CFO

NOVEMBER/DECEMBER 2018
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CLOUD ERP: TIME TO SWITCH?

LAST-MINUTE LEASE ACCOUNTING

BREAKING BAD

Investors and the public will no longer tolerate personal misconduct by executives. Now, boards have to do the same.

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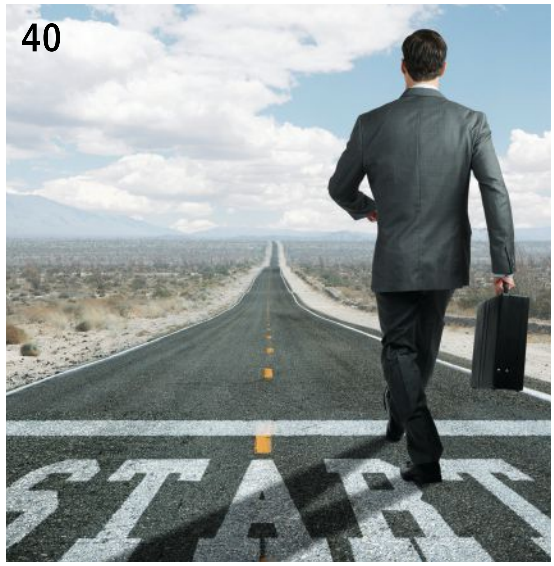

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Cover: Getty Images; this page, Getty Images (3)

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Up Front

By the Numbers

Getty Images (4)

FROM THE EDITOR

Good Behavior Is Good Business

Is a society healthier when almost every confrontation between two individuals gets filmed and then posted on the Internet for all to consume and either deride or applaud? I don't know. But we're past the point of any return, so, we have to adapt to a new level of transparency for all kinds of behavior, in the workplace and outside of it.

As our cover story explains, for denizens of the C-suite this is a sea-change. CEOs used to have to pen a racist editorial in *The New York Times* to destroy their careers; now, all it takes is a lewd comment on a semi-public conference call. Of course, some CEOs who have been caught in the #MeToo crossfire of late have done much worse, and they deserved to be outed. "Boards must have zero tolerance when it comes to issues like sexual harassment," says one CFO in our cover story, "Breaking Bad," on page 28.

Some might question, however, whether all this examination of corporate behavior is doing any good. In my opinion, if disrespectful, rude executives that emotionally torture their employees get their comeuppance, that's a positive.

I don't expect CEOs and CFOs to be saints and live up to some exalted standard of moral conduct. We tried that with sports stars; it didn't work. But I think treating employees disrespectfully is at the root of more severe examples of poor judgment. A culture in which top management says it's OK to berate an employee in front of a roomful of people or to fire direct reports regularly so as not to look "soft" is an invitation to more severe behavior, like sexual harassment.

More, practically, it's not good for the bottom line. The humble leaders are the ones who bring out the best in people. Empathetic CEOs, for example, more deeply appreciate employees' need to engage in meaningful work and they value their contributions more fully. And that aligns exactly with what the younger generations in today's workforce want.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

FINANCE
Conference season is coming to an end, but there are still plenty of CFO webcasts on tap in December. Topics include The Real Value of RPA, Scenario Planning Best Practices, and Five Questions Every CFO Should Be Asking Their Controller. Access those webcasts and more on CFO.com.

PODCAST
James Altucher's interviewees always have nuggets of sage business advice. In a November discussion with Howard Marks, the co-founder of Oaktree Capital, Altucher explores the definition of success, "second-level thinking," and why taking risks requires thought. See more on Altucher's website.

BEST PRACTICES
Tempted to launch a "signature" initiative? Think twice. Many companies suffer from "initiative overload," according to consultants from Genesis Advisers. These pet projects often leave lower level workers dealing with more projects at a time than they can handle. Read more on the Harvard Business Review website.

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Mark Bennington

A Better Benefits Experience

By Ramona Dzinkowski

What does it take to be a valuable partner in the group life and disability insurance markets? Success is about a lot more than just a solid balance sheet.

Today, serving businesses and their employees is about transforming the benefits experience. It's about making information accessible, from the point of sale through the claims process, and offering CFOs a better way to manage their risks. And it's about staying ahead of the trends to drive efficiencies and deliver services the way customers demand.

The Hartford's Group Benefits' commitment to transform the industry and simplify the claims process for customers, as well as ease benefits administration for employers, was demonstrated in November 2017, when it acquired Aetna's U.S. Group Life and Disability business. The transaction not only turned The Hartford into the second-largest group life and disability insurer, but it also bolstered The Hartford's distribution strategy and enhanced its capabilities in predictive analytics.

With the acquisition, The Hartford gained industry-leading digital capabilities and the technology to develop an integrated absence management platform—The Hartford's Ability Advantage. This platform provides a single portal that facilitates disability and leave-of-absence benefits administration for employers while offering claimants a simple, personalized method of getting claims handled.

Features such as text, email, or click-to-chat give customers the ability to stay up to date on their benefits activity and connect with their insurer the way they want to. Employees can manage their claims activity, set account preferences, and schedule a call with a claims representative.

For employers, examining the spectrum of employee absences helps them understand how absence affects their workforce's productivity. Employers can also track compliance with complex, ever-changing absence laws and policies; realize claims management efficiencies through greater automation; generate real-time, summary trend reports; and manage accounts through robust web portal and mobile capabilities.

> **"It's our belief that by focusing on people's abilities—and not their perceived limitations—we can help them return to active, productive lives following an illness or injury."**
>
> –Mike Concannon, Executive Vice President, Group Benefits, The Hartford

The Hartford's claims organization also has the capability to tap into its powerful data and advanced analytics platforms to see patterns that can be turned into actionable steps to help claimants recovering from an illness or injury. By mining its data, The Hartford is improving outcomes for employees, such as pinpointing and helping claimants address bio-psychosocial factors that can affect claim durations.

"This capability underpins a customer-centric approach to wellness and recovery, or our Ability Philosophy," explains Mike Concannon, Executive Vice President, Group Benefits.

The Hartford's industry-leading clinical claims model provides employees with compassionate care backed by one of the largest predictive analytic engines in the industry, to help them return to work efficiently and safely. But The Hartford takes things a step further.

"It's our belief that by focusing on people's abilities—and not their perceived limitations—we can help them return to active, productive lives following an illness or injury. We match this belief," Concannon adds, "with a passion for transforming how our customers experience the investments we're making in technology, products, and service that now protect the lives of more than 20 million people." [1]

Along with its Ability Philosophy, The Hartford has a mission to help employers and employees understand the value of income protection. The high cost of healthcare and rising deductibles have left employers looking for ways to provide more comprehensive benefits packages that fill medical coverage gaps. Employers see group benefits (i.e., short- and long-term disability, life insurance, and voluntary benefits) as a way to address employee needs, offer choice, and allow employees to personalize their coverage.

Group benefits also enable employers to attract the best candidates in a competitive jobs market. Employers today need a partner dedicated to helping them attract, retain, and protect employees with a portfolio of industry-leading benefits. As the number two group life and disability provider[2] and the number two workers' compensation carrier[3], The Hartford is uniquely positioned to accomplish just that.

Ramona Dzinkowski is a business journalist and president of RND Research Group.

[1] Based on The Hartford's internal reporting as of December 2017 combined with the Aetna acquisition.
[2] LIMRA Group Disability sales and inforce, Q2 2018.
[3] 2016 A.M. Best data based on direct written premium

WE BELIEVE THAT WHEN YOU TRANSFORM THE BENEFITS EXPERIENCE, YOU TRANSFORM LIVES FOR THE BETTER.

Our passion for transforming lives is exemplified by our unwavering commitment to making it happen. Through constant investments in technology, products and service we're helping more people live active, productive lives.

BETTER CUSTOMER OUTCOMES Our patented clinical claims model provides compassionate care backed by predictive analytics to help employees return to work efficiently and safely.

NEXT GENERATION TECHNOLOGY The Hartford's Ability Advantage platform helps manage claims, leaves and benefits administration in a single portal, offering employers and employees a simple customer experience.

PRODUCTS FOR TODAY'S WORKFORCE Our suite of top-rated life, disability, integrated absence and voluntary solutions offer the right mix for a competitive employee benefits package.

PARTNER OF CHOICE Based on recent research, 9 in 10 employers are likely to renew their benefits with The Hartford[1] – now protecting the lives of more than 20 million people[2].

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THE HARTFORD

Hospital Indemnity

Accident

Critical Illness

AD&D

Disability

Life

[1] 2018 Employer Advocacy Study, The Hartford.
[2] Based on The Hartford's internal reporting as of December 2017 combined with the Aetna acquisition.

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INBOX

In **"Accountants Protecting Their Turf,"** MIT professor Robert Pozen criticized a group of accountants who oppose the AICPA's recent expansion of its Accredited in Business Valuation (ABV) designation to include non-accountants.

"Do appraisers of business assets have to be accountants?" Pozen wrote. "To most CFOs, the answer would be no." The greater good, he argued, is to make more qualified appraisers available to businesses needing valuations.

One audience member begged to differ: "There are already two other organizations that certify valuators. **The AICPA's move is all about gaining a whole new segment of prospective members."**

He added, "The current ABV credential holders oppose it because the requirement to be a CPA is a market differentiator when they are trying to sell their services. Does it make them any better at performing valuations? No. But eliminating the requirement removes a certain cachet to being an ABV."

In **"Why CFOs Shouldn't Come From Public Accounting,"** consultant and former finance chief Danny Severns proposed that a CFO's primary responsibility should be making sure the company is adequately financed. Therefore, he opined, CFOs should come from the treasury function or investment banking.

Another ex-CFO disagreed. "At private companies, the CFO must be expert in accounting, as the financing is usually limited to banks or private investors, both of whom need accurate reporting, which the CFO needs to pitch on behalf of the company.

"At a public company," he continued, "a CPA is at a disadvantage only to someone with experience in investment banking. And **after the first time through, the curtain is easily slid back from this mystery."**

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1. Paid/requested outside-county mail subscriptions stated on Form 3541	92,723	90,989
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4. Other classes mailed through USPS	0	0
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H. Total	100,451	99,026
I. Percent paid and/or requested circulation	92.75%	92.56%
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C. Total requested copy distribution + requested/paid electronic copies	147,007	143,681
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STATS OF THE MONTH

CROSS-BORDER M&A

7%
Quarterly increase in inbound North American deal value*

-14%
Decline in outbound North American deal value

$81 billion
Total value of inbound deals, Western Europe

107%
Increase in outbound deals, Asia-Pacific

$31 billion
Outbound deals from Asia-Pacific targeting U.S. assets

* All data is for cross-border deal activity for the third quarter of 2018. Source: Hogan Lovells Deal Dynamics

TOPLINE

HEALTH BENEFITS

Will Insurer-PBM Deals Affect Health Costs?

It may take a while, but the recent combinations could meaningfully mitigate employer spending. By David McCann

The ongoing consolidation of the health-care industry may ultimately affect group health-care costs, but how is unclear.

Companies, for their part, appear to be skeptical that the cost outcome will be positive. But some key observers smell the potential for game-changing efficiencies in the delivery of medical services and drugs—over the long term, at least.

No one is expecting big changes soon, following the Justice Department's October approval of CVS Health's $69 million purchase of Aetna. That federal green-light followed another one in September for Cigna's purchase of Express Scripts, a leading pharmacy benefits manager (PBM) and CVS's primary competitor in the PBM business.

"From the surveys we've done, employers think these deals [may affect] their overall health ecosystems," says Tucker Sharp, global chief broking officer for Aon Health Solutions. "But they're not building that into any budgets, even for the long term. They're going to be watching to see what happens."

That could change, though.

Most consolidations in the health-care space in recent years have been horizontal—for example, health-care systems buying other health-care providers to gain scale and leverage over suppliers.

However, the two major deals approved this fall are vertical in nature, with two of the three largest U.S. health insurers joining with the two largest PBMs.

The combination of CVS and Aetna is particularly intriguing. According to CVS, 82% of Americans live within 10 miles of one of its retail locations.

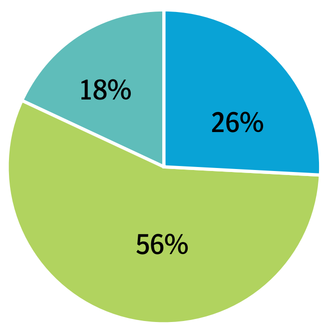
So, a big payday could come from the combined company creating health-care clinics at retail locations. To make it work, there would have to be incentives—in cost, quality, convenience, or some combination—for people to use the clinics instead of traditional medical providers.

But how much will that change people's behavior? "It's an interesting bet CVS is making," Sharp observes.

The potential implications of the deals go

Employers Weigh In

About a quarter of 420 surveyed employers think mergers of health plan providers and pharmacy benefits managers will lower health-care costs or improve quality of care.



- Optimistic that mergers will lower costs, and improve quality and the consumer experience
- Skeptical that mergers will lower costs, and improve quality and the consumer experience
- Mergers are a defensive move; this kind of integration will lead to increased costs

Source: National Business Group on Health far beyond retail health-care delivery, however. The game-changer could be the opportunity for health insurers and PBMs to finally start sharing information.

"A PBM is focused on managing an employer's drug spend, without regard for the total cost of care," notes Brian Marcotte, CEO of the National Business Group on Health (NBGH), a coalition of some 420 large employers. "But it's very possible for an increase in pharmacy spend to lower the employer's total cost of care."

How so? When pharmacy costs are managed in a silo, the PBM might leave a high-cost drug—that could, for example, allow optimal management of a potentially costly chronic condition—off a health plan's drug formulary.

"If that drug is able to manage that condition to the extent where someone is not going to the hospital, the overall costs for that person's care may be less," Marcotte points out.

"It's very possible for an increase in pharmacy spend to lower the employer's total cost of care."
—Brian Marcotte, CEO, NBGH

Treating chronic conditions is costly, to say the least. Eighty-six percent of the nation's $2.7 trillion in annual health-care expenditures are for people with such illnesses, according to the National Center for Chronic Disease Prevention.

Additional advantages from these health-care tie-ups could come from integrating medical and pharmacy data and bringing transparency to the point of prescription-writing. "That could allow a physician to understand the full price of the drug, the patient's obligation, and the efficacy of that drug vs. others," Marcotte says.

To be sure, several pieces must fall into place for his vision of a more efficient health-care system to materialize.

For one, Marcotte said, the pharmaceutical supply-chain model is "broken" and must be fixed. In addition, progress must be made in evolving to new physician-reimbursement and service-delivery models. CFO

FRAUD

Email Scammers Trip Up Finance

Accounting controls fail to prevent public companies from losses to fraud.

In an investigative report designed to highlight the need to beef up internal accounting controls to protect against fraud, the Securities and Exchange Commission found that the finance departments of public companies continue to fall prey to relatively unsophisticated cyber-scams.

The report was based on the SEC enforcement division's investigation of nine public companies that were victims of business email compromises (BECs). The companies wired a total of nearly $100 million, most of it unrecoverable, as a result of the frauds.

The BECs that the SEC studied broke down into two kinds: faked emails from executives and faked emails from vendors. In the first kind, fraudsters used spoofed email domains and addresses of executives (typically CEOs) so that it appeared, at least superficially, as if the emails were legitimate. The spoofed emails directed finance personnel to work with a purported outside attorney identified in the email, who then directed the companies' finance personnel to execute large wire transfers to foreign bank accounts.

In the second, slightly more sophisticated kind of BEC, fraudsters hacked the email accounts of companies' vendors and then inserted illegitimate requests for payments (and payment processing details) into electronic communications for otherwise legitimate transaction requests.

"The perpetrators also corresponded with unwitting issuer personnel responsible for procuring goods from the vendors so that they could gain access to information about actual purchase orders and invoices," the SEC said. "The perpetrators then requested that the issuer personnel initiate changes to the vendors' banking information, and attached doctored invoices reflecting the new, fraudulent account information."

Why did these scams succeed? The SEC pointed out that "systems of internal accounting controls, by their nature, depend also on the personnel that implement, maintain, and follow them."

In the cases studies, employees did not completely understand the company's existing controls or did not recognize indications in the emailed instructions that the communications weren't reliable, the SEC said. | VINCENT RYAN

Getty Images (2)

A Powerful Player In Wind Energy

By Bob Violino

Renewable energy projects used to be a luxury only the largest companies could afford. In the last five years, however, as costs have fallen and “going green” has climbed to the top of boards’ agendas, organizations of all sizes are placing greater emphasis on sustainable business practices.

Enter Xcel Energy, a utility that offers a comprehensive approach to powering business customers by leveraging energy efficiency incentives with renewable options.

The Minneapolis-based company serves businesses in multiple U.S. states (Colorado, Michigan, Minnesota, New Mexico, North Dakota, South Dakota, Texas, and Wisconsin) and is the number one utility wind energy provider in the nation. Today, wind power is the most competitively priced technology in most markets, according to Frost & Sullivan, as improvements in wind turbine technologies, power electronics, and management systems accelerate its adoption.

Xcel Energy invests in wind infrastructure through its “steel for fuel” strategy. The program replaces fossil fuel plants with wind turbines and solar energy systems. Xcel Energy plans to add 3,700 megawatts of wind capacity to its energy grid through 2021, bringing the total to 11,000 megawatts—enough carbon-free energy to power nearly 5.5 million homes.

The Cleanest Option

Xcel Energy uses sophisticated wind forecasting tools to predict the availability of wind generation and to power down fossil fuel plants on windy days. That saves customers tens of millions of dollars in fuel costs each year.

“We’re taking advantage of the rich wind resources right in our backyard to deliver the clean energy options our customers want,” says Brett Carter, Executive Vice President and Chief Customer and Innovation Officer at Xcel Energy. “Many businesses and communities are seeking renewable energy sources to meet their sustainable energy needs, and we have the ability to offer up to 100% carbon-free energy to our customers.”

> **“We have the ability to offer up to 100% carbon-free energy to our customers.”**
>
> -Brett Carter, Chief Customer and Innovation Officer, Xcel Energy

One such customer is cosmetics maker Aveda. Aveda is a pioneer in environmental responsibility, powering its entire company with 100% wind energy and also funding projects, schools, and technologies to advance the wind industry. The company favors wind energy because it doesn’t produce any air emissions and it doesn’t require water for production.

Aveda purchases WindSource from Xcel Energy, which is generated from 21 wind farms in Minnesota and helps increase the amount of wind energy available on the grid. Through the purchase of wind power and greenhouse gas emission offsets, Aveda covers the manufacture, transport, and use of 94% of its products.

Seeing Ahead

If Xcel Energy merely delivered energy, it would be just another utility. Instead, the company is also assisting clients in successfully expanding and relocating their businesses in an energy-efficient way.

Xcel Energy can increase speed-to-market with an inventory of document-ready certified sites in the eight states it serves. Each of the sites has gone through a robust certification process to ensure that it’s ready for development. The certified site program supports the company’s mission to grow jobs and increase capital investment in communities.

Xcel Energy is also preparing for a more diverse future in renewable sources. The company sees solar as the next opportunity to help meet its clean energy goals. Carter says, “We want to take advantage of the steady improvement in solar technology, particularly in utility-scale installments."

The expansion of climate-friendly energy sources is a necessity. More CFOs are becoming aware of the economic advantages of renewable energy, in whatever form it takes, and are committing their organizations to the transition.

They are “recognizing the risk in the literally sunk costs of investment in fossil reserves and the opportunity to invest in non-fossil energy sources,” says Neil Donahue, an engineering and public policy professor at Carnegie Mellon University.

Through procurement and investment decisions, the private sector is increasingly playing a role in driving the deployment of renewable energy, says María Mistrorigo Benintende, a senior industry analyst at Frost & Sullivan. In other words, Xcel Energy provides business customers low-cost, long-term ways of generating electricity reliably and, at the same time, helps them become a key part of the worldwide push for sustainability solutions.

Bob Violino is a regular CFO *contributor..*

GOVERNANCE

Boards Get Social

With the population growing more polarized around political and social issues, boards of directors are sharpening their focus on them as well.

PricewaterhouseCoopers asked 717 directors about the extent to which they think their company should take various social issues like human rights, income inequality, and health-care availability into account when forming company strategy.

With respect to health-care availability and cost, 36% answered "very much," a rise of eight percentage points from last year's annual director survey by PwC. Similar leaps in prominence applied to several other societal problems (see chart).

Whether these trends will continue to deepen likely will depend on shifts in public sentiment going forward. So far, directors who strongly favor taking them into account during strategy formulation are in the minority.

"Many directors are still neutral or don't think these issues should factor into strategy discussions," PwC noted in its survey report, adding that nearly one-third (29%) of those surveyed say "shareholders pay too much attention to them."

Boards are also taking a harder look at corporate culture, a likely response to the #MeToo movement and cases of companies defrauding clients.

Surveyed directors overwhelmingly (87%) agreed that corporate culture problems often start with the tone set by the executive team. But 79% of them said culture issues are also growing out of the tone set by middle management.

Some directors said their companies have improved employee training about culture issues, according to the survey. Still, only 17% say they have revised compensation plans, even though 67% say those plans can drive bad behavior. | D.M.

Should Social Issues Impact Strategy?*

The percentage of directors that thought scarcity of natural resources should be considered rose 10 points.

	2018	2017
Health care availability/cost	36%	28%
Resource scarcity	31%	21%
Human rights	28%	20%
Income inequality	15%	8%

Source: PricewaterhouseCoopers 2018 Annual Corporate Directors Survey

*Percentages reflect directors who agreed "very much" that an issue should be taken into account when formulating strategy.

BANKING

Streamlining Trade Finance

Seven global banking giants have teamed up to form a network aimed at speeding up the digitization of traditionally paper-based trade finance.

The banks—ANZ, Banco Santander, BNP Paribas, Citi, Deutsche Bank, HSBC, and Standard Chartered—said their "Trade Information Network" would "address the unmet demand for financing earlier in the supply chain by enabling corporates to easily and securely communicate trade information directly with banks of their choice."

Global trade finance, which allows importers to buy exported goods before delivery using documents such as letters of credit, amounts to more than $9 trillion a year.

But the industry is heavily paper-based and has been challenged by falling revenues—despite high commodity prices—as compliance and fraud risks rise.

The banks said the network could finance a "significant" part of the $1.5 trillion annual demand for trade finance from small and mid-size companies that is currently not met by the industry due to higher costs and risks.

The global trade finance gap is estimated to grow to $2.4 trillion by 2025, reflecting the massive volume of paper required for communication between customs brokers, freight forwarders, transportation carriers, government agencies, and banks.

According to the World Economic Forum, the cost-to-income ratio for banks in traditional trade finance is between 50% and 60%, meaning more than half of the price goes toward operational expenses. | MATTHEW HELLER

Getty Images (2)


90,000 square foot newly renovated plant.
14 overhead bridge cranes.
9 supervisors overseeing production.
1 productive manufacturer.
BETTER UNDERSTOOD

COMPENSATION

Gender Bias Skews Pay

A massive six-year study by the ADP Research Institute confirms that women, on average, are paid substantially less than men.

The research tracked the compensation of approximately 11,000 people who were hired into exempt salaried positions during the third quarter of 2010 and worked continuously for the same company through 2016.

At the outset of the study period, women's average base salary was 82% that of men's. Thereafter, the average annual growth in base compensation was marginally higher for women. But at the end of the study period, there was still a 15% salary gap.

The key differentiator: more women were hired into lower-paying jobs. In the $20,000 to $40,000 salary range, 121 women were hired for every 100 men. In the $40,000 to $60,000 range, an equal proportion of men and women were hired.

For higher-paying positions, far more men were hired than women. In the highest-salary category, $150,000 and up, only 44 women were hired for every 100 men.

In fact, despite marginally better annual salary hikes for women, in total compensation women actually ended up further behind, at 81% of what men made. That's because women's average ratio of bonus to base pay was only 83% that of men's.

"It seems that once an employee starts with a lower salary, it becomes an insurmountable obstacle to cross," the study report says.

Authors of the study didn't mince words in stating why women are paid less. The disparity is "likely to represent some form of systemic gender bias in the workplace that may occur due to recruitment, promotion, performance review, or pay practices," they write.

Unequal pay is a significant social issue, of course. But, the study notes, employers also should address it in order to mitigate the risk of legal problems or negative publicity. | D.M.

INVESTOR RELATIONS

Less Say for Proxy Advisers

The Securities and Exchange Commission has rescinded two guidance letters from 2004, a move that may reduce the influence proxy advisers have on say-on-pay and other shareholder votes.

The guidance letters informed investment management firms that outsourcing their proxy-voting decisions to proxy advisers would satisfy their fiduciary obligations, while avoiding potential conflicts of interest with regard to companies whose funds they manage.

For example, if an investment manager (like Vanguard) has proxies to vote on behalf of a company that's in one of its index funds, and also manages that company's pension fund, it could conceivably be influenced to vote with management, points out compensation and governance consultancy Farient Advisors.

By essentially delegating to proxy advisers the votes on its shares in that company, the investment manager would be "cleansed" of potential allegations of conflict, based on the 2004 letters.

"Critics of the SEC guidance letters argue that they effectively institutionalized proxy advisory firms, especially [Institutional Shareholder Services], as de facto regulators without the oversight required of actual regulators," Farient says. "The critics also contend that overreliance on such firms may not be in investors' best interests."

ISS's business model is arguably built on regulatory requirements, especially the SEC's 2003 rule mandating that investment managers disclose their proxy voting policies (and votes) and the 2010 Dodd-Frank Act, which mandated say-on-pay.

Many of the larger institutional investors have built internal governance expertise to guide voting decisions, using ISS data to help them screen companies to target. Smaller funds have generally found it more cost effective to essentially outsource their votes to ISS, according to Farient. | D.M.

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M&A

Dark Cloud Over Deals

Are M&A trends heading in a disturbing direction for buyers?

First, acquisition multiples have been hitting record highs each year, according to a report from The Boston Consulting Group (BCG). The median transaction multiple in 2017 was 14.2 times EBITDA. That was a 4.6% hike from 2016 and in line with the average annual increase of 5% since 2009.

Perhaps to justify the rising cost of deals, acquiring companies are making increasingly bold projections about the financial benefits—or "synergy value"—of business combinations.

BCG examined the 100 largest public-to-public deals by corporate non-financial buyers for each of the past 10 years. Synergy estimates were announced for roughly half of them.

A new high average synergy estimate has been established each year since 2013, reaching 2.1% of combined sales in 2017. "Synergies have [historically] almost always served to augment the case for an acquisition," BCG wrote. "In the current environment, they move to center stage, becoming the 'make-or-break' element of the buy-side case."

For the average deal in the sample, the climb in announced synergy value over the past several years translates into an increase in the targeted "synergy run rate" for pretax operating income of more than $200 million a year, the report states.

Are such rosy projections plausible, considering the bulging library of research showing that most M&A deals fail to achieve expected synergies or boost shareholder value?

Actually, markets generally welcome synergy announcements, BCG noted. Among the studied deals, they are associated with cumulative annual return (CAR)—the difference between the expected and actual returns on a security—of 0.1% during the three days before and after a deal announcement. Other deals averaged -0.9% CAR. | D.M.

Beware 'Mental Momentum'

Internal resistance to change—or "mental momentum"—prevents management from properly responding to downturns. By Tim Raiswell and Fredrik Hedlund

Imagine a company on the sunny side of the revenue curve. In its growth phase, the company is run by its owners—the people with the original idea for creating a uniquely valuable product or service. ¶ These visionaries make all the decisions; their mental bandwidth is allocated to evangelizing the product to an expanding customer base and dreaming up the next big product idea.

The last thing on their minds is effective budgeting or cost allocation—yet those are exactly the kinds of things that will help the company navigate its way through an economic downturn, which surely will arrive at some point.

As the company climbs the revenue curve, it needs a larger base of technicians and salespeople to continue to grow and realize its promises to shareholders. Collective decision rights are disaggregated, and, in the frenzy of high growth, profitable decisions are matched by unprofitable ones.

Once the company has reached the revenue curve's summit and sales growth slows to the single digits, things change. The management team's mental bandwidth is reallocated to business profitability concerns, shared-service arrangements, cost reduction, and frugal investment to restart growth.

But there are holdouts in the ranks. This isn't the way value is created, they say. The team knows its customers better than anyone. Cost reductions will only hurt the customer experience.

What keeps the CFO awake at night is not what needs to be accomplished to restore the faith of investors, but rather how to convince management that the business is different now and that these changes all need to happen immediately.

And there is no time when addressing that challenge is more important than during an economic downturn. CFOs can significantly boost their company's chances of success if they can counter the "mental momentum" problem—the internal resistance to change that prevents companies from responding to new market economics.

Below are several financial management strategies for use before, during, and after a downturn to counter inertia in the management ranks and guide a company to income growth.

Sensing a Recession

The problem of mental momentum is best solved before a downturn begins. The CFO can adopt two approaches to help sense weak performance trends and accelerate the company's timely response.

One is to arrive at a general theory of value creation for the company. This theory is a holistic view of how financial value is created—from meeting customer needs to growth in free cash flow. Once this theory exists and the CFO tests it, performance anomalies can be addressed quickly.

CFOs must be able to adjust their mental model quickly to the economic reality of a downturn, because the timing of decisions and actions becomes more important. Financial strategy, for example, is compressed into a much smaller time-window.

The second sensing technique is to make sales and cost forecasting a more useful exercise by adding an analytical layer that captures what is helping the business meet—or preventing it from meeting—its targets. The company should adopt a forecasting approach that captures emerging headwinds and tailwinds to performance.

Responding to a Recession

The CFO's role in investor communication during a recession is to guar-

Getty Images


Innovation,
Expertise,
Collaboration.

antee that the investor relations team grasps the changing business economics. The finance chief also must ensure that key messages from the financial value framework are disclosed in the company's investor messaging.

His or her theory of financial value creation acts as a filter for information to share internally and externally as market conditions change.

In addition, boards of directors require more frequent updates on financial performance during periods of instability. Staying focused on the elements of business economics that matter helps the board understand performance dynamics and relay better advice to management.

Cost Management

Cost reduction is the most prevalent strategy that management teams pursue at the bottom of a business cycle. Depending on how well executives have forecast the timing and severity of the downturn, cost reductions may be mild (hiring freezes, travel and entertainment limits) or structural, cutting into business capacity.

Fredrik Hedlund

Cost management can be simplified to two management competencies:

- Knowing where costs exist within the corporation
- Having a framework that distinguishes good (revenue- and efficiency-driving) costs from bad ones

Without good data and a reliable system generating it, it's hard to define critical relationships between cost categories and other performance variables like revenues. As such, a CFO's first order of business is to fix the underlying data problem and to identify how well current data and reporting structures answer the following questions:

- How well can financial and non-financial managers access cost data?
- How reliable and timely is the data?
- How easily can the data be manipulated to answer questions?
- How easily can the data be combined with non-cost data to answer analytical questions, such as which costs are strong leading predictors of sales or income growth?

Recovery Preparation

The CFO's goal with business-cycle management is to be one step ahead of the business, asking what might prevent successful execution in the next phase of the cycle.

In some cases, a fast return to standard practice—like growth investment—is well-advised, especially if competitors remain committed to a conservative approach.

Tim Raiswell

But in other areas, like cost management, the CFO may have used the recession to accomplish a much-needed adjustment to management's mindset about running the business efficiently.

In that case, returning to a system where costs increase at a set ratio to sales makes little sense.

To effectively assess costs, pricing, working capital, and growth investments, CFOs should rely on the business cycle management tools discussed above: the general theory of performance and an accompanying business forecast process that shows emerging risks to the organization's effective performance.

The former gives CFOs the confidence to draw conclusions about why business performance is or isn't tracking as anticipated. The latter allows CFOs to cover more ground as performance issues emerge—more ground than they would be able to with only backward-looking financials.

"The CFO's goal with business-cycle management is to be one step ahead of the business, asking what might prevent successful execution in the next phase of the cycle."

Economic Vigilance

All executives will face a downturn in the business cycle at some point in their careers.

In the downturn, the CFO must communicate changing business economics to the board and investors. If cost cutting becomes necessary, the finance chief should also own the categorization of business areas into those that will see the most stringent cuts and those that will need the headroom to grow.

Once the recovery phase emerges, CFOs should then transition their role to one of intense financial discipline, using what has been learned about the customer, the competitors, and the business during the downturn.

Not all austerity plans should be reversed. Some growth investments and overhead expenses will need to be reintroduced rapidly and aggressively, while some business areas will need to remain lean in the long term.

Management shouldn't exist in a constant state of anxiety about the business cycle. But economic vigilance should be a core competency of all those involved in performance management, from the CEO down to business-unit analysts.

Tim Raiswell is a vice president of research for Gartner. Fredrik Hedlund is CFO of Nielsen Holdings' global markets group.

Courtesy of the companies

How to Avoid Making Costly Bad Hires

Place less emphasis on experience, standardize interviews, and, if you do make a mistake, undo it fast.

The fact that a bad hire is a costly mistake isn't news. It's a well-known truth that hiring mistakes reverberate across an organization.

Unfortunately, in the current full-employment U.S. economy, where competition for top candidates is stiff, many companies struggle to find talent and are more likely to make hiring mistakes.

For those who need a refresher course, why are bad hires so costly? First, there are bottom-line costs like the employee's compensation. There's the lost investment in recruiting and training. And, in some cases, there's severance.

But bad hires also disrupt the organization and damage morale, reducing employee productivity and creating even more human resources headaches in the process.

Diminished customer satisfaction, work quality, and business reputation can also end up costing the company more money over the long term than would the immediate cost of replacing a bad hire.

One source calculates that when all such factors are totaled up, mistakenly hiring a manager with a $68,000 salary can cost more than 10 times that amount if the person is terminated within two-and-a-half years of hiring.

Effective hiring managers understand that having the best available pool of applicants for every open position is essential for finding the right hire. They employ solid recruiting processes and consistently optimize and re-optimize those processes to ensure the talent pipeline remains full.

So, what can companies do in a sellers' market? It all starts with smart recruitment. Here are some tips for employers looking to stay competitive while recruiting in a hot job market.

Recruit for skill, not experience. While some positions may require certain technical skills or certifications, employers can improve résumé flow and connect with higher-quality candidates by thinking more expansively about hiring.

Transferable skills like leadership, communication, resilience, and problem-solving are often far better predictors of future success than work experience. Recruit for competency, rather than pedigree or even degree.

In addition, rethink the way technologies like applicant tracking systems are used. They can give undue preference and higher visibility to candidates with ultra-specific skill and experience requirements.

Finally, consider training and onboarding part of the recruitment process. Train the right candidate rather than hire the wrong-but-experienced candidate. Or partner with a third-party provider or intermediary that provides the training, like some staffing companies are beginning to do.

Standardize the interview process. According to Brandon Hall Group, 69% of companies identify their interview process as the most important factor in quality of hire. Companies that lack a standard process are five times more likely to make a bad hire.

Clarify what should be covered at each stage of the process: screening interviews, first interviews, second interviews, peer interviews, and final interviews. Providing interviewers with a checklist of questions helps improve consistency and outcomes. Unless you're asking candidates the same questions, how can you properly compare them?

Cut bait on bad hires. When mistakes begin to surface, find another position in the organization that is a better fit for the individual, or cut ties altogether.

Whatever the solution, act fast. It's human nature to delay, defer, and rationalize second chances. Identify hiring mistakes and correct them before they begin to negatively impact the entire organization.

Importantly, don't punish good employees for bad hires. It's often your top performers who end up overworked and burned out from picking up the bad hire's slack, contributing to unwanted turnover.

Marshal resources and get help. Prioritize recruitment efforts. From employer branding to developing an effective interview process to crafting the right onboarding, a lot goes into recruiting. But it's worth the effort. Your company's performance is directly correlated to the talent and productivity of your employees, as well as your company culture and morale.

The current hiring climate is extremely challenging for all industries and companies. Investing in and committing to recruitment best practices will reduce the risk and cost of bad hires and pay dividends for years to come. After all, as Ross Perot once said, "Leaders don't flock; you have to find them one at a time." | BRIAN WEED

Brian Weed is CEO of Avenica, a career matchmaking firm specializing in placing recent college graduates.

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STRATEGY

Why Transition to a Subscription Business?

Predictable recurring revenue, easier borrowing, and strong cash flow are just some of the benefits. By Robbie Kellman Baxter and Daniel McCarthy

Most finance chiefs are probably already aware that subscription business models are highly valued by Wall Street. ¶ According to Zuora's Subscription Economy Index, subscription-based businesses are growing revenue nine times faster than the S&P 500. Some of the largest IPOs in the past year or so have been for subscription-based businesses: ADT, DocuSign, Domo, Dropbox, MongoDB, and Spotify, to name a few.

As has been widely covered, subscription businesses generate recurring revenue, which is more predictable and more durable. That makes the revenue easier to borrow against. The CFO of a subscription business also enjoys an enviable cash-flow position. Such businesses often get paid in advance for a year's worth or more of goods and services.

These businesses also foster more loyalty with customers. Interactions are more relational and less transactional because the organization is incentivized to form long-term relationships, not just look for the next sale.

How does a CFO and the rest of the executive team evaluate whether getting into the subscription business could be good for their company? They must weigh all the potential benefits against the potential risks and the things that will need to change along the way to make the transition successful.

The Advantages

One is data. A subscription business is typically able to collect more data about its customers because of the contractual nature of the customer relationship. That supercharges the company's ability to tag and track customer behavior and engagement.

It also allows the company to more efficiently develop and improve products and services and anticipate when a customer might cancel or upgrade.

Top-tier academics have been pushing the boundaries of what strategic insights can be learned about subscribers through data. The following are two notable recent examples.

"Customer-based corporate valuation" (CBCV) is an emerging, award-winning valuation framework popularized by Daniel McCarthy and Peter Fader, professors of marketing at Emory's Goizueta Business School and the Wharton School, respectively.

CBCV is a method through which a company can project its future revenue and profit (and thus valuation) more accurately by using five customer-based drivers. Those drivers are customer acquisition, retention, order rate, basket size, and cost to serve the customer.

This method greatly enhances the ability to evaluate new initiatives as well as benchmark performance over time. It also provides a shareholder value-focused accountability mechanism for the subscription company's chief marketing officer.

Second, an academic study co-authored by Raghuram Iyengar, another professor of marketing at Wharton, found that subscription programs are more effective with customers that make higher initial purchases than those that make lower initial purchases. That suggests subscription membership programs will be more successful if tailored toward big buyers.

Tough to Swallow?

Although the payoff for subscription transformations is big, there is a likely short-term cost: a dip in revenue.

Getty Images

Robbie Baxter

Daniel McCarthy

Thomas Lah and J.B. Wood refer to this transformation as "swallowing the fish" in their book, "Technology-as-a-Service Playbook: How to Grow a Profitable Subscription Business." They call it that because the revenue curve dips below operating expenses before operating expenses decline and revenue increases.

It can be hard to swallow that fish, especially for the board of directors and shareholders, so it is crucial that they understand this process and have the right expectations.

The change must also be clearly and effectively communicated to the investment community, so that their expectations are calibrated as well. Without the support of shareholders, it will be difficult to make the investments required for the transition to be successful.

Many CFOs are blinded by the power of the model; they fail to first check whether their company can create subscriber value to justify the recurring fees. Others are nervous about leaving short-term revenue on the table by switching to a model that depends on the long term.

The hardest part is changing the culture. Every role in the organization will have to change, not just finance.

Change Top to Bottom

There's no way around it: the company will have to be customer-centric, not product-centric. Transformation must occur in every area, including but not limited to the following:

Product. The product team must focus on customer needs instead of just building cool things. That might mean spending less time optimizing the engine and more designing the cup holders. While it might be less sexy to the engineers, it will be more sexy to customers (and, in turn, shareholders).

Marketing. The marketing team will need to spend more time communicating with existing customers, to encourage behaviors that will result in greater engagement.

In the "membership economy," the moment of transaction is the starting line, not the finish line. Also, marketing will have to invest more in market analysis to understand the most promising target audience, to identify lookalikes, and to help onboard new subscribers.

Support. The company might need to transition resources from customer support into customer success. Customer support solves problems as they arise, when customers call to complain. Customer success is about proactively reaching out to make sure customers are happy and engaged.

Sales. The role of sales becomes easier as word-of-mouth and viral outreach replace the sales pitch, and compensation might become tied to not just the transaction but to retention.

"Many CFOs are blinded by the power of the model; they fail to first check whether their company can create subscriber value to justify the recurring fees."

The biggest challenge is cultural—how the whole team will work together to optimize customer lifetime value. It's not enough for marketing to acquire new customers if those customers won't stay and pay. Finance and marketing will need to coordinate with the sales and product teams, which will need to look to the customer success team for feedback on how satisfied customers actually are.

In turn, the customer success team must listen to the marketing analytics/data science team to glean insights into what subscribers value and the correlates of customer churn.

Ultimately, a subscription is just a pricing decision, not a strategy. The leadership team needs to have a strategy that works equally well for the company and the subscriber. Otherwise, it won't work.

Getting Started

At some point, you'll have to rip off the band-aid. If you try to time a transformation perfectly, you will probably miss your chance.

Balancing the potential loss of short-term transactional revenue with long-term subscription revenue requires a very clear vision of who the membership will serve and what the nature of the "forever" promise will be. That promise is a commitment to handle something for the customer forever—continuously innovating, repackaging, and evolving to make sure the company is providing the best solution.

Build out that vision, from both the customer's and the company's perspectives, and describe the value for each. It's not enough to say, "We're moving to subscription because it's good for the company." Even with a vision, transforming to a membership model is tricky. Start with a big vision and a small test of the first step to see if what is envisioned is possible.

Once the company has proven some of the key elements of its big membership vision and is ready to scale subscriptions across the organization (if that's the intent), remember that getting the strategy right is the easy part. The hard part is changing the culture. CFO

Robbie Kellman Baxter is the founder of consulting firm Peninsula Strategies. Daniel McCarthy is an assistant professor of marketing at Goizueta Business School and founder of Theta Equity Partners.

Courtesy of the authors

CAPITAL MARKETS

Private CFOs in the Public Eye

The rise of "crossover investors"—institutions that fund private start-ups—blurs the line between public and private status. By Jeff Majtyka and Willa McManmon

In 1996, more than 7,400 companies were listed on the major U.S. stock exchanges; today the number is less than half of that. There are many reasons for the decline, but among the more consequential is the emergence of crossover investing. ¶ Crossovers are traditional institutional investors that also invest in private start-ups. Their growing interest in accessing pre-public equity is fostering a new "gray market" that blurs the line between public and private status.

To a degree, the private markets are cannibalizing the public markets. Today there are more than 300 private companies valued at $1 billion or more—the "unicorns"—and in many cases their cap tables now often feature mutual and hedge funds alongside the traditional venture capital players.

With access to a broader pool of capital, these companies are able to extend their maturity periods outside the scrutiny of the Securities and Exchange Commission and public markets. Indeed, we have seen a significant lengthening of the pre-initial-public-offering incubation period, from about five years in 2014 to nearly eight-and-a-half in 2017.

Traditional investors are creating crossover funds to access private companies, trading off the risks of an illiquid investment in a less-mature company.

Of course, the VC community is built to assume those risks. But institutional investors often hold smaller stakes and no board seats, leaving them to grapple with how to access information and build the influence with management that better enables them to evaluate their investments.

And that evaluation is crucial to the

crossover investors themselves, given that institutions must mark the value of their private investments at regular intervals. That effectively creates a quasi-public valuation benchmark that can impair market perception of a company, not to mention affect the next capital raise.

Street-Conscious

The inter-relationship of information and valuation is the realm of investor relations. For traditional private companies, however, IR is a capability often not prioritized until close to, or after, the clock starts on an IPO.

Private-company CFOs with crossover investors, especially those with prior public-company experience, increasingly appreciate the need to build IR muscle earlier. The trick is balancing the value in gaining access to Wall Street money and relationships, which can add buzz and pay valuation dividends at IPO time, with the obvious benefits of maturing in private.

Crossover investors tell us they appreciate that they'll be getting limited information. But at the same time, they say, many start-ups lack basic skills and an understanding of how to shape their narratives and communicate effectively with non-VC investors. They worry that if a portfolio company does not hone these skills it will lead to missed opportunities and problems that can surface later during an IPO or in the aftermarket.

As advisers who have worked on all sides of this dialogue, we believe gray-market companies need to be thinking earlier about how to work effectively with Wall Street. They have an opportunity to gain valuable insights that can accelerate their maturity and make them smarter and better-informed competitors, ultimately strengthening the IPO story.

On the flip side, getting investor communication wrong can impact Wall Street's early impressions of a company, leading to unfavorable comparisons to better-prepared peers. That can impact valuation.

Getty Images

Jeff Majtyka

Willa McManmon

As the gray market evolves, and especially if private-market valuations lose some of their frothiness, CFOs will see the pressure from Wall Street ratchet up. While investing too much, too soon in IR isn't optimal, private companies with crossover investors should be accelerating their focus, at least into the 18-to-24-month window ahead of a potential IPO.

Some Pointers

Optimize the company's narrative. Stories aren't sold to portfolio managers (PMs) the same way they're sold to VCs. PMs want to know not just the problem you solve, but a crisp three-to-five-year investment thesis that will ultimately win in the public markets. Having a simple story tuned to a professional investor's way of thinking can pay dividends in your next round and later in your IPO.

Start earlier on defining key performance indicators. With Wall Street investors come disclosure decisions. CFOs traditionally don't focus on selecting metrics to disclose publicly until a short time before the IPO decision. In the crossover world that discussion needs to begin sooner.

Choosing the right KPIs and total-available-market definitions separates the wheat from the chaff.

Don't wait too long to build a quarterly reporting function. Too often private companies start reporting quarterly only when they have to, either because the cap table has expanded and investors demand it, or because the company has raised a bond or other security that may require it.

But quarterly reports are about much more than nettlesome disclosure; they're also about creating a disciplined process that helps the finance team mature and provides experience in thinking on one's feet with sophisticated investors. It's a function that is vital to ultimate public-market success, and it takes time and repetition to perfect.

Build your Wall Street credibility, stealthily but purposefully. While performance counts above all else, messaging and relationships play a big role in pursuit of a premium valuation.

Successful private companies often boast premium valuations, but carrying those into the public markets is by no means assured. Building constructive and informed relationships with opinion leaders on the Street builds future investor confidence, which impacts valuation.

CFOs we talk to often speak of "optionality"—believing an IPO will come later, but being ready to flip a switch if the board decides otherwise. Understanding and communicating effectively with new crossover investors will play an increasingly vital role in creating that optionality. CFO

Jeff Majtyka is the founder and president of Ellipsis, an investor relations and strategic communications firm. Willa McManmon is the firm's West Coast managing director.

New Foreign Investment Hurdles

National security fears drove the temporary regs.

The U.S. Treasury Department in October issued new temporary regulations on foreign investments in U.S. companies that will give the government more power to block transactions on national security grounds.

Under the rules, foreign investors must alert a Treasury-led interagency committee to all deals that would give the foreign investors access to critical technology in one of 27 industries, including semiconductors, telecommunications, and defense. Those industries were picked because a strategically motivated foreign investment could pose a threat to America's "technological superiority and national security," Treasury said.

The regulations were established under the Foreign Investment Risk Review Modernization Act, which passed in August and is to be fully implemented by February 2020. The law does not single out China, but it's seen as a slap at the regime in Beijing, which has been accused of using such tactics to steal American intellectual property.

The regulations were scheduled to begin on Nov. 10. The requirements do not apply to any transaction completed prior to that date, or any transaction for which the material terms were established prior to October 11.

In March 2018, President Trump blocked Broadcom's proposed $117 billion takeover of Qualcomm, citing national security. Broadcom had been a U.S. company until 2016, when it was acquired by Singapore-based Avago. It redomiciled to the United States in April of this year. | WILLIAM SPROUSE

Top: Courtesy of the authors; Bottom: Getty Images

Strategic Risk-Taking:

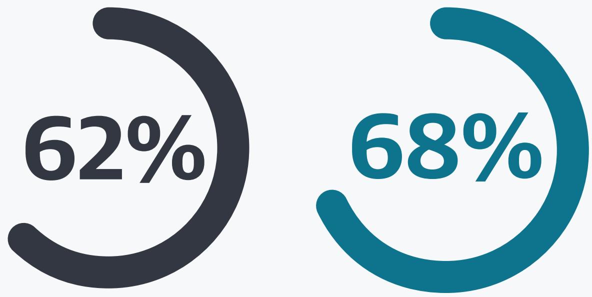
How Insurance Helps Businesses Stay Agile

Business leaders know that their companies need to take smart risks in order to grow and compete in the new economy. But what obstacles prevent them from taking strategic risks? And which tools support them? Liberty Mutual and CFO Research conducted a survey of 152 C-suite executives at companies with $25 million or more in revenue from a wide range of industries to find out.

To Stay Competitive, Businesses Must Take Risk

In a rapidly changing marketplace where new technology, regulations, and startups cause industry disruptions on a daily basis, business leaders know that strategic risk is a key to staying competitive.

Percentage of business leaders who agree or strongly agree



Significant risk is necessary to stay competitive.

Managing risk is critical to hitting revenue targets.

Obstacles Impede Strategic Risk-Taking

Although they know that strategic risk is important, only a little more than half of leaders say their businesses are taking the risks they need to maximize business results.

59%

Percentage of business leaders who say their business is taking necessary strategic risks.

Factors preventing companies from taking strategic risks

Insurance Is Key to Business Success

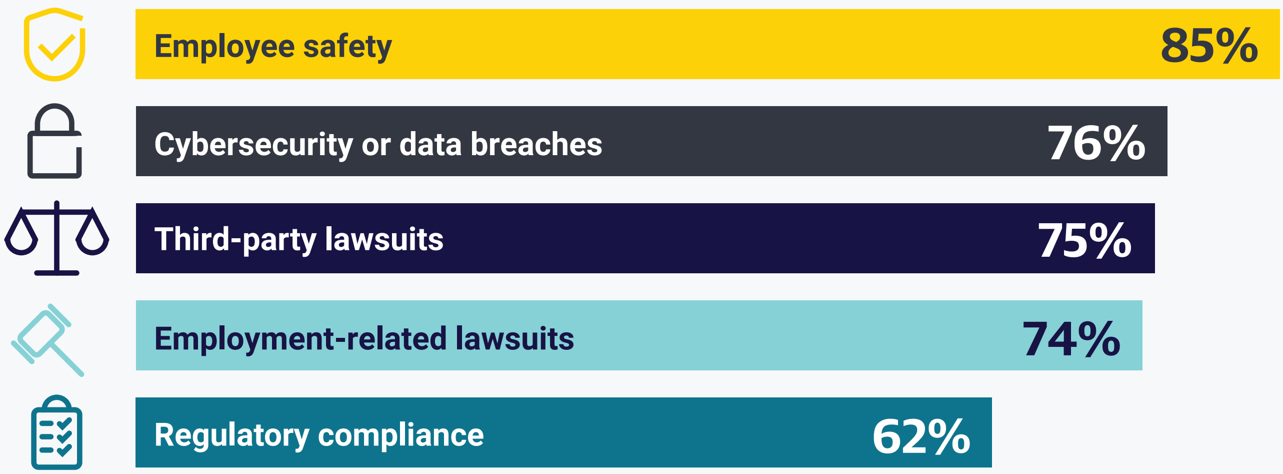
For business leaders, insurance is a key tool in the strategic-risk toolkit. Respondents report that having the right insurance program mitigates risk, bolsters business value, and helps them achieve business objectives.

Percentage of business leaders who agree or strongly agree

56% agree that the ROI on insurance programs helps achieve business goals.

68% agree that insurance mitigates risk, reduces volatility in earnings, and boosts business value.

Top 5 areas where insurance helps business leaders mitigate risk



Risk Management Enables Agility

As a business leader, you know that taking strategic risk is a crucial part of staying agile. But your ability to make decisions and respond to industry change can be hampered if you don't feel fully protected. For more information on risk management and further results from this survey, visit lmi.co/CFO-risk.

Liberty Mutual INSURANCE

CFO

Breaking BAD

Investors and the public will no longer tolerate personal misconduct by executives.

Now, boards have to do the same.

Not every day does the CEO of a large public company contentedly smoke marijuana on a podcast (which was also recorded on video), shortly after tweeting he has secured funding to take the business private, blindsiding the board of directors. But this is Elon Musk after all, the Johnny Depp of CEOs.

Musk took Tesla's institutional investors, shareholders, employees, and customers on quite a hair-raising ride in the second half of 2018. His abrupt tweet about having secured funding to take the company private culminated in a decision by the Securities and Exchange Commission to strip away his chairmanship, fine him and Tesla $20 million each, and mandate the appointment of an independent chairman and two independent board directors to oversee his communications.

The swashbuckling billionaire CEO isn't the only person running a public company whose bizarre or inappropriate actions have been in the spotlight. Much worse than Musk's cryptic tweets are accusations of sexual harassment against 273 business, media, and broadcasting executives, according to Temin and Company's #MeToo Index. Among them are former CEOs Leslie Moonves (CBS) and Steve Wynn (Wynn Resorts).

In this age of 24/7 social media feeds, chief executives and other high-ranking corporate officers—the public faces of their companies—have never been more public. Careless comments, thoughtless actions, and criminal conduct go viral quicker than you can say "resignation," damaging a company's reputation and all the businesses and people that rely on the organization for their livelihoods.

"Today, a CEO of a large company gets out of bed and walks across the street and it's public information," says Stephen Kasnet, vice chair and lead director of the board at both Granite Point Mortgage Trust and Two Harbors Investment. "It's so easy for others to know what they're doing and thinking."

Some CEOs curry the attention. Nothing wrong with that if their statements and deeds enhance their organization's long-term financial performance and their social media quips don't violate securities laws governing material misstatements. The ability to transform a CEO's fame into corporate and product brand-building is a positive, but there is a downside if their fame is used carelessly or inappropriately. A CEO's (or any other corporate officer's) unguarded comments or conduct can unmoor the corporate ship and attract government investigators.

BY RUSS BANHAM

Getty Images

They can also affect how people within the organization treat their subordinates. "The CEO sets the tone and the culture of the organization; if they raise their voices, use profanity, or express certain beliefs, others in the company may infer these behaviors and beliefs are OK," says Ron Shah, CFO of Hodges-Mace, a provider of employee benefits services.

All of those alarming possibilities are putting institutional investors on guard. "Executive misconduct is a really big focus this proxy season, especially in relation to the #MeToo movement and issues surrounding human capital management," says Courteney Keatinge, director of environmental, social, and governance research at proxy advisory firm Glass Lewis & Co. "Corporate culture and governance are at the top of the list of investor concerns for boards to supervise."

Big Mouths

Is executive misbehavior new? To be fair, today's captains of industry are not much different from their peers of yesteryear. When they're used to people hanging on their every utterance, some CEOs become imperious know-it-alls. Take Henry Ford, founder and president of Ford Motor. In the 1920s, Ford fumed about a "Jewish conspiracy" in a series of op-eds in his hometown newspaper, the Dearborn Independent. The series' title said it all: "The International Jew: The World's Problem."

Bear in mind that Ford, a brilliant mechanic and businessman, dropped out of high school after ninth grade to work on the family farm. His geopolitical expertise was formative, at best. [*Editor's note*: Russ Banham is the author of the book, "The Ford Century."] Ford's fulminations ended when Jews boycotted the company's motorcars. With sales slumping, he retracted his anti-Semitic comments.

In the decades that followed, most CEOs kept their opinions to themselves. If they exhibited certain behaviors like

"Combine a smart guy with a huge ego and give them a bully pulpit, and at the end of the day their ego can destroy the organization."

—Stephen Kasnet, vice chair of the board, Two Harbors Investment

using profanity or drinking to excess during their two-martini lunches, they had enough power over employees' careers and means of support to keep them quiet. And what happened in the office tended to stay in the office. Apple co-founder and CEO Steve Jobs is remembered for his sharp outbursts nearly as much as his visionary ideas. But as Jobs' biographer, Walter Isaacson, wrote, many years later, there was the "good Steve" and the "bad Steve."

Even in the era of the personal computer's invention, a video recorder wasn't in the hands of every consumer to document boorish acts, and the Internet wasn't around to disseminate sordid video clips instantly. No longer is this the case.

Travis Kalanick, the founder and former CEO of Uber, allegedly tolerated a workplace culture that included sexual harassment and discrimination. He also famously berated an Uber driver from the back seat of the driver's car while the dashboard camera filmed the flareup. The ill-fated trip was the last straw for shareholders, who mounted a successful revolt to remove Kalanick as chief executive.

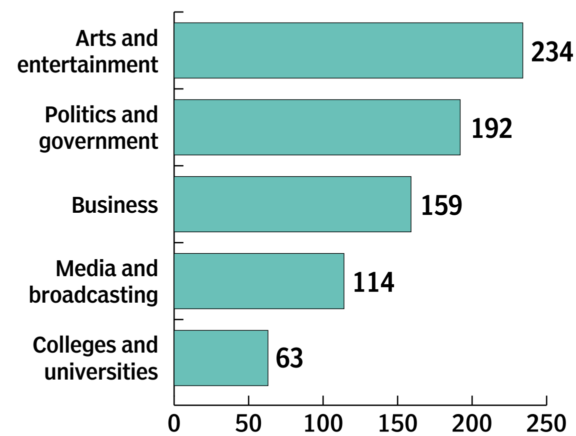
If YouTube and other video-sharing sites aren't pushing transparency enough, anonymous employee feedback sites like Glassdoor and Indeed provide an anonymous forum for people to lift the veil on their bosses' transgressions. A recent exposé published on LinkedIn, for instance, disclosed the conduct of the CEO of a Seattle-based government agency, who "looked women up and down" and pitched temper tantrums, on one occasion kicking an office chair across the room.

Cult of Celebrity

Many companies have made great strides in setting employee conduct policies, and at large multinationals these highly designed, magazine-like doc-

#MeToo Unearths Bad Behaviors

High-profile allegations of sexual harassment, sexual assault, rape, workplace misconduct, and other related behaviors have mushroomed. They are occurring across many sectors of society.*



*Number of allegations, December 15, 2017, to October 3, 2018.
Source: Temin and Company #MeToo Index

Photo courtesy of the company

BAD ACTORS

Left to right: Bad boy Musk; Uber's Travis Kalanick caught on camera; sexual abuse accusations dog Les Moonves; Google kept Andy Rubin's behavior quiet; a racial slur tarnished Papa John's John Schnatter.

uments can run 30 to 40 pages, even guiding workers about what to do in sticky situations. (The Starbucks code of conduct tells baristas how to handle an inappropriate email from a co-worker.) Presumably, these codes of conduct apply to everyone from the CEO on down.

But in many organizations, the rules are elastic when it comes to the head honcho. The problem is that many boards hire CEOs who, by nature, are overconfident individuals. Smart CEOs say dumb things for a variety of reasons, chief among them raging overconfidence. When the weighty crown of celebrity is placed upon such big heads, it creates a compulsion to engage followers on social media with the brilliance of their beliefs on most every subject.

"Combine a smart guy with a huge ego and give them a bully pulpit, and at the end of the day their ego can destroy the organization," says Kasnet. "The more power someone gets, the more it justifies their 'genius.'"

Musk apparently was given leeway to do whatever he wanted by his handpicked board because of his wildly creative and obsessive ways. "Most CEOs filmed smoking pot in an interview would be gone the next day," says Stephen Horowitz, CFO of CareCentrix, a national provider of post-acute home-care services.

But even smoking marijuana on a podcast seems to pale in comparison with the flood of sexual harassment accusations being levied at CEOs and other corporate executives. In those cases, directors can no longer look the other way.

"There cannot be a double standard just because it's the CEO," says Peter Cappelli, the George W. Taylor Professor of Management at The Wharton School. "Nobody should be let off the hook for something like sexual harassment. This is what organizational culture is all about. People are watching to see who gets punished and who gets rewarded."

Others share his perspective. "Boards must have zero tolerance when it comes to issues like sexual harassment," says Ken Stillwell, CFO of Pega, a provider of customer-engagement software. "I don't care if the person is the world's best CEO; you can't barter away sexual harassment without compromising your integrity. Some things are non-negotiable."

Boards that fail in this regard have only themselves to blame. "An organization's reputational risk is a pressing governance challenge, yet few boards give it the attention it deserves," says Chuck Saia, CEO of Deloitte risk and financial advisory and previously the firm's chief risk, reputation, and crisis officer. "It's not hard for the board to sit down with the CEO to document the organization's shared beliefs. What's harder is to ensure the CEO lives by them and is held accountable for them."

"It's not hard for the board to sit down with the CEO to document the organization's shared beliefs. What's harder is to ensure the CEO lives by them."

—Chuck Saia, CEO, Deloitte risk and financial advisory

Ego Management

To be fair, many CEOs are aware of the impact their words carry. "When I communicate, I always do my best to exercise caution," says Therese Tucker, founder and CEO of publicly traded BlackLine, a provider of finance and accounting software. She takes this responsibility to heart. "Words are so powerful. How something is phrased can come across in ways that the speaker or writer did not intend."

Indeed, many corporate officers lead their organizations

Photo credits: YouTube (2), Getty, Wikipedia, Papa John's

with humility and empathy. According to psychological studies, humble CEOs are more self-aware of their strengths and limitations and are more open to others' ideas. Research also indicates that empathetic CEOs more deeply appreciate employees' need to engage in meaningful work and value their contributions more fully.

So, is there a way to balance the visionary genius of a Jobs, Kalanick, or Elon Musk with their eccentricities? Certainly, directors should not stifle a CEO's creative impulses, despite their seeming eccentricity. But there are ways to keep these rogue entrepreneurs in check. Sensitivity training—making people more aware of behaviors that may inadvertently cause offense to others—is a good start. At the very least, it might guide CEOs to curate what they say before they say it.

Some CEO behaviors and comments can be partly chalked up to youthful immaturity—the case with such wunderkinds as Bill Gates, Jobs, Marc Zuckerberg, and Musk, all of them business founders and CEOs in their 20s. A young business leader with a big ego is bound to push the limits of respectability. "Some CEOs gain credibility by being the 'wild one,' which fits the brand of the company they're leading," says Tucker. "That's OK, as long as the company has a set of values everyone [including the CEO] ascribes to—values like treating all people fairly and giving them the opportunity to bring their authentic selves to work."

Bosses who fail to follow these behavioral standards may be outed, whatever their age. But Saia says companies can also build their own anonymous feedback sites to ferret out indications of a problem before it blows up into a scandal. He also advises the use of real-time technology tools that take the pulse of a company's reputation.

"Using machine learning, data analytics, and image-recognition software, you can ferret out and monitor what people are saying about your products, services, and work-

"No CEO is irreplaceable. To underline this fact, always have a succession plan in place for the person's immediate replacement if need dictates."

—Sheila Hooda, CEO, Alpha Advisory Partners

Out of Office

Workers' off-duty acts may be protected by state laws.

In this hyperpolitical, tense social climate, it's not just CEOs whose actions are under a microscope. Many workers, professional and otherwise, have been caught on a smartphone camera outisde of work behaving, shall we say, shamefully. Others have been dismissed after posting inexcusable offensive comments on social media. In the world of at-will employment, companies often don't hesitate to let workers go. But in some states, there are specific off-duty behaviors for which you *can't* fire someone. The following are some examples.

ARIZONA

Employers may not threaten or intimidate employees in ways that would influence political opinions, views, or actions; enclose written or printed political propaganda in pay envelopes; or post political notices or threats should a particular candidate be elected.

CONNECTICUT

Employers may not subject an employee to discipline or termination based on his or her exercise of First Amendment rights. However, an employer may discipline an employee if the exercise of those rights interferes with job performance or the working relationship between the employee and employer.

COLORADO

Political activities and some off-duty behaviors protected. Employees can't be prevented from participating in politics, running for public office, or being elected to public office. Nor can they be terminated for engaging in lawful activities during nonworking hours, unless the behavior is "rationally related to a particular employee's responsibilities or is necessary to avoid a conflict of interest."

MASSACHUSETTS

Employers may not threaten or attempt to influence an employee to vote or to withhold a vote. They also may not threaten or attempt to influence an employee to give or withhold a political contribution.

NEW JERSEY

Employers may not terminate an employee or take any adverse action against any employee based on smoking or use of other tobacco products. May do so "if the employer has a rational basis for action that is reasonably related to employment, including the current or prospective employee's responsibilities."

NEW YORK

Protects political activities, recreational activities, union activities, and legal use of consumable products outside of working hours and off of the employer's premises. Off-duty activities can be restricted if they create a material conflict of interest related to the business.

Source: XpertHR

Photos courtesy of the companies

place culture to nip things in the bud," he says.

Unseasoned CEOs can be provided a mentor drawn from the board, such as the lead director or board chair. History suggests there is merit in this concept. Apple's board forced 30-year-old Jobs to resign in 1985 for being overly demanding and difficult to work with. Eleven years later, the board chair, Edgar Woolard, brought him back to lead the foundering company. "Most important was that Woolard served a vital role as Jobs' sounding board, confidante, and critic, helping to keep him in line and put Apple back on track," says Sheila Hooda, CEO of Alpha Advisory Partners and a member of two boards (Virtus Investment Partners and Mutual of Omaha).

The Right Thing

Certainly, the risk of CEO misconduct cannot be tabled by the board when bad behavior goes public. If a board becomes privy to a CEO's misconduct and simply hopes it will fade away, it won't. Employees in the know will report the situation on social media or leak it to traditional media. "It comes down to the board," Kasnet says. He once served on a board of directors whose CEO's judgment was overridden by his "ego-driven self-aggrandizement," he says. "When we realized this, we made a change. Was it tough to do? Sure, but it was the right thing to do."

Says Hooda: "The board has a fiduciary responsibility for the organization's culture, reputation and long-term financial performance—all of which rest upon the CEO's ethics and integrity as the culture champion of the organization. No CEO is irreplaceable." To underline this fact, she suggests an organization should always have a succession plan in place for the person's immediate replacement if need dictates.

Another way to tame a CEO's animal brain is money. "For years, boards were concerned that clawback policies, by not having clearly defined terms, would lead to litigation and other legal implications," Keatinge says. "That's changing, with more progressive companies retaining outside counsel to create clawback provisions that won't cause legal troubles down the line."

Depending on the violation, the CEO could retain a role in the organization in return for forfeiting part or all of his or her incentive-based compensation. In cases of serious offenses, the executive could be pink-slipped along with the monetary forfeiture.

"If the CEO is going the wrong way, then put a leash on the CEO—sooner than later," says Kasnet. "Too often the board waits until the eleventh hour, and by then it's too late."

Stillwell agrees. "There is no return on investment worth CEO misconduct," he says. "Not just shareholders suffer the bad behavior—an extended ecosystem of employees, customers, business partners, suppliers, vendors, and communities also suffers."

Boards of directors also have to be careful of the context in which they let executives go. Sexual harassment allegations by six women against Moonves led to his resignation in September. CBS is now on the hot seat for the former CEO's severance package—a whopping $184 million exit payout, unless it is determined he was "fired for cause." Two independent investigations are underway to figure out whether the allegations legally provide the means to give Moonves nothing.

Were he to receive the full amount, it could cause a public backlash against CBS. "Amply rewarding a guy who has been fired for the sexual harassment and intimidation of women will not sit well with many people," says Keatinge from Glass Lewis. "What kind of message does that send to employees in the organization? How can they feel respected, appreciated, and safe in knowing their allegations matter?"

Likewise, Sergey Brin, president of Google's parent company Alphabet, reportedly gave a "hero's farewell" and a $90 million severance package to Andy Rubin, creator of the company's Android operating system, upon the latter's resignation in 2014. What was not revealed at the time was why Rubin resigned—he'd been accused of coercing another employee into a sexual act. According to *The New York Times*, Rubin is one of three former Google executives accused of sexual misconduct who received substantial exit packages, all shielded by the company.

"Amply rewarding a guy who has been fired for the sexual harassment and intimidation of women will not sit well with many people."

—Courteney Keatinge, director of ESG research, Glass Lewis & Co.

Who in an organization can prevent such blatant errors in judgment? While boards of directors play a critical role in taming CEOs' behavior, there may be a role for the CFO as well.

"My fiduciary responsibility as the CFO of a public company is to protect shareholders," says Stillwell. "In certain states, this responsibility extends to other stakeholders like vendors and suppliers. That's my job, but I'm also a human being. I would never abide behavior I consider intolerable. Would I bring evidence of a CEO's sexual harassment of an employee to the board? In a heartbeat."

But Stillwell hopes that day will never come. "Great business leaders understand that the company is much more than themselves," he says. "They know there are many livelihoods depending on them to do the right thing."

Russ Banham is a Pulitzer-nominated financial journalist and best-selling author.

CLOUD ERP: The Time Has Come

Low up-front costs, hands-off maintenance, and automatic updates make cloud systems deserving of a serious look.

Hardly any software vendors today want to be stuck with an on-premises-only product portfolio. In the ERP subsector, probably the most important technology area for CFOs, it took market leaders Oracle and SAP longer than most to diversify into the cloud. But now they're leaders there as well.

BY YASMIN GHAHREMANI

PHOTO ILLUSTRATION FROM GETTY IMAGES

But while the global cloud ERP market is expected to grow, it likely won't be at a lightning-fast pace. Statista forecasts that the market will be $28.8 billion in 2022, representing an 8% compound annual growth rate since 2016.

So far, CFOs as a group—those at large companies, at least—have been fairly reluctant to trust their core financial and operational data to public clouds. Still, companies' overall growing fondness for cloud computing could influence faster change in the ERP arena.

Research and advisory firm IDC estimates that 70% of companies' core applications currently run on-premises or in co-location facilities. The rest are in private clouds (23%) or public clouds (8%).

In a recent survey by 451 Research, however, 60% of participating technology professionals said they expected their companies' approach to IT in 2020 would be focused on off-premises cloud solutions.

More Robust

In the ERP market, count Jeff Buchheister among the converted. His company, Cetera Financial Group, replaced its old on-premises system with an Oracle cloud solution in August after an eight-month implementation period.

It's early days, but Buchheister, Cetera's finance chief, is impressed. Because Oracle, like other cloud providers, handles all of the system's administration and maintenance, the IT department has eliminated two full-time positions. What's more, his finance team is reporting efficiencies that he predicts will save him at least 10% on accounting staff costs.

A key reason Buchheister chose a cloud solution was to avoid having to keep asking the board of directors for permission to implement upgrades. Automatic upgrades are included in cloud subscription costs. "The cloud solution's ability to constantly keep us upgraded with new functionality and to keep us from falling versions behind was really attractive," says Buchheister.

Such converts are driven by not only automatic updates and drastically reduced maintenance expenses, but also lower up-front capital costs and faster start-up times for rented software delivered through the Internet.

Looking Ahead

$28 billion
Expected size of global cloud ERP market in 2022

8%
Market's expected compound annual growth rate, 2016-2022

35%
Proportion of new product-centric ERP deployments in large enterprises that will be cloud-based in 2020

Sources: Statista, Gartner

Modern cloud ERP software is more robust than earlier incarnations, as well. As the market has matured, vendors have addressed earlier security fears and added capabilities that have users whizzing in hours through tasks that formerly took days.

Still, among organizations that aren't ready to move to the cloud, some may never be. Many are stepping gingerly, adopting a hybrid approach in which they move some ERP functions to the cloud but keep those that store proprietary data on premises. Still others think the most sensitive data is actually *safer* in the cloud, but they keep some processes on site. It's not just fear that is staying the hands of those reluctant to move.

"There are hackers trying to get into our systems, and there is a benefit to us in having our ERP system sitting outside of our primary network."

Jeff Buchheister, *Cetera Financial*

"It's hard for a company with years of investment sunk into an on-premises ERP system to make that move to a more modern cloud-based solution," says Melanie Posey, research vice president and general manager at 451 Research. "Then there's the extent to which the business depends on that system for day-to-day operations. So, there are a lot of reasons to keep the ERP as-is."

When a company moves close to fully amortizing the cost of its old on-premises systems, though, it becomes more likely to migrate to cloud solutions of one type or another. Flavors include a software-as-a-service (SaaS) solution running in a multi-tenant public cloud, a single-tenant private cloud hosted by a cloud vendor, and a private cloud maintained in-house.

Cost Questions

At such a time, a company wants to understand the financial ramifications of switching to the cloud.

The SaaS payment model is a lure for some. Instead of paying an upfront hardware cost and annual licensing fees, cloud users pay as-you-go subscription fees. That said, from a total-cost-of-ownership standpoint, cloud solutions may actually prove more expensive.

After five or six years, subscription fees will likely outweigh the ongoing maintenance fees a company would pay for an on-site solution. "If you do a careful analysis, an

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on-premises solution, while not as easy to implement and maintain, is going to be a lower-cost solution over the long term," says Jeff Carr, CEO of Ultra Consulting.

That assessment, however, assumes that the company will continue to use the on-premises ERP for a lengthy period of time, Carr acknowledges. And, as in the case of Cetera, the opportunity to reduce staffing costs could be an important factor in going with a cloud ERP solution.

Another factor lifting cloud ERP sales is the fact that other enterprise applications already run in the cloud, as do myriad consumer products that people feel comfortable using online. Once eyed skeptically as a potential security risk for the kind of sensitive data that's in an ERP system, cloud software is now perceived as much more mainstream.

Perceptions have slowly changed as vendors have touted encryption capabilities and the enhanced security protocols available on cloud platforms like Amazon Web Services. "In corporations that rely on on-premises solutions, adherence to updates and compliance often lags those that are well maintained by a software vendor," says Juergen Lindner, vice president of SaaS at Oracle.

Cetera's Buchheister buys the argument. "We're better off having Oracle, which has a very large team that focuses on this with 100% of their time, handle our ERP security than employing our IT department to do it," he says. "As we're a financial services company, there are hackers trying to get into our systems, and there is a benefit to us in having our ERP system sitting outside of our primary network."

A business-continuity advantage, too, appeals to some cloud converts. Ryan Newman, vice president of IT at Traeger Grills, says that to create the same disaster-recovery capabilities provided by the company's cloud ERP vendor his team would have to duplicate the server that hosts the system and put it in a mirrored site in another part of the country, where it would have to be monitored 24/7. "That's very expensive," Newman says. "In terms of maintaining reliability, the cloud is a no-brainer."

Access to new technology rounds out the list of reasons firms are adopting cloud solutions. When the San Diego Tourism Authority moved past its 10-year-old, on-premises ERP system, it was able to meet a savings target of $200,000 because of reduced capital and maintenance costs.

The organization also valued features that helped streamline business processes, including a user-friendly interface and dashboards that made it easier to monitor the status of transactions. The accounting team now can load banking data daily, enabling daily reconciliations. "The monthly closing process has been accelerated to only an hour or two, as much of the subledger accounting and posting is done throughout the period instead of period-end," says CFO Richard Meza.

"In corporations that rely on on-premises solutions, adherence to updates and compliance often lags those that are well maintained by a software vendor."

Juergen Lindner, *Oracle*

No Walk in the Park

All of the benefits aside, the road to cloud ERP can be rockier than one might expect.

Eric Kimberling, CEO of Third Stage Consulting, cautions CFOs not to underestimate the effort involved. The cloud doesn't automate the necessary redefinition of business processes or aid in getting up to speed on how the new software works. "Those are the two hardest parts of any sort of transformation," he says.

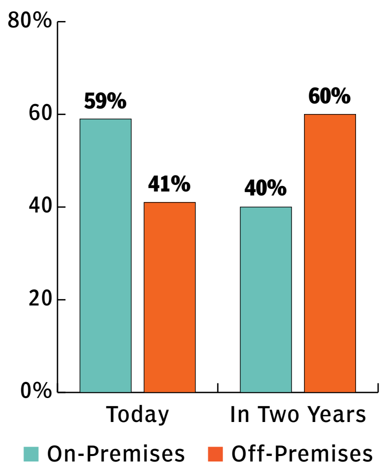
Cloud systems also require giving up some of the control that on-premises solutions afford. "You go from a 100% flexible solution to a relatively standardized one," says Henner Schliebs, global vice president of financial audience marketing at SAP. "With cloud, you're put into a framework that someone else thought through, and you might not be able to [easily] adapt your processes to those brought by the vendor."

That could be a good thing, though, as unnecessary customizations run up costs. "Modifications can eat you up," says Carr. "Every time you make one the cost goes up and the schedule gets expanded."

Ironically, another cloud issue that takes some companies by surprise is the trouble that can arise from automatic software updates. Dalsin Industries, a sheet-metal fabrication contract manufacturer, moved from an on-premises Epicor system to a Plex

Off-Site Exodus

Which best describes your organization's overall IT approach and strategy?



Source: 451 Research, "Voice of the Enterprise: Cloud, Hosting, and Managed Services, Budgets & Outlook, 2018," survey of 931 technology professionals

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cloud ERP in 2012. Two years later, it moved back on-site with Epicor.

Keith Diekmann, Dalsin's vice president of technical operations, was initially excited about automatic updates. But they turned out to be not so much the answer to a thousand prayers as the subject of countless obscenities.

Specifically, he found the lack of control over them to be frustrating. Updates sometimes broke parts of the system that his team would then have to fix. Plex—which recently announced it would shut down its Plex Cloud service on November 30—did send notices about updates, but made no mention of the associated potential for breakage in the system, says Diekmann.

In one instance, the function that handled packing lists malfunctioned. "That was like a fire drill," says Diekmann. "We weren't able to ship anything for half a day."

Dalsin's decision to revert to an on-premises system was significantly influenced by dissatisfaction with the Plex product's standard costing method. But Diekmann is relieved that his team can again test system updates in a virtual environment before going live with them.

Hybrid Headaches

Hybrid solutions, where some functionality is on-premises or in a private cloud and some in a public cloud, can present a different set of problems.

For one, connecting the disparate types of software can be difficult. "Being able to integrate in an intelligent, cost-effective way that links the right data and makes sure it's accurate and seamless is one of the most challenging aspects," says Kerrie Jordan, senior manager of product marketing at Epicor.

Traeger Grills learned about the difficulties of hybrid implementation the hard way. In 2015, the maker of wood pellet grilling systems dumped its on-premises system and began using an Epicor solution running in a private cloud. It kept its integration applications and proprietary data in a public cloud.

Newman admits management didn't start with a sound integration strategy. At one point, he says, 75% of IT staff time was being spent integrating platforms. Rather than change some non-standard business practices to match the best practices built into the Epicor system, Traeger implemented customizations. "We forced the system to do things it wasn't built for," says Newman.

The result was "havoc," he says. For example, the company had lots of interfaces with third-party software packages, such as an e-commerce system and a point-of-sale system for events. The data architecture around those broke, so in some cases the company lost orders. In others, it failed to take payments.

Traeger Grills learned some tough lessons about the potential havoc that can result from implementing a hybrid ERP solution.

Newman got to work with his team and dissected all of the interface connections to see what went wrong. Eventually, they unified the connections into one consistent interface with the Epicor system. But it took two and a half years to put out all the fires.

Advice for Easing Entry

Companies that do opt to enter the cloud should "realize it's a business project, not a technology project," says Geoff McPherson, director of client services as Panorama Consulting. Here are some tips for optimizing the journey.

Lay the groundwork. Before even beginning to look at vendors, think about the company's goals and how to reach them. Consider what happens to people's roles once a new system is in place and their tasks are eliminated. Will you retrain them? How can you keep the workplace from descending into nervous rumors? "These projects get out of control because people haven't thought about the human aspect," warns McPherson.

Consider processes that will need to change, too. Let's say you're a manufacturer and your shipping process is archaic and paper-based. You want to automate the system using a barcode system in the warehouse so workers can get orders on a tablet computer updated every hour. "Now you have to map out the whole warehouse," McPherson notes. "Where do you put the barcodes? You also have to think about buying those tablets and barcode scanners."

Lead and prioritize. Upper management needs to decide how important it is to go through this type of transformation. "It's got to be the number one or two priority," says McPherson.

Also, finance should partner with the chief information officer to stay aligned throughout the migration process. Epicor's Jordan says there's often pushback from the IT organization, borne out of misconceptions that they'll be made irrelevant. "The reality is that cloud applications allow them to move away from the administrative tasks of keeping the

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lights on to focus more on strategic initiatives for the business," she says. "Making sure the IT team is on board and supports the decision is important for the CFO."

Get users involved. Cetera brought in temporary help to backfill the roles of six employees in the accounting department—including the controller and the heads of accounts payable and accounts receivable. They were sent to a war room to focus on the implementation process.

"They were involved in all the considerations around user roles and access rights, and they did the user acceptance testing," explains Buchheister. "They got on-the-job training as they were doing implementation that's enabled them to be very helpful in post-implementation support."

Meza, the CFO at the San Diego Tourism Authority (SDTA), had his accounting team run tests to verify that balances were completely migrated from the old system. "The team tested every account to ensure accurate conversions rather than relying on sample testing," says Meza. Exposure to the new system was also an efficient way to get the team comfortable with its functionality and processes.

Invest in training. Traeger's Newman brought in system experts knowledgeable in both specific business processes and the Epicor system the company was adopting. One consultant shadowed the Traeger accounting team for a week to identify business processes that weren't working well and recommended fixes on the spot. He also identified where the system wasn't meeting the team's needs and customizations were justified.

Keep customizations to a minimum. Many customizations requested by multiple customers aren't needed anymore because they're baked into ERP software as best practices. The few legitimate ones are unique to an organization and offer a competitive advantage. "Think of them as [part of] the company's secret sauce for how it interacts with customers or differentiates its product," says Kimberling.

The SDTA went into its cloud migration aiming to to minimize customizations and simplify processes. It scrapped its old CRM customizations and streamlined its general ledger, decreasing the number of accounts. It also closed all older requisitions and purchase orders and simplified order entry and revenue recognition rules.

As well, the budget process was streamlined to take advantage of the new system's ability to create standard look-up tables that the organization uses to provide a list of approved budget descriptions to the users, says Meza. All expenditures are required to be reported against an approved budget description. That makes the monthly reconciliation to budget more efficient and accurate, he adds.

Successes like that don't come easily, though. "These projects are bigger than people think they are," says Panorama's McPherson. "Take the time to get it right."

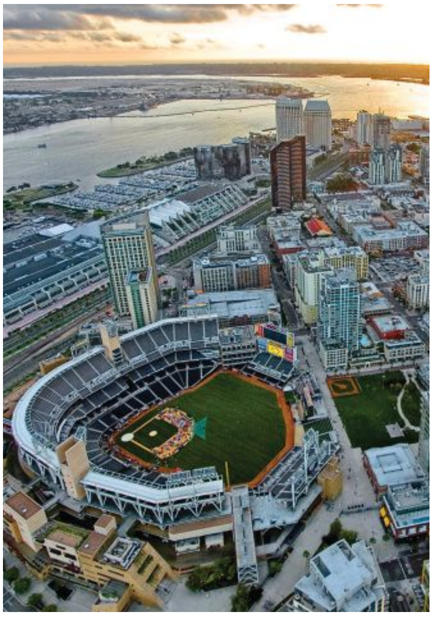
Overall, as companies continue to retire legacy on-premises systems, they'll have to mull lots of pros and cons before deciding what comes next, and to avoid making key mistakes along the way. The choices they make may have much to say about how well they'll be able to leverage modern software systems to the future benefit of their businesses. CFO

Yasmin Ghahremani writes about business and technology.

Transition Tips

Migrating your ERP to the cloud is not as easy as flipping a switch, according to technology consulting firm Emerald TC. Some preparatory work is required. Consider the firm's following tips:

1. Establish goals for your ERP project.
2. Build a cross-functional team composed of everyone who will use the system to guide the process of choosing the right cloud ERP for the company's needs, identifying reports, and assessing data elements for the integration.
3. Take an inventory of current data elements throughout all departments. Back up all data.
4. Review the business processes you are seeking to improve. Cloud ERP makes processes go faster, but making a bad process faster is just increasing the speed of frustration.
5. Add extra time for project completion. Questions, broadening the scope of work, and minor glitches all take time to address.
6. Share all documentation, data dictionaries, and other information with your integration partner. The more information that is shared the better.
7. Look for a cloud ERP vendor with a proven history of successful transitions for companies in similar industries. Ask for and check on references.
8. Allocate extra time for training groups and individuals who will use the system.



The San Diego Tourism Authority is happy with its conversion to a cloud ERP.

Getty Images

Ready or Not

Many companies still have plenty of work to do to comply with the new leasing standard. What's holding them up? **By Rob Lenihan**

In February 2016, the Financial Accounting Standards Board issued new rules on lease accounting that will move most operating leases onto a company's balance sheet. Currently, only capital leases are required to be recognized on the balance sheet. ¶ Public entities are required to adopt the new leases standard for reporting periods beginning after December 15, 2018; nonpublic entities have an extra year to adopt.

Both public and private companies have been working the past two years to come up with a clear plan to meet all the requirements of *Accounting Standards Update No. 2016-02, Leases (Topic 842)*. While many have plans in place, implementation is another matter. Some organizations are still well short of full compliance.

The change in lease accounting comes on the heels of the revenue recognition standard implemented in 2017. Christopher Wright, global leader of business performance improvement at Protiviti, says the effort needed differs from that needed to comply with the new revenue recognition rules.

Lease accounting is much more a joint effort between information technology and accounting departments, Wright says. "For example, the companies with large lease portfolios see this as an opportunity to automate not just the accounting, but in some cases the data flow and the management information they use for their real estate portfolios."

Not only are organizations getting their heads around how the new standard works, they are evaluating new IT tools, says James Barker, a senior consultation partner with Deloitte.

But there's little room for a shoddy compliance effort. "The risk of getting lease accounting wrong is substantial and involves higher post-implementation costs and a loss of stakeholder confidence," according to KPMG.

System Changes

What are companies facing on the IT front? Lease management systems have multiplied since the new lease accounting guidance was released. To avoid becoming overwhelmed, some companies are considering only vendors that offer end-to-end lease management, accounting, and standardized reporting. Others are considering third-party tools that offer more limited functionality.

Joseph Brown, national managing partner of strategic federal tax services and ASC 842 advisory services at Grant Thornton, says that many enterprise resource planning (ERP) systems are still under development and not yet in compliance.

But third-party products, boasting names like LeaseAccelerator, LeaseQuery, Visual Lease Accounting, and LeaseWave, are not silver bullets. Many vendors are still working out kinks in their software products, Barker says. Because of that, some clients have gone through multiple testing phases to ensure the systems work. Some end users are *still* testing.

Complexity and delays are resulting in some organizations having to move to a "plan B" to get through initial compliance with the lease accounting standard. "The timeline has evaporated so quickly that some companies are moving to processes that may be more manual in nature," says Sean Torr, managing director with Deloitte risk and financial advisory.

Adds Barker: "We've heard from many companies who've said 'we're

"It's all about getting the inventory correct; once the inventory of leases is understood, then a company can scope out its level of effort."

—Christopher Wright, global leader, business performance improvement, Protiviti

Left: Getty Images; Above: Courtesy the company

Electronic Invoice Processing: Low Touch, High Value

By Keith Button

Can your organization afford to wait 5, 8, or even 10 days to get accurate information about invoices sitting in the pipeline? Few can.

That's why perhaps the most important benefit of automated invoice processing is the data it captures. Sure, companies save money by reducing manual processing. But the real benefit is more strategic. Moving to electronic invoice processing lets companies capture and access data faster. That data can be tapped by the CFO and the finance team to better manage suppliers and cash flow.

In contrast, organizations that use paper invoicing and manual processes are often flying blind for long periods, which inhibits productivity. Organizations need good long-term visibility on spending, quick access to data on suppliers, and accurate information on products and services purchased. Digitization can help them achieve this.

Faster, Simpler

In June 2018, DocuWare launched DocuWare Kinetic Solution for Invoice Processing—automated invoice processing targeting small and midsize companies (those with 1,000 or fewer employees). The goal was to provide scalable, cloud-based digital tools that boast faster and simpler implementations than other industry solutions. DocuWare's applications improve the way finance professionals work and require little or no input from their IT departments.

By automating the accounts payable (AP) workflow—capturing, indexing, vendor-matching, routing, and archiving invoices—DocuWare Kinetic Solution for Invoice Processing also makes the audit process much more efficient, says Jo Ann Kreidel, Solution Manager, DocuWare. For example, auditors and AP users can easily execute searches by vendor, dollar amount, or date, and see the approval process and related data for every single invoice. Audits can consume an inordinate amount of time, and Murphy's Law inevitably applies. Says Kreidel: "An auditor will give you an invoice to look for, and, if you're relying on paper, there is a chance that it's not there."

> **"People want to make their work-life better, and this can be achieved by digitization and making processes more efficient and error-free."**
>
> -Jo Ann Kreidel, Solution Manager, DocuWare Corporation

Another benefit of the software is that it creates a secure, quickly searchable invoice archive, says Kreidel. That index of information has other uses as well: staff can use data captured during the automated invoicing process to help predict costs with more detail and greater reliability. Armed with that data, sourcing teams can negotiate better deals and optimize supplier partnerships.

The ability to quickly process, match, review, and approve invoices (or resolve discrepancies) affords the CFO's team the opportunity to take advantage of early payment discounts or benefit from other favorable payment terms. With manual processes, the information the CFO's team needs for those early payment discounts may be missed, costing the company money.

The most visible benefits of automating AP, of course, are the cost savings from reducing or eliminating paper and removing high-touch manual processes, Kreidel says. While every company's costs are different, invoices handled manually can cost five times more than those handled by automation.

A Teachable System

DocuWare's use of "intelligent indexing" to automatically capture the predefined data fields from scanned invoices for processing is a game changer, Kreidel says. When the system encounters an unfamiliar invoice format, it shows the AP user which fields it is uncertain of. With a few mouse clicks, the AP user "teaches" the software to correctly read the unfamiliar format so that future invoices can be processed automatically with limited manual touch.

Such efficiency improvements let CFOs redeploy AP team members on transformative projects or use the same number of team members to meet processing needs as a company grows. In addition, automated AP processing ultimately makes a company more attractive to both its employees, because it provides a better working experience, and to its suppliers, because vendor invoices are promptly processed.

"I haven't had anyone say, 'Nah, I think I'll stay with paper,'" Kreidel adds. "The benefits of DocuWare Kinetic Solution for Invoice Processing speak for themselves—people want to make their work-life better and this can be achieved by digitization and making processes more efficient and error-free."

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just not comfortable that this system will be ready by January 1. We're going to use either old-fashioned spreadsheets or some other approach to get the adoption taken care of. Then, over time, we'll get the new system fully implemented.'"

Take Your Pick

Whether companies adopt new systems before or after the December deadline, they have to weigh their needs carefully. Wright advises clients to first understand what they'd like to get from their system: "If they want it to do the accounting and book journal entries, that's fine. If they want it to pay landlords and help them manage the real estate with data and some automation, that's a different system."

Be sure to ask questions of vendors, Wright says. "Have them show you what happens when you change the discount rate, whether that flows through. What happens when you modify a lease's life or modify the payment? How does that help you determine whether it's an operating or a finance lease?"

Companies also have to apply a measure of due diligence, says Brown, running reports and testing the accuracy of disclosures and the system's ability to provide accurate journal entries. Ultimately, he says, the end user is responsible for the accuracy of what the software generates.

Due to the complexity of some of the lease system requirements, Torr says a large number of companies have engaged, or are planning to engage third-party vendors to handle their technology solutions. Even in that case, however, an organization needs a "detailed set of requirements that it's articulating to the vendor," he says.

Spot the Lease

With companies racing to meet the lease accounting standard deadlines, experts have plenty of last-minute advice to help an organization ensure it is ready. (See "A Pre-Flight Checklist," page 45.)

One tip is to not underestimate what it's going to take to get to the finish line. Angela Newell, a national assurance partner with BDO, says that gathering all the data around leases can be difficult, particularly in globally operated companies.

"You may find the leases are maintained in the home country and often they're not in English," she says. "If you don't have a centralized lease repository, then getting the data can be a struggle." An organization may have a lease that's 10 or 15 years old, and the lease document may be squirreled away in a file drawer.

In addition, Newell says some companies have not always done the best job in identifying whether their service arrangements include embedded leases (contained within larger business arrangements). "Although it is possible that some of these contracts may not meet all aspects of the lease definition after considering the specific terms," a Deloitte report said, "it is critical that companies engage in a thoughtful analysis to identify and document contracts that may contain embedded leases."

Since the definition of a lease is changing, Newell says, some contracts that did not include a lease under the old standard, ASC 840, might contain a lease under the new one. Physical inspection of offices or manufacturing locations may be required. During such an inspection, personnel might be able to identify leased assets that don't appear on an asset listing or registry, such as a large-format printer or medical testing device.

"It's all about getting the inventory correct; once the inventory of lease accounting is understood, then a company can scope out its level of effort," says Wright.

Engaging Constituencies

Plenty of other details need addressing. In the new standard, for example, the definition of the incremental borrowing rate for the lessee has changed. The rate has to be a collateralized rate, Newell says, like that for a mortgage.

Many companies, though, borrow via unsecured lines of credit. Those companies will need to estimate their incremental borrowing rates, either by looking to companies with similar businesses and credit ratings or by adjusting their own rate to reflect a collateralized basis, says Newell.

Modifying disclosures is another

Adoption Trends: A Quick Look

U.S. companies' plans for adhering to the leasing rules are all over the map.

43% of organizations are in the final implementation stage of deploying a tool and migrating data (as of October 29, 2018)

30% of organizations increased their finance budgets in response to the new lease accounting standard

53% of public companies expect significant system changes to accommodate the new leasing standard

27% of companies plan to leverage existing processes and software to comply

13% plan to implement a standalone point solution

11% plan to implement a solution within their existing ERP system

Sources: LeaseQuery, PricewaterhouseCoopers, Deloitte, KPMG hurdle. Lessees are now required to disclose any significant leases they have entered into but which are not yet effective. Auditors are not accustomed to auditing these leases, and companies are not used to tracking them for financial reporting purposes.

In addition, as companies stare down the barrel of the lease accounting deadline, they can't forget the constituencies that need to be apprised. Finance has to prove first and foremost to the auditor that it has "a complete and accurate population of leases," says Grant Thornton's Brown.

Companies should be communicating with their audit firms often about how they are approaching a variety of items related to reporting, materiality, disclosures, and future-state processes.

Also important is discussing matters that involve significant uncertainty and judgment, such as the use of capitalization thresholds or the planned methods for determining incremental borrowing rates.

Companies have to have a future-state process, including policies and controls to ensure that they're accounting for how they're (a) entering into leases; (b) modifying leases; (c) terminating leases; and (d) ensuring that it is all materially accurate on an ongoing basis, Brown says.

"The timeline has evaporated so quickly that some companies are moving to processes that may be more manual in nature."

—Sean Torr, managing director, risk and financial advisory, Deloitte

Brown says companies and their accounting firms are discussing what will be required and what approaches should be taken around materiality—that is, what kind of lease assets are immaterial and therefore need not be capitalized.

"We have not really seen a bright line around materiality in terms of some of the accounting for this," Brown adds. "A lot of companies tend to group-think. The standard has no materiality threshold, but that doesn't mean companies aren't applying one."

Asking for Help

What does FASB have to say about all this effort? FASB Vice Chairman James Kroeker recognizes that the new standard represents uncharted waters. Finance teams that are having problems with implementing the standard should not be afraid to ask for help, even at this late stage, he points out. "If you are struggling with any last-minute issues, don't forget that the FASB staff is available through our technical inquiry service. We want to hear from people."

After all, as with any standard, there are "unknown unknowns"—"you don't know what you don't know," Kroeker says. "I don't think there's been any major standard we've issued that we haven't later had some request for interpretive guidance or an improvement here or there." CFO

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A Pre-Flight Checklist

Don't let January 1, 2019, pass without weighing the following questions.

On systems. Have your organization's lease accounting systems been end-to-end tested? Have appropriate end users of lease data been engaged? Have you engaged with your auditors to understand their approach to testing your lease systems?

On lease data. Has all appropriate lease data been fully captured? Is the newly centralized data accurate? Is there a process to maintain lease data? Is lease data aligned with the organization's accounting policies?

On internal controls. Are controls in place around manual processes for interim lease accounting solutions? Have the effects of transitioning data to the cloud been considered? Do you have alignment with your auditors?

On employees and vendors. Has the organization staffed enough well-trained, highly skilled professionals to manage the implementation? Is there a clear understanding of who is responsible for which aspects of lease accounting? Have role-specific communications and trainings been developed? Has a support structure been created for stakeholders across the organization?

On policies. Are data and system workstreams aligned to accounting policies? Do you have alignment with your auditors around the new accounting policy, including management judgements? Have stakeholders been clearly communicated with about elections to support alignment? Is there a process for keeping policies current with gudiance?

On external stakeholders. Do investors and lenders understand the KPI and covenant impacts of lease accounting? Have software user groups been tapped to see how others are overcoming challenges? | R.L.

Source: Deloitte

Above: Courtesy the company

The Shifting Nature of Finance Work

For finance teams to adapt, they have to tackle process inefficiencies and clear workflow bottlenecks. By Chris Schmidt

If there's a phrase to describe the marching orders of finance departments, it's "adapt as fast as you can." Not only are finance chiefs and their teams trying to accomplish more on modest budgets, they are also tasked with new responsibilities and adjusting to new ways of working. And the timeline for making significant progress on transformative initiatives is as short as ever.

So, how is it all going? A recent CFO Research survey of 158 U.S. senior finance executives, in collaboration with XCM Solutions, explored a variety of management- and workflow-related challenges facing the modern CFO.

Senior finance executives were asked to identify the highest priority challenges they face. The top five challenges were all connected to workflow: compliance requirements; doing more with the same or fewer resources; dealing with the pressure to achieve business objectives; having the resources to get work completed (capacity); and internal roadblocks or bottlenecks. (See Figure 1.)

FIGURE 1

What are the highest-priority challenges you face in your finance leadership role?

Compliance requirements and deadlines	44%
Accomplishing more with the same or fewer resources	42%
Pressure to achieve business objectives	33%
Capacity, i.e., having enough resources to get work completed	32%
Internal roadblocks or bottlenecks	31%
Talent recruitment and retention	30%
Quality control processes to ensure accuracy	25%
Governance management and risk mitigation	19%
Internal or external client service	10%
Lack of transparency on work in progress	10%

Multiple responses allowed.

In a climate in which finance department spending is being cut, resource allocation issues are particularly troublesome to CFOs, the survey found. The most common problem that keeps CFOs up at night is creating and maintaining the capability for the finance department to be flexible, in particular to meet deadlines and to address process snags. Tied for the second most common issue are (1) keeping staffers accountable for their work and (2) forming a team that can adjust to rapidly changing priorities.

To be able to accomplish most of the above, senior finance executives need visibility into projects, due dates, and deliverables. But the survey found that lack of such visibility is the third most common issue that prevents finance chiefs from getting a good night's rest.

Oftentimes, CFOs can't easily identify potential missed deadlines or bottlenecks in finance's work processes. This lack of visibility poses risks in accounting, tax, finance, and audit—risks that the required work won't be done accurately, efficiently, and on time, raising costs and leading to other negative consequences.

Take the example of tax, an area in which roadblocks and bottlenecks can lead to problems with accuracy and deadlines. To start the process, a company's accounting group typically brings financial data into the company's income tax system, creating a trial balance. If that data is delayed, then the tax work is delayed and less time is available to complete the taxes before filing deadlines. Tax-preparation workflows are even more complicated when companies have subsidiaries, overseas operations, franchise taxes, and sales taxes.

Far-Flung Finance

As CFOs and their finance teams are forced to get more work done with the same amount of resources, they are putting in more hours in the office and at home. In particular, many are working weekends to keep up. Nearly two-thirds of respondents said that more than 10% of their finance team members worked weekends to keep pace with the workload.

Thankfully, however, more than half of the senior finance executives also indicated that work schedules are more flexible. Some of their team members work outside the traditional 9-to-5, full-time, 40-hour work week. According to the survey, at least 10% of respondents' finance team members have the option to (1) periodically work remotely; (2) work outside the main finance office; or (3) work non-traditional flex hours (not 9 a.m. to 5 p.m.).

36%

Finance executives who say training staff is the most critical investment they are making to drive increased productivity and growth

Those nontraditional work arrangements help in recruiting and retaining finance staff. But the challenge for CFOs is how to keep the whole finance team informed in real time. With accounting, compliance, tax, and audit work, accuracy suffers when new team members don't clearly understand how to execute a specific task or when a contract worker or remote-office employee hasn't been updated on a new procedure.

For example, if a team member isn't up to date on the latest guidance for the new revenue recognition standards, the team's productivity can suffer when inaccurate reporting has to be corrected and audit risk increases.

Fortunately, business process solutions can help effectively manage workflow challenges. With nontraditional work environments, especially when finance team members aren't working in the same office, solution-defined assignments and progression deadlines, for example, can promote better teamwork, boost morale, and reduce potential miscommunication when projects are handed off. The benefits for workers include clearly defined expectations with appropriate workloads at appropriate skill levels. For organizations, in addition, solving unaddressed workflow issues can keep staffers from having to trudge into the office on weekends.

Big Data, Big Opportunities

Digital technologies have been a great benefit to finance's overall efficiency. But they also have changed CFOs' roles. The survey showed that 72% of senior finance executives are spending more time on data analysis and predictive analytics than they did five years ago. This flood of data and technology presents great opportunities for finance leaders, especially as companies call on their CFOs to help mold businesses' futures.

But it also disrupts long-established processes. Analytics tools, for example, connect finance to operations and other business units, requiring collaboration and the capability to incorporate new data sources. Work processes have to evolve with a greater emphasis on analytics and analysis, but at the same time, finance has to ensure that the day-to-day operational work is still high quality.

One of the defining advantages for businesses in the world of big data, the internet of things, and artificial intelligence is the ability to make real-time, data-based decisions—and that also applies to allocation of work assignments. Business process solutions allow CFOs to re allocate work assignments in real time to prevent workflow bottlenecks. Specific work assignments and staffer progress can be compared at the project level, on a monthly basis, or minute-by-minute.

Those kinds of people analytics, when combined with effective staff training, are the best investments organizations can make to drive increased productivity and growth. They also ensure finance can meet the demands of future-focused strategic initiatives. CFO

FIGURE 2

In what areas is your organization making the most critical investments to drive increased productivity and growth?

Training existing staff	36%
Investing in cloud-based technologies	26%
Increasing transparency through data-driven measures and controls	26%
Lean Six Sigma or other business process optimization initiatives	24%
Maintaining legacy technology investments to extend their useful life	22%
Automation through artificial intelligence or robotics	21%
Hiring more staff	17%
Hiring consultants to uncover issues and recommend solutions	15%

Multiple responses allowed.

Getty Images

Bio Material

Whether it's job experience, education, native country, or length of tenure, finance chiefs have a smorgasbord of backgrounds. For example, which MBA program has produced the most sitting CFOs of large companies? To test your knowledge of such facts about finance chiefs at Fortune 500 and S&P 500 companies, take our quiz. Data is as of Aug. 1.

1 What role did the most CFOs (27%) have in their immediately prior position?

A. Controller
B. Divisional president
C. CFO
D. COO

2 Which sector has the greatest percentage of CEOs (28%) who were formerly CFOs?

A. Technology
B. Consumer products
C. Industrial
D. Financial services

3 In which sector do CFOs have the longest average tenure (5.9 years)?

A. Energy
B. Financial Services
C. Retail
D. Health care

4 Which Big Four public accounting firm formerly employed the most current CFOs (66)?

A. Deloitte
B. Ernst & Young
C. KPMG
D. PricewaterhouseCoopers

5 What percentage of CFOs have investment banking experience?

A. 12%
B. 6%
C. 9%
D. 15%

6 After the United States, which is the most-common native country for a CFO (15)?

A. United Kingdom
B. Canada
C. India
D. Australia

7 From schools belonging to which college athletic conference do the most CFOs (80) have undergraduate degrees?

A. Big 12
B. Big Ten
C. Ivy League
D. Atlantic Coast

8 From which school's MBA program do the most CFOs (45) have degrees?

A. University of Chicago
B. University of Pennsylvania
C. Harvard University
D. Stanford University

Answers: 1-B; 2-D; 3-C; 4-D; 5-A; 6-B; 7-B; 8-A

Source: Crist Kolder Associates dataset of 673 CFOs at either Fortune 500 or S&P 500 companies.