Survey. Year after year, the survey's respondents have indicated that the secret to being a great commercial bank is customer service, especially at the account manager or relationship manager level. That still matters, but what was more notable this year were the increased importance of "reputation and brand" and "value for fees charged." If there's one thing business executives want, in other words, it's a bank they can have faith in.

The survey, conducted by CFO Research in September and October 2017, garnered 253 responses. Respondents (30% of which were CFOs and 32% CEOs) were asked to score their current commercial banks on strategic partnership, customer relationship, lending/availability of capital, transaction/payments processing, and internal reporting/connectivity.

Generally, executives responding to the survey thought banks were doing a decent, if unspectacular, job. The average overall score for the service attributes listed above was 7.0 on a scale of 1 to 10, down from 7.43 in 2016.

In the individual categories, JPMorgan Chase scored the highest in customer relationship (8.2) and transaction/payments processing (8.5). BB&T was the top scorer in strategic partnership, with a 7.4, and TD Bank tallied the highest for lending/availability of capital, at 7.8. Citibank rounded out the high scorers with a 7.9 for internal reporting/connectivity.

Similar to 2016, about 56% of respondents said they would strongly recommend their commercial bank to another executive. What makes a bank recommendable? Some executives noted global capabilities, technology platforms, and industry knowledge, but those are mostly table stakes. The anecdotal evidence is that what separates the best banks are the personal aspects. One respondent noted that his com-

Mansoreh Motamedi/Moment/Getty Images

A Question of Trust

pany had been with its bank for more than 20 years. “Our relationship managers have met with us and given us the service the bank should,” the executive explained.

Adept problem-solving is another trait of a recommendation-worthy bank. “There are many challenges in day-to-day interactions,” said one executive of the experience with his bank. “But once [problems are] brought up, my branch will step up and make things right.” Said another executive of his financial institution: “They take the time to get to know you as a person and not just a number of the bank. They do all the normal bank things fine; they just go above and beyond to get to know the customer.”

“Above and beyond” was a pervasive theme, and the actions that merit that description ranged from the mundane (“ensuring that employees have access to ATMs with their corporate cards while traveling overseas”) to life-changing. “During a very difficult time in 2004 and again in 2008, the world felt like it was crashing in on us, and the support from our bank was exactly what we needed,” wrote one executive.

Respondents also were asked to rate their overall satisfaction with their existing banks. On a scale of 1 to 100, finance executives that bank with JPMorgan Chase rated it the highest at 82. Citibank earned the second-highest satisfaction score (80.1), followed by PNC Bank (74.4) and TD Bank (72.5). Not surprisingly, Wells Fargo scored the lowest of any systemically important financial institution.

A few smaller banks were rated

Tops in Satisfaction

The top 10 U.S.–chartered commercial banks ranked by perceived customer satisfaction

1. JPMorgan Chase
2. Bank of America
3. Citibank
4. Wells Fargo
5. Capital One
6. PNC Bank
7. U.S. Bank
8. Bank of New York Mellon
9. TD Bank
10. State Street Bank & Trust

Ranking the Banks

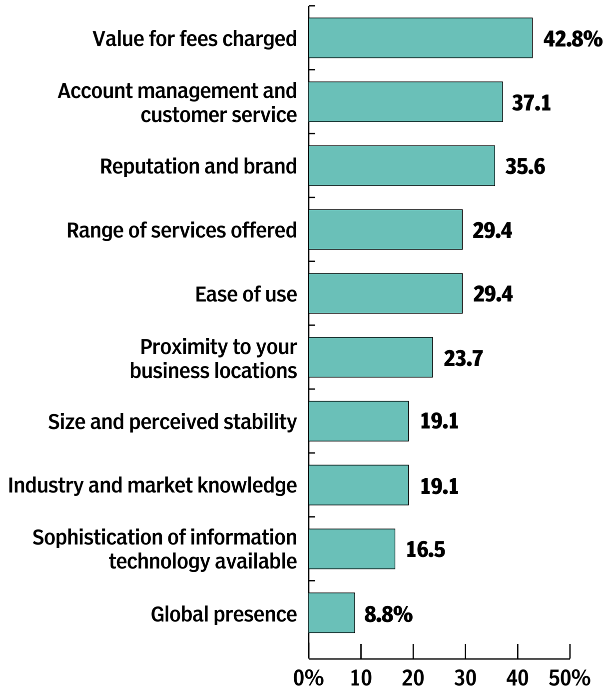
Asked to score their commercial banks on five key service attributes, executives rated these institutions the highest in each category.*

Service attribute	Higest scorers	Bank’s Avg. score
STRATEGIC PARTNERSHIP: Understands my company and industry; helps my company identify and prepare for changes in the business landscape; offers key expertise on critical issues; fills my company’s skills gaps when necessary.	BB&T Citibank JPMorgan Chase	7.4 7.4 7.3
CUSTOMER RELATIONSHIP: Is customer-centric; provides stability via strong relationship manager; is responsive to requests; has strong client service organization.	JPMorgan Chase BB&T PNC Bank	8.2 7.7 7.6
LENDING/AVAILABILITY OF CAPITAL: Offers favorable rates/terms; offers a range of lending solutions; offers custom lending solutions; assists with regulatory requirements.	TD Bank JPMorgan Chase Citibank	7.8 7.7 7.3
TRANSACTION/PAYMENTS PROCESSING: Provides fast, accurate, efficient services; delivers strong value for fees charged; supports new technologies; offers full range of transaction services.	JPMorgan Chase PNC Bank Citibank	8.5 8.2 7.5
INTERNAL REPORTING/CONNECTIVITY: Integrates with my financial systems; aggregates financial information across my subsidiaries, geographies, and accounts; provides clear and consistent alerts, confirmations, and exception reporting; supports new reporting technologies and customization of reports.	Citibank JPMorgan Chase Bank of America	7.9 7.4 7.1

*Attributes ranked on a scale of 1 to 10, with 1=poor and 10=excellent.

What Customers Value

Which characteristics are most important in choosing a commercial bank?



Multiple responses allowed

very highly on individual service attributes, overall customer satisfaction, or both, but lacked a sufficient number of responses to be named as aggregate higher scorers. They included Frost Bank, Regions Bank, and KeyBank.

Getting Satisfaction

In addition to their own banking relationships, executives were asked to judge which of the largest U.S. commercial banks were best at satisfying customers. From a list of the top 10, measured by consolidated assets, respondents selected the 4 (in order) they would award this status. Then, a weighted scoring system was applied to the survey results to create an overall numerical ranking.

A perception ranking allows the survey to reflect not just first-hand customer experiences, but also the wide range of additional information that business people use to form an impression of a financial institution, whether or not their companies bank there.

In the resulting ranking (see "Tops in Satisfaction," facing page), JPMorgan Chase nabbed the top spot, as it did in 2016, with Bank of America launching over scandal-plagued Wells Fargo to secure second place. Wells Fargo fell two notches, to fourth. Other institutions improving over their 2016 ranking were Capital One, Citibank, and Bank of New York Mellon.

Reputation Resurgent

What qualities are most important when working with a commercial bank? After "value for fees charged" and "account management and customer service," "reputation and brand" now catches a business customer's eye, ahead of both "range of services offered" and "ease of use." There is no substitute for a bank that is trustworthy, it seems. However, trust is not an easy thing for a bank to earn.

The failure of banks to deliver on promises, especially those tied to their willingness to lend, is particularly distasteful to commercial customers. One executive described a bank that expressed a desire for "programmatic growth in balance-sheet lending to help fund [the customer's] growth." After the company switched its accounts, the bank demanded all of the company's no-risk, fee-based business, "while in the same breath saying that they really are only interested in using their balance sheet for portfolio-level transactions."

The experience of other executives, however, proves that financial institutions can be true business partners. One respondent wrote of a bank that "stayed with [his business] during a catastrophic event without calling the loan under the default provision. The bank understood … and did not add to the issues by being nervous nellie pains-in-the-backside," he said.

Hoping for Better?

Where are commercial banking relationships headed? While about 52% of respondents said their organizations' relationships with their commercial banks hadn't changed over the past five years, 22% said those relationships had become "much more" or "somewhat more" difficult. And 20% of respondents said their organizations had added or ended a major commercial banking relationship in the last two years. But some executives appear hopeful that their banks will do better in the next two years, with nearly 24% saying their companies' relationships with their commercial banks would become "somewhat" or "much" easier.

Should companies hold out for a financial institution that can win their trust? Absolutely. But perhaps the best information from survey respondents is that businesses should do their due diligence when selecting a bank, and stick to what they can control.

"As we continue to grow and become more financially sophisticated, we have greater access to partners with improved technology, allowing for greater efficiency," said one executive. Added another: "We have a demonstrated track record of success, and ultimately [now] present our banks with a more attractive risk-adjusted reward profile."

No banker wants to see a creditworthy, profitable customer leave—that's one banking truth businesses can rely on.

Vincent Ryan is editor-in-chief at CFO.

America's Got Talent, But Where Is It?

In the third-quarter Duke/*CFO* Outlook survey, U.S. finance chiefs bemoan the fact that good workers are hard—if not impossible—to find. By Josh Hyatt

As it turns out, predictions that the economic recovery would inevitably draw companies into a fierce tug-of-war for talent were off-base. As far as finance executives are concerned, the hiring process now more closely resembles a scavenger hunt.

That insight into labor market dynamics emerged from the third-quarter results of the Duke University/*CFO* Magazine Global Business Outlook Survey, which drew responses from 850 CFOs.

The results signified only the second time in the survey's 21-year history that U.S. CFOs ranked "attracting and retaining qualified employees" as their top concern. The challenge they identified isn't shiny new, however: the identical issue landed in the top spot in the immediately preceding quarterly survey.

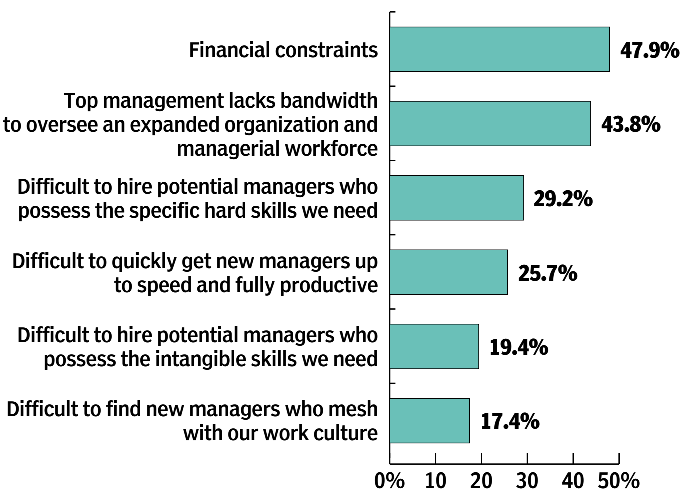
By all indications, the concern isn't likely to be toppled from its prominent perch any time soon. At just a smidge over 4%, the U.S. unemployment rate is the lowest it has been since 2001; economists have declared that the country is slouching toward "full employment," meaning that the rate doesn't have much further to fall.

The tightening labor market is partly due to solid economic growth. It also reflects the fact that an estimated 10,000 baby boomers are leaving the workforce every single day—even better economic news for those who identify as millennials and want to move up the corporate ladder. As the Duke/*CFO* survey results suggested, though, the lingering recruiting and retaining challenge isn't only a reflection of the surging economic cycle. To hire and keep the talent they need, companies also need to address structural hurdles, both internal and external.

Lacking Bandwidth

When lack of management time and expertise prevents pursuit of growth projects, time and money are the biggest obstacles to expanding the management base.

Reasons for not hiring more managers:



Note: Multiple responses allowed

Source: Duke University/*CFO* Magazine Global Business Outlook Survey, Q3 2017

Endangered Species

The shortage of qualified workers, CFOs reported, is reshaping corporate strategy—namely, by inhibiting growth. Among respondents, 89% said they don't expect their companies to be able to pursue the full panoply of value-creating projects they'd like; about half of them cited the inability to hire the employees they need. Especially in short supply, U.S. CFOs said, are the managerial competencies needed to implement ambitious growth initiatives.

Traditionally, of course, companies provided workers with training. But as loyalty has frayed on both ends of the employer-employee relationship, training budgets have waned.

If workers are only planning to stay for about four years (the average tenure in a single job, according to the U.S. Bureau of Labor Statistics), investing in training offers a less-than-tantalizing return on investment. In any case, about a third of the skills that employees of U.S.–based companies will need to maintain their productivity in 2020 will be different from those they now rely on. In some fields, the dwindling ranks of candidates with proven skills may be the result of an educational system that has, for the most part, de-emphasized vocational training and permitted apprenticeship programs to fade. (From a policy perspective, corporations and the government have been locked in a battle over the cost of training, each insisting the other should fund more of it.)

It's little wonder, then, that U.S. CFOs who participated in the survey said the pool of potential managers is shallow: those possessing industry-specific experience and technical knowledge, plus the necessary critical thinking skills for solving complex problems, are in short supply. Even the once-venerable MBA degree is under scrutiny. An understanding of management theory, as helpful as it is, is no substitute for firsthand experience in guiding a company's growth trajectory or modeling a competitive strategy for a fast-changing marketplace.

40%

U.S. CFOs who said the difficulty hiring and retaining IT workers negatively impacts their organizations

Changes in Aptitude

As hard as it is for a company that is looking to scale to find management talent with the requisite skills, survey respondents who said their companies were struggling to hire rank-and-file employees indicated that many job candidates lack even basic writing and math skills—capabilities that serve as a foundation for more-specific skill-building. It's easy to speculate why that would be the case: The alphabet has surrendered share of brain to emojis, with Snapchat and texts having rendered traditional syntax and spelling obsolete.

But the fault may reside with employers as well. During the Great Recession, when companies had their pick of overqualified candidates, they got in the habit of being rigidly selective.

Senior management's hesitancy to expand their workforces to pursue growth projects is also part of the complex story around the struggle to fill the labor gap. In the survey, 27.3% of respondents indicated they weren't hiring more workers to reduce perceived shortages because they didn't know how long they would need the expanded workforce, and it would be costly to cut back headcount later when some workers were no longer needed.

Waging Gracefully

Not surprisingly, hiring employees for the IT department is becoming especially problematic. In the survey, 40% of U.S. respondents said that difficulty hiring and retaining technology workers was having a negative impact, either moderate or substantial, on their organizations. Within the IT function, the shortage was most pronounced in areas such as operations support, innovation and product development support, core functions, and big-data analysis.

The tight labor market does hold some good news for workers and managers in all functions. In part because of the market conditions, many U.S. companies said they expect to raise wages in the next 12 months.

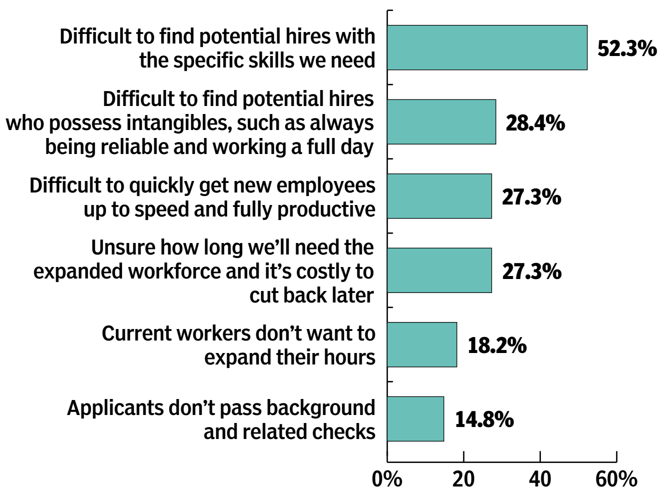
Finance executives who participated in the survey projected average wage growth of about 3%, with the strongest gains occurring in technology, health care, and construction. Workers are learning what makers of popular toys instinctively know how to exploit around the Christmas holidays: There's more money to be made in scarcity.

For individual employers, higher wages will be just the price of admission. Boosting salaries may attract more qualified people to certain roles, but structural issues in the labor market will remain. Hiring the best talent, in other words, will continue to be a struggle. CFO

In Search of Specific Skills

When a nonmanagerial labor shortage prevents pursuit of growth projects, finding candidates with the necessary skills is by far the biggest hiring challenge.

Reasons for not hiring more employees:



Note: Multiple responses allowed

Source: Duke University/*CFO* Magazine Global Business Outlook Survey, Q3 2017

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Meeting Directors' Demands for Information

Many CFOs are failing to deliver mission-critical information and decision-support data to their boards of directors. By Chris Schmidt

Investors, consumers, regulatory bodies, and the media are putting heavy pressure on boards of directors. They are being held accountable for a whole range of strategic missteps, risk management errors, and security flaws. One survey of board members in 2016 found that directors see a disconnect between these high expectations and what they can realistically accomplish in their positions.

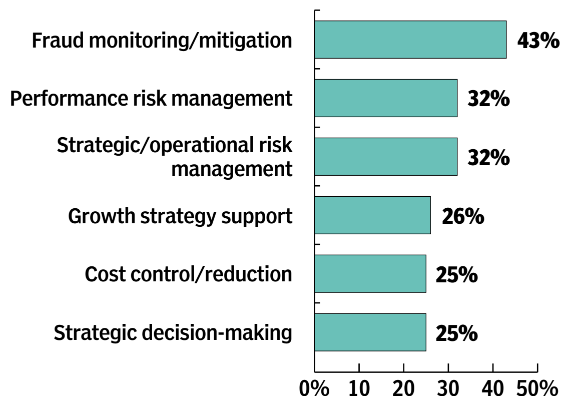
One of the possible reasons boards see limitations on what they can accomplish is that they aren't getting all the information and insights they need to do their jobs. And where does that information need to come from? The chief financial officer.

A new survey from CFO Research, in collaboration with treasury management software provider Kyriba, found that CFOs aren't always delivering the information and decision-support that boards want as they seek to manage burgeoning corporate risks. The survey identified key areas where CFOs need to communicate more effectively, and act more decisively, to help boards protect shareholder value.

Right now, the surveyed finance executives contended, many CFOs are indeed failing to deliver mission-critical information and decision-support data to boards in six key areas, led by fraud monitoring and mitigation, which was cited by 43% of the executives polled. Nearly one third also said CFOs weren't providing valuable support on performance risk management, or on strategic or operational risk management. And one in four said CFOs weren't delivering on growth strategy support, cost control and reduction, and strategic decision-making. (See Figure 1.)

FIGURE 1

In which areas do boards of directors most often fail to receive critical information and decision-support data from the CFO?



Note: Multiple responses allowed

After decades of investing in finance, treasury, and risk management systems, why are some CFOs still not able to meet their boards' expectations for information and insights? The most commonly cited factor by the 167 U.S. senior finance executives surveyed was a suboptimal organizational structure in which different corporate functions and business units are walled off from each other, operating in their own silos. That hindrance was cited by one in every two survey respondents (50%). Other major contributors included a corporate culture that does not promote or facilitate a better relationship between the CFO and the board (41%), a lack of time on the CFO's part (30%), communications issues (29%), and, finally, the composition of the board itself, cited by 27% of respondents.

To their credit, CFOs seemed to have gotten the message that they need to do better in fulfilling the support needs of the board. It's not out of altruism: CFOs jeopardize their own ability to influence the enterprise when they fail to deliver the insights and advice that corporate board members need to make decisions.

A whopping 94% of the survey respondents said their CFO is seeking better ways, and better technologies, to meet demands from the boardroom and the CEO. On the technology front, finance executives said, the specific areas where CFOs need better tools to help boards make better decisions were fraud risk (cited by 34% of respondents), compliance risk (30%), performance risk (30%), and regulatory risk (29%).

Fraud risk is high on boardroom agendas in large part because it remains a stubborn and growing problem. Many companies have embraced a broad range of fraud-fighting tools and strategies, including user authentication processes, use of electronic payments rather than vulnerable paper checks, and daily reconciliations. However, the incidence of fraud shows no signs of diminishing.

Indeed, the survey found that 4 in 10 (40%) finance executives said their industries were experiencing higher rates of payments fraud than they did two years ago. Only 16% of survey respondents strongly agreed that the finance teams in their industry had strong-enough processes and technologies in place to capably and efficiently detect fraud.

94%

Senior finance executives who say finance is seeking better ways to meet information demands from the boardroom and CEO

Given that a big part of corporate treasury's role is safeguarding corporate cash, it's not surprising that this focus on payments fraud interests the board. The treasury functions most important to boards, the survey found, were cash and liquidity management and forecasting (cited by 66%); risk management, as it related to all risks (46%); and financial transactions, including debt, investment, and foreign exchange (46%).

The Board Partnership

Most directors today expect to have a close, direct working relationship with the CFO. The good news from the survey was that a strong majority of survey respondents (94%) said their CFO was perceived by their board as a critical, strategic business partner.

Asked to identify in which areas CFOs can deliver the most value for the board and the CEO, the finance chiefs responding to the survey chose managing business planning and continuity (cited by 52%), managing financial risk to prevent loss (51%), reducing costs and improving margins (43%), helping unlock working capital to spur growth (37%), and ensuring regulatory compliance (30%).

Asked to identify the areas where it was most important that boards receive critical information and decision-support data from the CFO, a majority of respondents cited both budgeting and forecasting and strategic decision-making, followed by cost control and cost reduction. (See Figure 2.)

The finance executives polled by CFO Research said that, apart from acquiring better technology, CFOs can take additional measures to make that technology, and the insights it can help provide, more useful to corporate directors and CEOs.

For starters, said one finance leader, CFOs should establish a consistent way of providing information to boards so that board members aren't continually forced to learn new ways of seeing things. "Put together a standardized set of metrics and formats of financial data that you share with the board of directors at every meeting," the executive suggested. "Don't make them try to understand new formats all the time."

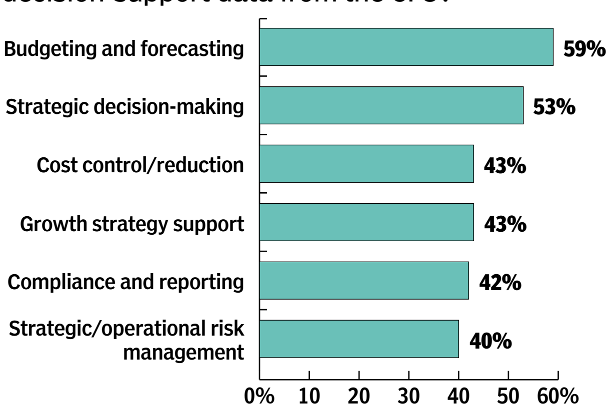
CFOs also can hone their own listening skills. "Learn what matters to [directors] by listening first, and then tailoring the message accordingly," one survey respondent wrote. Along those same lines, another respondent encouraged CFOs to have an "honest give-and-take with [directors] on what current technology can provide, versus what information is desired by the board of directors."

Another finance leader cautioned CFOs against falling into the trap of "prettying up" reports to the extent that boards don't get the full story that the data has to tell them—even if that story isn't always upbeat. "Find ways to eliminate manipulation," this executive said. "Providing information directly from the systems, without the opportunity for teams to 'clean it up,' is critical."

Notwithstanding these comments, CFOs should continue to look for ways to improve how they present data to their CEOs and the boards. There's a big difference between "cleaning up" data so that the bad news is hidden and presenting data in a clear, easy-to-follow, and, ideally, interactive format. That's becoming all the more important now that big data and advanced data analytics create the potential for decision-makers to be inundated with information. Fortunately, new data visualization and business intelligence tools can be invaluable for CFOs looking to provide guidance. CFO

FIGURE 2

In which areas is it most important for boards to receive critical information and decision-support data from the CFO?



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Tax, As It Was

In discussions of the likelihood that federal tax reform will be enacted this year or in 2018, it's often pointed out that it has been 31 years since the last reform effort became law. While the Tax Reform Act of 1986 is viewed by some as a starting point for this year's effort, the times have changed considerably. What do you recall about the 1986 act?

1 Which member of Congress introduced the act in the House of Representatives?

A. Tip O'Neill
B. Jim Wright
C. Dan Rostenkowski
D. Tom Foley

2 Members of Congress are seeking to lower the maximum corporate tax rate from 35% to 20%. What maximum corporate tax-rate cut did the 1986 law establish?

A. From 46% to 34%
B. From 56% to 40%
C. From 30% to 18%
D. From 40% to 25%

3 What reduction of the top individual tax rate on ordinary income did the 1986 law enact?

A. From 65% to 30%
B. From 58% to 35%
C. From 50% to 28%
D. From 40% to 20%

4 The 1986 act sought to achieve revenue neutrality by shifting a large dollar amount of the tax burden from individuals to corporations. What was the dollar amount?

A. $72 billion
B. $12 billion
C. $35 billion
D. $24 billion

5 The act also sought to achieve revenue neutrality by offsetting tax cuts for individuals by eliminating loopholes in the U.S. tax code. What was the dollar amount of annual tax loopholes cut by the act?

A. $110 billion
B. $60 billion
C. $80 billion
D. $40 billion

6 From what percentage to what percentage did the 1986 act reduce the amount of income tax liability that could be offset by the business tax credit?

A. From 85% to 75%
B. From 100% to 80%
C. From $50% to 35%
D. From 80% to 70%

7 At what percentage did the act set the maximum tax rate on capital gains realized by a corporation?

A. 28%
B. 34%
C. 38%
D. 24%

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

Sources: Congress.gov, Encyclopedia.com, *The New York Times*