# CFO

SEPTEMBER 2018
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**WORKING CAPITAL: SUPPLIERS CAN WAIT**

**BLOWING UP BEST PRACTICES**

# CFOs to Watch 2018

**Dhivya Suryadevara**
**CFO, General Motors**

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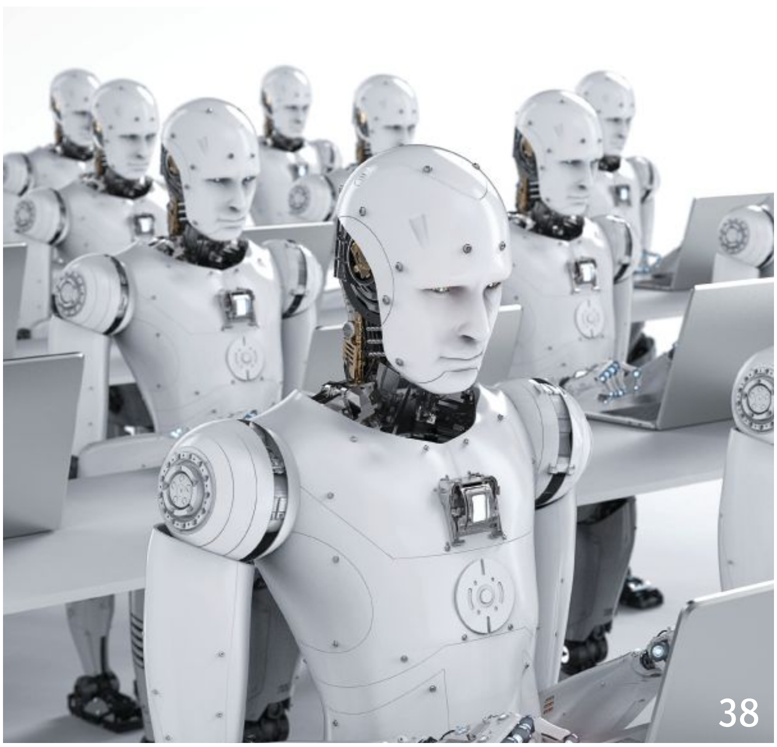
September 2018
Volume 34, No. 4



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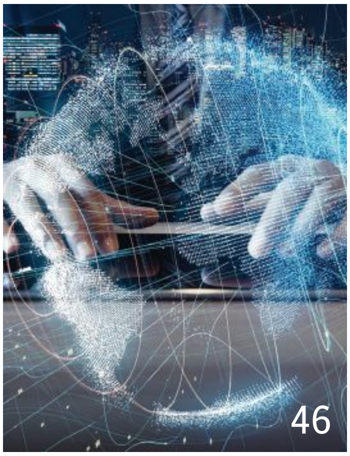





: Authors of "Detonate," Geoff Tuff and Steven Goldbach

## Up Front



## By the Numbers





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FROM THE EDITOR

# Will It Ever End?

Should CFOs be wary of the current U.S. economic expansion (dating back to June 2009) because it is getting very long in the tooth? Yes, but, thus far, many experts think the chances of an economic contraction happening soon are remote. ¶ Standard & Poor's global economics unit pegged the chances of a recession in the next 12 months at only 10% to 15%. In other words, there's an 85% to 90% chance a recession *won't* happen by next September.

In the coming months, the U.S. economy "will continue to enjoy tailwinds from fiscal policy while monetary policy remains supportive of growth, notwithstanding a gradual normalization of monetary policy," said Beth Ann Bovino, S&P Global's chief economist, in mid-August.

Don't be too afraid of risks like suppressive tariffs or, more severely, a possible all-out trade war between the United States and other nations, implied Bovino. That's because they are occurring in the context of fiscal stimulus, i.e., President Trump's corporate tax cuts.

U.S. finance chiefs seem to be in agreement. As measured by the latest Duke University/*CFO* Business Outlook Survey, their optimism was still at an all-time survey high as of June. (See "Data Security, Talent Scarcity Preoccupy CFOs," on page 44.) In the next 12 months, CFOs expect to boost full-time employment at their firms by 3% and lift wages and salaries by 4%.

While the forecasts of CFOs hold some weight, I often think of their projections, when measured by surveys, as attitudinal. To be successful at business, you have to maintain a baseline optimism.

When forecasting, though, it's best to be realistic. CFOs need to at least prepare for a soft landing, a shift to a slow- and then a no-growth economy. S&P predicts that real gross domestic product will decelerate to 2.5% growth in 2019 and then dip to 1.8% after that, as "cumulative monetary tightening begins to bite."

That would be fortune smiling on the U.S. economy. A much worse case would involve rampant inflation, a huge stock market correction, or an emerging markets implosion. Or all three. No one wants that. But smart CFOs will at least have thought through such scenarios.

**Vincent Ryan**
Editor-in-Chief

## EDITOR'S PICKS

**FINANCE**
CFOs on the West coast, and others, will want to check out the **2018 CFO Rising West Summit** on October 17-18 in San Francisco. The speaker lineup includes executives from Nike, Applied Materials, Samsung, TiVo, and Doppler Labs. See the Innovation Enterprise website for more details.

**HUMAN CAPITAL**
How do you motivate a talented employee who has hit a ceiling and is totally fine with staying there? According to executive coach Whitney Johnson, there are two possible avenues. Read **"What to Do When a Good Employee Stops Trying to Grow"** on the Harvard Business Review website.

**TECHNOLOGY**
**"Six Questions That Can Help Guide Digital Transformation"** is a podcast interview of two MIT researchers who wrote a book on how to appeal to digital customers. Among the crucial questions management teams have to ask of their organizations: "What is our key competitive advantage—content, experience, or platform?" Listen to the full recording on the Knowledge@Wharton website.

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Mark Bennington


Overarching
Security
Against New
Exposures

In response to a CFO.com story, **"16 Years Later, SOX Compliance Continues to Evolve,"** readers vented their feelings about Sarbanes-Oxley.

Commented one, "If every company paid into a fund to cover losses like Enron's in an amount equal to about half of what is spent on SOX compliance, there would likely be way more than enough available to cover ongoing losses to shareholders from fraud and negligence."

He called the costs for complying "absurd" because only "a minute percentage of public companies may be run by bad actors."

A kindred soul said, **"It was the mother of all knee-jerk reactions. For this CPA, it made working at a publicly-traded entity unbearable.** There simply was no limit to the scope of this beast. Much of it was unrelated to ensuring an entity's financial results were properly stated. I have almost zero confidence this paperwork exercise has done anything except increase compliance costs."

**"Study Finds Disturbing Evidence of Earnings Management"** highlighted a proliferation of large earnings surprises whereby quarterly per-share earnings exceeded analysts' forecasts not by just a penny or two, but by much more.

Greatly abetting this trend has been an increasing manipulation of non-GAAP numbers, according to university professors who conducted a study of reported earnings over a 17-year period.

Some in the audience cheered, taking the opportunity to vigorously denounce the unofficial metrics.

Wrote one, "Only GAAP earnings should be reported, and **financial accounting standards should return to reporting all 'transitory' items in a separate section."**

Going even further, another reader said, "Overall, the lack of standardization for certain ratios that are evaluated as critical financial measures (like EBITDA) causes folks to have a lack of trust in the system. Basically, we need GAAP [treatment] for these 'value' measures in order to arrive at standardization."

But the reader also questioned the practicality of his solution: "Honestly, I don't believe it is 100% possible to standardize all metrics across all industries. It is a consuming task, and I don't believe the value created will outweigh the effort. It would ultimately strip some companies of their ability to show strengths in their operations."

Back to the drawing board.


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## STATS OF THE MONTH


**37.7%**
Gross margin before depreciation, U.S. nonfinancials*

**17.2%**
Median SG&A as a percentage of revenue

**0.72%**
Income taxes as a percentage of revenue (all-time low)

**3.71%**
Capex as a percentage of revenue

**1.65%**
Dividends and stock repurchases as a percentage of revenue

* Data is from all publicly held nonfinancial U.S. companies with total assets of $100 million or more. All numbers are for the 12 months ended March 2018.

Source: Georgia Tech Financial Analysis Lab

TOPLINE

TAX

# Supreme Court Ruling Scrambles Web Retailers

**Could the decision be almost as significant as the tax-code rewrite? By David McCann**


It may be awhile before online retailers can assess the full extent of the hit they took in late June with the Supreme Court's landmark decision in *South Dakota v. Wayfair*. But one thing is for sure: for most such businesses, the damage will be heavy.

The 5-4 ruling in favor of South Dakota applies to thousands of online retailers and allows states to require them to collect and remit state sales taxes for internet transactions. The ruling overturns the court's 1992 decision in *Quill v. North Dakota,* which restricted states from collecting sales tax from retailers that didn't have an in-state physical presence.

Many other states, perhaps most of them, likely will now adopt a South Dakota-style law of their own, according to Paul Graney, state and local tax leader for law firm Marcum LLP.

Jeffrey LeSage, Americas vice chairman of tax for KPMG, said the ruling "could turn out to be almost as significant for American businesses as the recent rewrite of the U.S. federal tax code. It's a decision that reflects the realities of an increasingly digital economy."

Businesses will need to closely examine and retrofit their operations to determine where they have to collect tax, whether their goods are taxable, and how they are going to handle the new tax computation, filing, and remittance obligations, LeSage noted.

Eschewing a physical presence test, South Dakota and a few other states had adopted an economic threshold test for determining a retailer's liability for collecting and remitting state sales tax.

In South Dakota, the law applies to online retailers with annual sales of $100,000 in the state or 200 transactions in the state. States with higher thresholds, such as Alabama and Tennessee, can keep their laws in place.

The ruling creates a slight competitive uptick for brick-and-mortar sellers, as it eliminates a slice of the pricing advantage that online retailers have enjoyed. But the impact should be minimal, as goods are generally cheaper when bought online regardless of sales taxes.

In recent years, many states have adopted laws designed to get around the *Quill* decision. About 20 states have a "click-through" nexus, meaning that a company is deemed to have a physical presence in a state if it advertises on the website of a company that does have such a presence.



Getty Images

About 10 states—including some of those 20—have notice-and-reporting laws. They require companies selling through marketplace facilitators such as Amazon.com and Walmart.com to either (1) collect and remit state sales tax, or (2) annually notify customers that they may owe use tax or provide the state with a list of their customers so that the state can go after them.

(Most states have laws that require residents to pay use taxes on internet purchases, but they are almost impossible to enforce without notice-and-reporting measures.)

For the most part those workarounds have been on hold while states waited for a decision in the *Wayfair* case. Now states are likely to consider the workarounds "more trouble than they're worth" and abandon them in favor of a South Dakota-style economic threshold test, says Graney.

However, the Tax Foundation warns that "this ruling is not a blank check for states. The court specifically observed that South Dakota's law minimizes the burden on interstate commerce. Other states should craft their laws accordingly."

The majority opinion by Justice Anthony Kennedy detailed several features of South Dakota's law that ease that burden, including an assurance that "no obligation to remit the sales tax may be applied retroactively."

**"This ruling is not a blank check for states. The court specifically observed that South Dakota's law minimizes the burden on interstate commerce."**
—The Tax Foundation

Congress could act to standardize and clarify the economic thresholds that establish nexus for states to require online retailers to collect and remit sales taxes.

While Graney doesn't expect Congress to get involved, he thinks it should. Otherwise, he says, companies likely will initiate more litigation. CFO

GROWTH COMPANIES

# Would JOBS Act 3.0 Help Startups?

## Legislation passed by the House would ease limits in the 2012 act.

Finally making substantive progress following years of discussion about changes to the Jumpstart Our Business Startups Act of 2012, the House of Representatives in July passed bipartisan legislation in a 406-4 vote.

The legislation, the JOBS and Investor Confidence Act of 2018, dubbed "Jobs Act 3.0," is a package of 20 bills that make it easier for small businesses to access capital markets and take advantage of the original JOBS Act.

While the bills' passage in the Senate is uncertain, advocacy groups and congressional representatives are lauding the legislation.

Jobs Act 3.0 expands the definition of "accredited investor," the classification of people allowed to put money into private placements. The original JOBS Act required accredited investors to have annual income of $200,000 or a net worth of $1 million to invest in a Regulation D offering. The new bill permits investors with the right "experience and expertise" to also participate.

That could be helpful, as a knock against Title II of the JOBS Act (which deals with Reg D offerings) is that companies must review potential investors' tax forms and obtain their bank and brokerage statements to ensure they're accredited.

The change "increases the pool of investors who can invest in early-stage companies without complicating the securities law process," says Chris Sloan, chair of the emerging companies group at Baker Donelson.

JOBS Act 3.0 also allows angel investors and entrepreneurs to interact without running afoul of securities laws. While the original JOBS Act allowed startups to raise large private placements through general solicitations in social media and other avenues, the exemptions granted were narrow.

Another piece of the legislation could give a boost to Title III capital raises, the so-called crowdfunding provisions that allow startups to raise $1 million every 12 months through qualified funding portals.

Part of the legislative package, the Crowdfunding Amendments Act, allows crowdfunding investors to pool their money under the guidance of a registered investment adviser. These special-purpose vehicles may make crowdfunding more appealing to both businesses and prospective investors. | VINCENT RYAN

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COMPLIANCE

# Some Companies Ignoring GDPR

During the six-year lead-up to the May 25, 2018, effective date of the European Union's General Data Protection Regulation (GDPR), attention was focused on the maximum financial penalty for noncompliance: 4% of a company's global annual revenue.

But some companies may not believe that the EU and its member countries will be able to collect such sums.

For that or other reasons, more than one in ten (11.7%) of 490 participants in a Deloitte webcast in June said their companies were taking a "wait and see" approach on GDPR compliance.

"A lot of people are sitting back and saying, 4%? That'll never happen," says Rich Vestuto, managing director, Deloitte risk and financial advisory. "Well, what is the wake-up point, then? One percent? Half a percent? You're still talking about a tremendous financial penalty."

Additionally, 21.2% of those polled said "don't know" or "not applicable" when asked whether their companies can currently demonstrate a "defensible position" on GDPR compliance.

Only about a third (34.5%) of the audience said "Yes, we can demonstrate compliance today," while about the same proportion (32.7%) expected to be compliant by year-end.

GDPR aims to provide data protection and privacy for all individuals within the EU and the European Economic Area. It imposes a long list of rules for protecting the data and privacy of customers and employees. It also holds organizations liable for noncompliance by third parties that have access to employee or customer data.

The global appetite for digital privacy measures makes it difficult to see willful noncompliance on GDPR as anything short of foolhardy. California has approved similar regulations "that are every bit as strict as GDPR," Vestuto says. It's widely believed that Australia, Canada, and New Zealand will follow. | D.M.

HUMAN CAPITAL

# Gig-Economy Downsides

Experts often describe the "gig economy" glowingly. They see it as an evolved state of work in which a contractor is not tied down to one company or one project.

And, the argument goes, this new model lets companies throttle their workforces up and down depending on economic conditions. Less talked about, but also part of the decision to employ gig workers, is the cost savings from not providing employee benefits.

As it turns out, however, the realities of the gig economy are far from its perceived ideals. And that presents a problem for gig workers.

A new study from Oxford University, "Good Gig, Bad Gig: Autonomy and Algorithmic Control in the Global Gig Economy," unearths problems with gig-economy work, specifically for people registered via remote work platforms, like Freelancer.com and Fiverr.com.

The people that the researchers both interviewed and surveyed generally perform jobs in research, translation, and programming, and live in Southeast Asia and Sub-Saharan Africa.

The respondents and interviewees had some good things to say about working gigs. Most (72%) cited flexibility in choosing and changing the order in which they undertook tasks. And 74% said they were free to choose or change work methods.

But this autonomy comes at a price, including long, irregular, and anti-social hours, leading to sleep deprivation and exhaustion, according to study co-author Alex Wood.

Also, according to Wood, "the competitive nature of online labor platforms leads to high-intensity work, requiring workers to complete as many gigs as possible as quickly as they can and meet the demands of multiple clients, no matter how unreasonable."

More than half (54%) of respondents said they had to work at very high speed, and 60% said they had to work to very tight deadlines. As a result, 22% said they experienced physical pain as a result of their work. | V.R.



Getty Images (2)

M&A

# Shareholders Bring Fewer Lawsuits

Among business practices investors revile is when companies in their portfolios provide meager details about planned M&A deals.

In 2017, shareholders initiated class-action litigation in response to 73% of public companies' announced deals valued at more than $100 million, according to Cornerstone Research.

However, shareholders' appetite for such lawsuits has actually waned markedly over the past two years. Between 2009 and 2015, investors challenged more than 90% of such M&A deals, Cornerstone reports.

The average number of lawsuits per deal fell from 4.1 in 2015 to 2.8 in both 2016 and 2017. And the percentage of cases voluntarily dismissed by plaintiffs climbed from an average of 26% from 2013 through 2016 to 52% in 2017.

The shift is traceable to a January 2016 decision by the Delaware Court of Chancery to severely limit its approvals of "disclosure-only" settlements in such cases. (A majority of large, publicly held U.S. companies are domiciled in the state.)

For several years before 2016, deal litigation typically was settled quickly, with defendants—usually the merging companies and their executives—agreeing to provide supplemental disclosures about the challenged deal and pay plaintiffs' attorney fees.

In exchange, plaintiffs agreed to release defendants from other disclosure-related and breach-of-fiduciary-duty claims.

The proportion of litigated M&A deals shot up from just 40% in 2005 to a high of 94% in 2013 due in large part to courts' willingness to approve disclosure-only settlements. | **D.M.**

### Lightening Up

Class-action litigation in response to mergers and acquisitions has waned.

| | Avg. 2013-2016 | 2017 |
|---|---|---|
| Number of M&A deals challenged by shareholders | 139 | 112 |
| Percentage of M&A deals challenged by shareholders | 84% | 73% |
| Average number of lawsuits filed per M&A deal | 4.2 | 2.8 |
| Percentage of M&A deal litigation voluntarily dismissed | 26% | 52% |

Source: Cornerstone Research

CAPITAL MARKETS

# VCs Invest at Frenzied Pace

Investment in U.S. venture-backed companies is on pace this year to top $100 billion in deal value for the first time since the dot-com era.

Financial data firm Pitchbook reported that $57.5 billion of venture capital was invested in 3,912 companies through the first half of 2018, exceeding 6 of the past 10 full-year totals.

In 2017, VC investment totaled $84 billion for the year, the most since the early 2000s.

"The first half of 2018 shows that the investment environment for venture-backed companies is just as robust as it was in 2017, and 2018 may end up even stronger than that banner year," said Bobby Franklin, CEO of the National Venture Capital Association, which collaborated on the report.

Record financing for unicorns drove last year's investments. The group raised $19.2 billion, accounting for 22.8% of total dollars, yet making up just 0.9% of deal volume.

Through June 2018, $11.8 billion, or 20.5% of the total, was invested in VC-backed unicorns. But according to Pitchbook, deal values also increased notably in the angel and seed stage, boosted by the emergence of pre-seed financings.

And median deal size reached an all-time high for the angel and seed stage—$1.4 million in the first six months of 2018.

"Different from previous years, it's not just unicorns or top-end companies raising large rounds," said John Gabbert, founder and CEO of PitchBook. | **MATTHEW HELLER**



Getty Images

# SEC: Trim Awards for Informants

The Securities and Exchange Commission has proposed amendments that would give commissioners more discretion over the size of awards for exposing corporate malfeasance.

Under current rules, whistleblowers can get 10% to 30% of monetary sanctions from SEC enforcement actions. The new rules would allow commissioners to reduce bonuses for cases over $100 million, with an award minimum of $30 million. For smaller cases, they could raise the award to $2 million.


The SEC pointed out that "forty percent of the aggregate funds paid by the Commission to whistleblowers have been paid out in only three awards" and said excessively large awards are not "reasonably necessary."

Another amendment would require that a whistleblower report a possible securities law violation to the SEC in order to qualify for protection against employment retaliation under the Securities and Exchange Act. (Previously, the SEC interpreted such protection as applying in the case of internal reports also.)

"The proposed rules are intended to help strengthen the whistleblower program by bolstering the commission's ability to more appropriately and expeditiously reward those who provide critical information that leads to successful enforcement actions," said SEC chairman Jay Clayton.

The SEC voted 3-2 in late June to propose the amendments, with the two Democratic commissioners dissenting. "Practically speaking, this means the commission could reduce the reward if, in its sole discretion, it thinks the award is too large," said commissioner Kara Stein. "I am worried that this subjective determination would be used to as a means to weaken the whistleblower program."

Commissioner Robert Jackson said, "We're asking [whistleblowers] to put their livelihood on the line to help us enforce the law. Adding uncertainty to that process risks that would-be whistleblowers will stay quiet."

The SEC approved an award of $33 million in March, the highest-ever award to a single person. | WILLIAM SPROUSE

STRATEGY

# Blow Up Your Best Practices

**Many common corporate activities and thought processes actually promote mediocrity and inhibit needed business-model transformations. By David McCann**

What if it turned out that best practices were not "best" after all? What if adhering to best practices actually signaled a company's mediocrity? ¶ Those aren't frivolous or absurd musings. They're central tenets of a quite serious book, "Detonate" (Wiley, May 2018). It aims to help organizations "spot traditional business activities that need to be questioned" during an era when business is increasingly defined by disruption.

"The entire concept of best practices, by definition, means that you're doing the same thing as your competitors," write the authors, Geoff Tuff, a leader in Deloitte's innovation and applied design practices, and Steven Goldbach, the firm's U.S. chief strategy officer.

The book's title references the authors' desire for companies to blow up many cherished notions about how to do things. Some of their recommendations are startling.

Here's one: "Revenue should be the last thing you worry about." And they mean that literally.

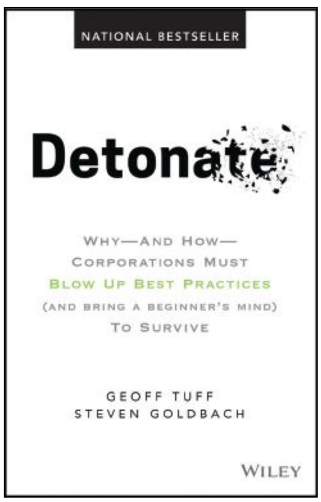
A revenue target, the authors note, is usually based on measuring past revenue performance, comparing that to "expert forecasts" of what the company's industry will do next year, and planning for how to increase the company's market share.

After revenue is locked in, the company decides how much profit it wants to make. "That tends to be a function of what [it] promised the capital markets" or "what [it] might need to fund obligations such as debt servicing."

Only then does the company turn to costs: "knowing" its revenue, what can it afford to spend to hit the profit target? According to Deloitte research, 68% of companies forecast costs based on a percent-of-revenue target.

All of that is backward, the authors proclaim, and with vigor.

"This pattern reflects no reality that we've ever inhabited," they write. "In fact, reality works in the opposite way. Costs create revenue."




Here's what they mean. Each year, a company has to give its revenue providers—customers—a reason to behave favorably toward the business, whether by continuing to buy its products, switching from competitors, or agreeing to pay more.

"And by thinking about what behavior needs to happen to cause revenue, you then naturally have to think about what your business needs to spend to cause that behavior," the authors observe. "Sometimes this might look like it might have in the past. Many times it won't. Unfortunately, businesses rarely ask the questions at this level of granularity."

Indeed, it's imperative for executives to "get out of the habit of believing they have an inalienable right to revenues because [the company has] grown at a particular rate for the last few years," Goldbach tells *CFO*. "It's a risky habit, because it perhaps causes you to not spend enough to [retain] customers in the wake of disruptive competition."

## Four Core Principles

Focusing activities on understanding and driving human behavior is one of four core principles the book espouses for enabling companies to challenge orthodoxy. It calls changing human behavior—that of employees as well as customers—"the fundamental subatomic element of business."

A second principle is to "bring a beginner's mind" to all business activities.

Executives that have grown up in a company or industry may rightly claim some degree of expertise—in how they do things, how competitors are likely to act in certain situations, how regulators view mergers, and what motivates employees.

However, the authors warn, "if new competitors are suddenly showing up on the scene completely unpredictably, and new technologies appear at your disposal for various purposes in dizzying frequency, your wisdom is actually not just useless but possibly dangerous."

The third core principle is that companies should embrace impermanence.

The archetypal corporation believes it will never go out of business. Today, “impermanence reigns at all levels,” the authors write. At the personal level, no one is employed for life. At the macroeconomic level, frontier economies can leapfrog over developed economies in new and surprising ways, as exemplified by the rise of mobile-first economies in sub-Saharan Africa.

In between, businesses “have to be prepared to create structures, processes, and systems that aren’t expected to last forever.”

Fourth, with respect to “almost any business activity that is done in the face of uncertainty,” companies are best off making what the authors call “minimally viable moves.” For instance, a first-of-its-kind product must be tested in the marketplace, but the size of the test should be limited.

The book gives the example of Forbes, which in 2000 mailed nearly a million barcode scanners to subscribers. The devices enabled the scanning of barcodes within print ads, which took users to a website for more information.

But, disastrously, users of the product needed to plug it into a computer and be connected to the Internet. Since WiFi was far from ubiquitous, readers would have to sit at their desks to browse the magazine and use the scanners. The device quickly flamed out.

Testing the device among a small portion of its readership would have saved Forbes enormous expense and months spent convincing advertisers to put barcodes in their ads.

## What Else to Detonate?

De-emphasizing the focus on revenue, as discussed above, is among several recommendations the book offers for abandoning common business practices. Each recommendation rests on one of the four core principles.

For one, “Detonate” counsels that a strategic planning schedule, such as an annual strategy review and reset, is largely a waste of time. “We’ve always found it curious that planning needs to align with the earth’s rotation around the sun,” the authors comment.

Again, behavior change is the core principle at work. “For customer behavior, your planning period should reflect the minimum amount of time you need to test whether your actions are having the desired effect,” the authors write.

**Executives must “get out of the habit of believing they have an inalienable right to revenues because [the company has] grown at a particular rate.”**

—“Detonate” by Geoff Tuff and Steven Goldbach

The book also criticizes organizations for their overuse of external, easily obatainable information. According to a Deloitte survey, 85% of respondents’ companies subscribe to published industry data reports, and 55% of respondents said executives ask for such syndicated data before making important decisions.

The core principle that applies here is keeping a beginner’s mind. A beginner might naturally lean toward deciding what measures to use based on the company’s objectives rather than on data that happens to be easily available.

In the latter case, “Over time, the strategy becomes oriented around trying to drive improvements in the publicly available data. This does not necessarily drive business performance.”

Notably, such data is equally available to competitors. So, companies should seek ways to create proprietary data and insights, the authors contend.

Another “best practice” to detonate: Companies should put much less stock in what customers say they want. So, businesses should stop trusting insights generated from customer surveys and focus groups, and instead “start observing, simulating, and inferring.”

Transformative business models tap into customer behaviors that are unknown because they don’t currently exist. “We have to create the behavior,” the authors write.

The authors are perhaps most passionate in their recommendation that companies stop celebrating failure. The practice excuses mediocrity, they say.

“We understand that organizations are trying to encourage risk-taking ... but when your license to operate is tied to your ability to generate return value to your business owners, carrying around a mindset that failure is OK is irresponsible."

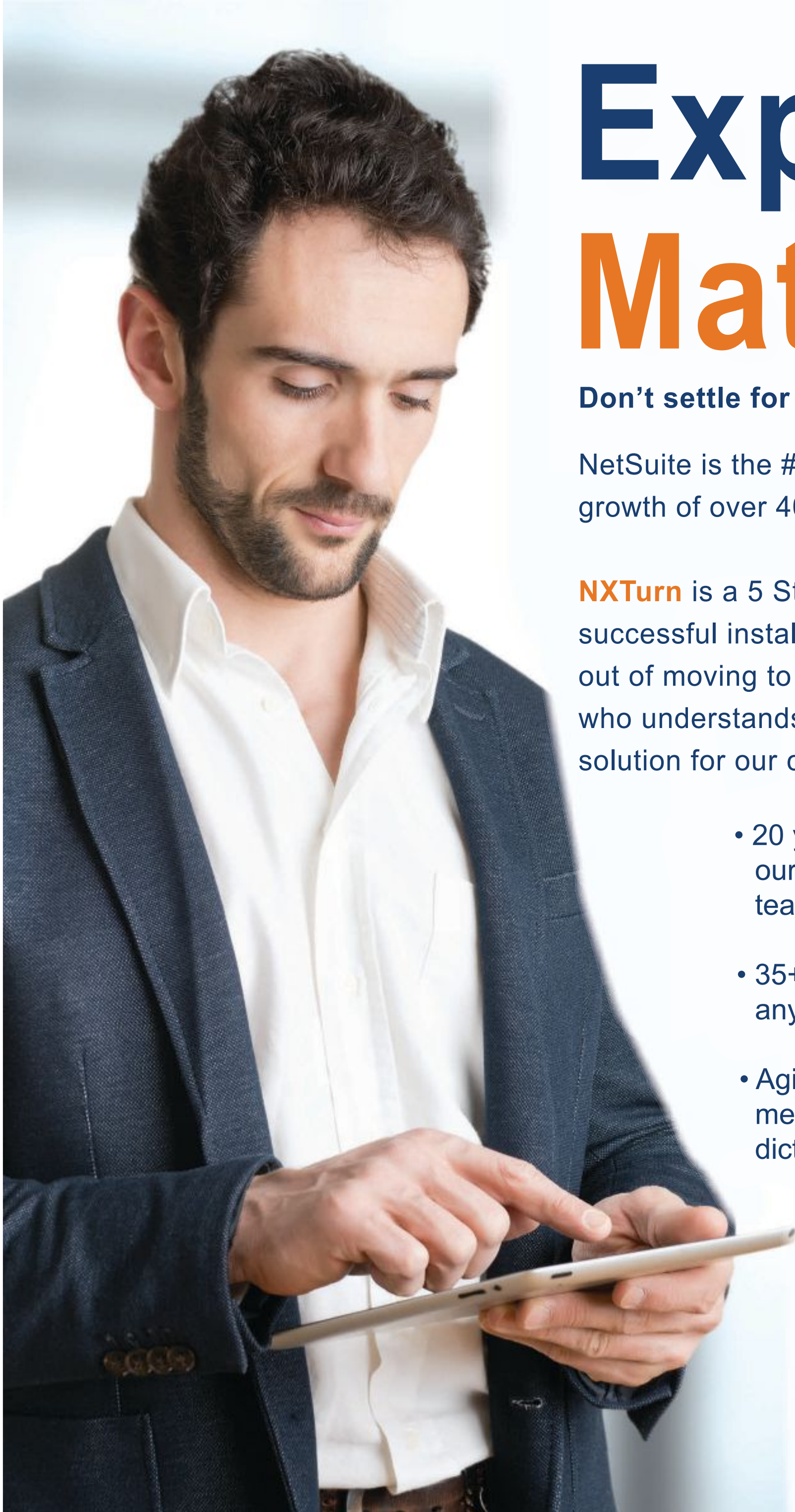
How can companies appropriately view failure when, as the authors say, experimentation in the marketplace is necessary for successful business-model transformations? The concept of minimally viable moves provides the answer. “It’s OK to have an incorrect hypothesis,” says Goldbach. “But design something so that if your hypothesis is incorrect, you can adjust course.”

One of the book's most startling thoughts: growth isn’t an imperative for a company; it’s a choice. “Topline growth, in and of itself, doesn’t create intrinsic value for a business,” the authors opine. Growth requires investment in new capabilities to serve the needs of new customers. Often, "the cost of finding these new capabilities will outweigh the opportunity.”

Many companies should simply embrace impermanence by accepting the idea that they’re not going to exist forever. That could mean “resisting the urge—when topline growth in any given category starts to trail off—to diversify into new areas.” CFO



Courtesy of the Authors



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CASH FLOW

# Working Capital: Suppliers Can Wait

**The cash conversion cycle shortened in 2017, largely because many companies paid suppliers as slowly as possible. By Ramona Dzinkowski**

Companies' liquidity is at record levels in the United States. According to the 2018 *CFO*/Hackett Group Working Capital Scorecard, cash on hand for the 1,000 largest U.S. companies rose by a whopping 17%, or $154 billion, in 2017. Much of that increase can be explained by what appears to be an unquenchable thirst for debt (up 10% over 2016), topped up by the liquidity effects of the U.S. tax reform law.

Under those circumstances, one would expect CFOs to be none too worried about tying up some capital in day-to-day operations—for example, keeping inventory on the books a couple of days longer than necessary. But one would be wrong.

Despite holding huge bundles of cash, many U.S. organizations are still pushing hard to be working capital efficient.

The cash conversion cycle is the most relied upon metric to determine how effectively a company is converting resources to cash. It consists of the length of time it takes companies to get receivables in the door (days sales outstanding, or DSO); the length of time inventory is on the books before it's sold (days inventory outstanding, or DIO); and the time a company takes to pay its suppliers (days payables outstanding, or DPO). The CCC equation, of course, is DSO + DIO – DPO.

In 2017, the 1,000 companies in the scorecard reduced their cash conversion cycle (CCC) by 0.8 days, to 36.5 from 37.3, the fifth straight year of improvement.

(The numbers exclude the oil and gas industry because oil and gas "by nature behaves quite different than other industries. Its performance is largely geared toward the price of oil, which is strongly influenced by the decisions OPEC and other oil-producing countries make on production," according to The Hackett Group.)

Looking deeper into the shorter cash conversion cycles reveals that companies are not necessarily getting better at collecting on receivables and managing inventory: instead, for the third year in a row, it was the ability and willingness to lengthen payment terms (and thereby increase DPO) that primarily pushed CCCs lower.

## Stretching Out

Across the more than 50 industries covered in the scorecard, DPO reached its highest level in 10 years, 57.4 days, up from 53.3 days in 2016. Translation: Many organizations are taking almost two months to pay their suppliers. In contrast, a decade ago DPO for the Hackett 1,000 clocked in at 40 days.

The flip side of higher DPOs is higher DSOs for suppliers. Sales took longer to transform into cash in many industries. Overall, DSO deteriorated the most of all working capital measures in 2017, rising by 5% to 39.7 days (up from 37.8 days in 2016).

While pushing out supplier terms may not benefit the overall economy and can damage cash-strapped companies, it's a trend that is not losing any momentum.

Craig Bailey, associate principal in the working capital practice of The Hackett Group, says that at this point lengthy DPOs are driven by a "me too" factor as much as a buyer's individual market clout.

"It's very much a knock-on effect amongst peers," Bailey says. When a company benchmarks its DPO against competitors, the immediate reaction is,



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"I could do this too and get the same benefits," he says. Extending DPO has also become a competitive tactic.

"If I'm paying my supplier on very favorable terms, I'm actually financing its ability to offer much more attractive terms to my competitor," explains Bailey. "So, you see this standardization, where extended terms become the new industry norm."

## Lost Opportunity

Although 2017's working capital results were respectable overall, many companies still left a lot on the table, failing to minimize the amount of capital tied up in receivables and inventory, or hold onto payables as long as possible.

For example, companies in the upper quartile in their industries in DPO paid suppliers 3 weeks slower than the median performers did. The top performers in DSO collected receivables 2.7 weeks faster than those at the median, and the companies best at managing inventory held stock on the books for less than half the time that median performers did.

The inefficiency at some companies is evident in in this year's "working capital opportunity" number—$1.13 trillion. That's the potential value that subpar performers could capture if they brought their payment, receivables, and inventory management performance up to a level closer to the best performers in their industries. That opportunity number total represents about 6% of the U.S.'s 2017 fiscal-year GDP.

Much gets in the way of efficiency, however. One of the obstacles to capturing that missing value has been consistency. Very few organizations have been able to demonstrate steady, multiyear working capital improvements. The results of the 2018 scorecard (the *CFO*/Hackett Group scorecard has been published since 1997) show the attention to working capital efficiency rarely lasts very long.

In 2017, out of the 1,000 companies, 100 had improved their CCC for the last three years, but only 34 managed to sustain that performance for 5 years. Moving further out, less than 10 companies in the study have kept it up for as long as 7 years.

Why do businesses struggle to maintain long-run working capital productivity improvements? It comes down to management diligence and

**"If I'm paying my supplier [quickly], I'm actually financing its ability to offer much more attractive terms to my competitor."**

—Craig Bailey, associate principal, The Hackett Group

the appetite (or lack of it) for change, suggests Todd Glassmaker, director, strategy and business transformation at The Hackett Group.

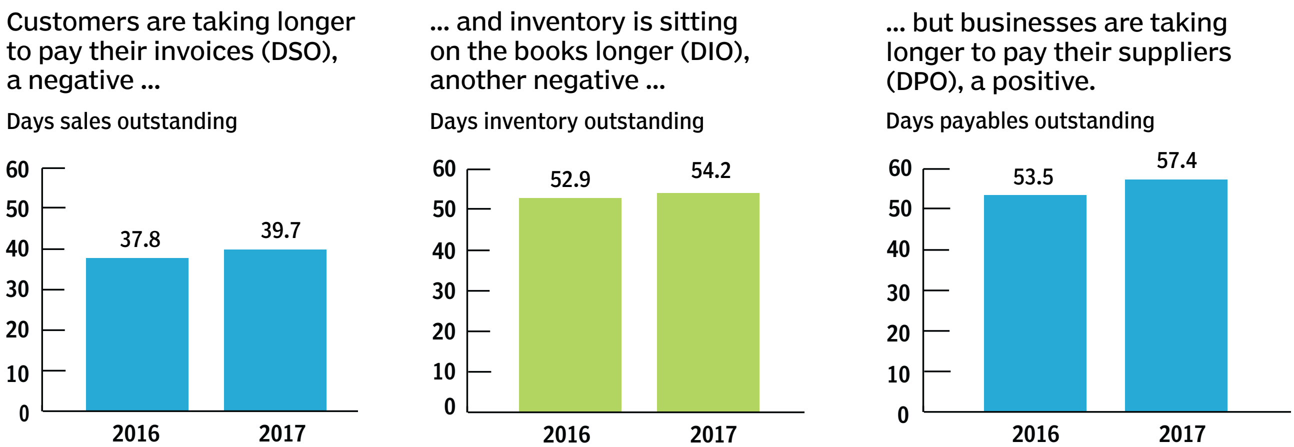
"Due to low interest rates, companies haven't necessarily been willing to take on fundamental process improvements to working capital management," says Glassmaker.

"Also, when companies see a deterioration in CCC, they're not [always] quite sure why it's happening or how it's happening. Companies need to be more rigorous in understanding where their exposure is." For example, customers may be withholding payments due to disputes and deductions caused by internally controllable issues, such as errors in pricing, discounts, and quantities.

The sustainability of working capital efficiency is not helped by the increasing volume of M&A deals.

## DPO Makes the Difference

What drove the reduction in companies' cash conversion cycles in 2017?




Source: The Hackett Group



Courtesy of the Author

Acquirers and their targets often experience post-transaction setbacks in all aspects of working capital management, explains Bailey.

"Organizations are so busy with the post-merger integration that they're distracted from managing working capital and focusing on the quality of processes," he says. "When a company's working capital position has significantly deteriorated after [a transaction], it's generally due to very different cultures, processes, and [enterprise resource planning systems] trying to merge."

The companies that supply services, goods, and parts to the participants in a takeover transaction experience knock-on effects. Collections problems tend to arise, for example, "due to new market data, new contacts, and new processes to follow, all of which take time [for the merged company] to set up," Bailey says.

## How Working Capital Works

**Days sales outstanding (DSO): AR/(total revenue/365)**
Year-end trade receivables net of allowance for doubtful accounts, divided by one day of revenue.

**Days inventory outstanding (DIO): Inventory/(total COGS/365)**
Year-end inventory, divided by one day of cost of goods sold (COGS).

**Days payables outstanding (DPO): AP/(total COGS/365)**
Year-end trade payables divided by one day of COGS.

**Cash conversion cycle (CCC): DSO + DIO – DPO**
Number of days for each indicator added up for the assets part of the balance sheet and subtracted for the liabilities.

Note: Some companies use revenue instead of cost of goods sold when calculating DPO and DIO. The Hackett Group's methodology uses COGS across the payables and inventory categories to reflect an accurate output.

## The Road Forward

The path to sustained improvements in working capital efficiency is not a mystery.

"Payables are the most natural focus for companies when it comes to optimizing working capital," explains Shawn Townsend, director, strategy and operations, at The Hackett Group. "However, it's also important that the organization's supply chain remains stable."

So, many organizations have begun turning to the often-ignored domain of inventory optimization to improve their working capital positions. In 2017, overall DIO rose by 2.4% for the Hackett 1,000 companies, reaching 54.2 days. The metric has been weakening since 2014.

"Inventory often comes last for an organization which is just starting to look at working capital, the reason being that payables and receivables are the domain of finance," says Gerhard Urbasch, senior director at The Hackett Group. "Inventory management is rarely cross-functional, and organizations will often be wary to reduce inventory due to the risk of supply chain disruption."

However, as Urbasch explains, that dynamic is changing.

"Organizations with world-class levels of DPO and DSO are now starting to look at inventories, and we expect this focus on inventories to continue to increase," he says. An inventory focus may hold the most promise for industries that can't dictate payment terms, like chemicals or commodity producers.

"There are a lot of things that can be done to help offset many of the adverse macro factors that confront such industries," says Urbasch. Among them are ensuring the business has the right tools for deciding replenishment parameters, improving master data quality, and understanding which products should be made-to-stock versus made-to-order.

## Risks Ahead

While 2017 saw overall improvement, it is clear that the way companies managed their payables and receivables may not work in 2018 and beyond.

Forecasting the results of next year's working capital scorecard is particularly difficult, according to Hackett's Bailey, as "what we see is a lot of uncertainty going forward, which will bring some interesting working capital management challenges."

Tariff disputes among the United States and its trading partners, for example, threaten to disrupt international sources of supply. That will create uncertainty around inventory holding requirements and, ultimately, lead companies to take a wait-and-see approach to new technology investment. In Europe, on the other hand, Brexit could disrupt cross-border trade.

To keep on top of working capital, especially the inventory piece, organizations will have to improve their use of technology.

"Now we have the internet of things and companies have invested significantly in that technology," Urbasch says. "But what we see is that even with the new technologies in place, companies are hardly leveraging their ERP systems. So, if they maintain the same level of globalization in their supply chain without optimizing technology, as many are doing, we could probably see an increase in inventory and DIO going forward."

For companies looking to keep their cash conversion cycles low, the rest of 2018 and 2019 may be a constant battle. More than ever, having world-class processes in place and monitoring performance will be essential. CFO

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

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**Although relatively young and a corporate CFO for the first time, Suryadevara is no novice when it comes to high-stakes financial maneuvering.**

CFOs TO WATCH 2018

# Time to Shine

**A new crop of CFOs (and a couple of veterans) have risen to prominence in 2018. Do they have the finance acumen and strategic savvy to tackle the obstacles their companies face?**

**Ascending to the top of finance at a** consumer giant, trying to revive the shares of a popular social media app, guiding a company through a backdoor listing, allocating capital to development of a leading-edge product, assuming the mantle after an internal controls debacle—our CFOs to Watch will be in the middle of some daunting circumstances in the next 12 months.

**Dhivya Suryadevara** CFO, General Motors

But that's exactly why we chose them. Their experiences and those of their companies can provide lessons for many other finance chiefs.

In this fourth annual installment of CFOs to Watch, we mixed things up a bit. We picked some CFOs who were relatively new to their jobs—and some brand new to the CFO position itself. That made choosing them for this list a bit risky—sometimes new jobs don't last long.

But we didn't feel like we could avoid it. A number of veteran CFOs of large multinationals retired in 2017 and 2018, leaving the next generation to tackle digital disruption, activist investor pressures, global trade upheaval, talent scarcity, and, ultimately, another cyclical downturn in the U.S. economy.

The executives profiled represent some of the brightest lights of this new group. But odds are that not all of them will succeed. They could see enormous successes and spectacular failures. Some of these CFOs' careers could be made in the next couple of years, some derailed.

Either way, observing these executives in their current roles and throughout the arc of their careers should be interesting.

*The profiles on the following pages were written by David McCann, deputy editor of* CFO*; freelancers Russ Banham, David M. Katz, and Bob Violino; and* CFO*'s editor in chief, Vincent Ryan.*

Photo courtesy of the company

## Leading an Icon

**The new CFO of America's tenth-largest company was** not yet born when the man she replaced as of Sept. 1, Chuck Stevens, began working for General Motors.

Another interesting demographic fact: as of spring 2019, the new finance chief, Dhivya Suryadevara, and her boss, chief executive Mary Barra, may be the only such female tandem among Fortune 500 companies once CFO Patricia Little retires from The Hershey Co.

From a human-interest and corporate culture standpoint, then, there will be plenty of reason to keep tabs on Suryadevara. But those elements aside, she faces abundant opportunities and challenges, given the colossal transformation enveloping the automotive sector. No company is more in the thick of it than GM, the industry's leading player.

Among the ground-shaking shifts that will test Suryadevara's financial and operational mettle, GM last October announced a long-term vision of an all-electric path to zero emissions and crashes. The company is gearing up to introduce two new all-electric vehicles in 2019, based on learnings from the Chevrolet Bolt EV. GM expects by 2023 to have no fewer than 20 all-electric vehicles for sale.

Even more revolutionary is the ongoing march toward a future of autonomous vehicles. The company took a leadership position in that arena with its 2016 acquisition of start-up Cruise Automation. In 2019, GM Cruise is scheduled to debut its first self-driving vehicles manufactured at scale.

How Suryadevara influences GM's efforts to keep pace with its top competitor in autonomous vehicles, Alphabet subsidiary Waymo, may have a big impact on the company's financial fortunes.

"There will be a significant first-mover advantage in this space," Motley Fool analyst Daniel Miller recently wrote. "The first company to produce these vehicles will gain a lead in gathering real-world data from them, which could allow it to uncover issues and make crucial improvements."

Suryadevara must decide how to deploy a $2.25 billion investment in GM Cruise that the company landed in May from SoftBank Vision Fund. GM also expects to invest $1.1 billion of its own funds in the development project.

Farther down the road, the financing, plus GM's plan to report GM Cruise's results as a separate segment, sets the stage for a possible spinoff of the driverless-vehicle operation. That would be another weighty task for the new CFO.

### Truck Overhaul

Meanwhile, big changes are under way, with more to come, in GM's traditional auto-manufacturing business. With profit margins on trucks, sport-utility vehicles, and crossovers significantly surpassing those for sedans, auto-industry forecasting firm LMC Automotive predicts that by 2022 about 73% of U.S. consumer vehicle sales will be in those product categories.

In announcing its first-quarter results this year, GM said profits were down, even though revenue was up, because of heavy spending to overhaul factories to produce more trucks.

Although relatively young and now a corporate CFO for the first time, Suryadevara is no novice when it comes to high-stakes financial maneuvering. Since joining GM in 2004, she has helped win upgraded credit ratings, issued $2 billion in notes to fund discretionary pension contributions, and expanded and renewed the company's $14.5 billion revolving credit facility.

Her most recent roles have included, successively, chief investment officer of GM Asset Management, where she led the company's $85 billion pension operations; corporate treasurer; and vice president of finance.

While the number of women CEOs at Fortune 500 companies has dropped sharply (by 25%) in the past year, the opposite is true for the CFO role. Suryadevara becomes the 64th woman finance chief in the group, doubling the number 10 years ago. | DAVID McCANN

## Smelling Like a Rose

**In charge of new business development at The Estée Lauder** Companies, CFO Tracey Travis must be feeling pretty good. The company's "Leading Beauty Forward" initiative, designed to reallocate its cost structure to invest in future growth, is reaping dividends.

Announced in 2016, the program is the force behind Estée Lauder's exceptionally strong 2017 net sales and earnings, up 5% ($11.8 billion) and 12% ($1.25 billion), respectively, from the prior year. That momentum continues in 2018, as second-quarter profits surged 25% on robust sales.

**Tracey Travis** ➡
EVP& CFO,
Estée Lauder

> **"[Travis is] quite serious, polished, and very measured in her approach, and a very 'tough cookie.'"**
> –**Olivia Tong**, Bank of America Merrill Lynch

"This year has been a monster for them—in a good way," says Olivia Tong, senior U.S. cosmetics, household and personal care products analyst at Bank of America Merrill Lynch. "And a good part of it is due to Tracey."



Photo courtesy of the company

Travis brings an impressive résumé to her role leading finance at the multinational manufacturer and marketer. Prior to hiring on in 2012, Travis was the CFO at Ralph Lauren, guiding its successful capital restructuring and acquisitions of licensed brands—work she would repeat at Lauder.

Interestingly, she began her career at General Motors as an engineer. After being awarded a GM fellowship to pursue an MBA, she returned to the automaker as a finance executive. "Tracey brings a more industrial, sciencey background to running finance, which sets her apart," says Tong. "She's quite serious, polished, and very measured in her approach, and a very 'tough cookie.'"

Over the past two years, Estée Lauder's capital has been allocated to such high-growth opportunities as building its presence in key international markets China and Italy. Money also has been directed toward sprucing up online direct-to-consumer and retailer e-commerce sites, as well as enhancing its digital and social media marketing.

Major acquisitions have included Deciem, a five-year-old beauty business with 10 brands, including the popular skincare treatment The Ordinary; Too Faced Cosmetics (Lauder's largest acquisition at $1.4 billion); and Becca Cosmetics, a premium brand noted for its diverse color offerings for all skin tones. The latter two acquisitions alone added 2 percentage points to Lauder's 2017 sales growth.

"Tracey has done a pretty decent job in terms of acquisitions, identifying brands that will help the company improve performance in growing markets and channels," says Tong. "Too Faced, for example, is very profitable at Sephora retail stores. Meanwhile, other longstanding brands like Clinique compete very favorably at higher-end department stores."

### Holding the Line

The compelling narrative is one of a company that has pulled together an enviable compendium of beauty products to sell to diverse consumers according to their buying preferences. Online, some buyers may prefer buying directly from Lauder's website, others from direct-to-consumer channels, and some from partnering e-commerce websites like Macys.com or Nordstroms.com. At brick-and-mortar department stores consumers can experience (and buy) Lauder's wide-ranging brands. "Channel diversification has been very important to their recent success," says Tong.

Not that everything is smelling like a rose. The China market is a case in point, with tariffs possibly fomenting retaliatory measures against beauty products.

"If China retaliates or its economy slows down, the question is whether or not this will slow the company's growth," said Tong. "There's also the possibility of an anti-American backlash against U.S. companies in general, although Estée is really a global brand and not as American as, say, Coca-Cola."

Nevertheless, CFO Travis will be expected to maintain profit margins. For instance, the capital expense for a portion of the Leading Beauty Forward initiative has been offset by a selective workforce reduction that continues. "Tracey's task will be to continue to find cost savings in a year when Estée might not have such stellar growth," says Tong. "She can be depended upon to keep everything in check." | **RUSS BANHAM**

## A Fresh Face

**Erik Bass, who's known John McCallion since MetLife's** new CFO was head of investor relations at the company from 2011 to 2012, thinks that experience has served McCallion well in his early days as finance chief.

McCallion "knows the investors and analysts and how they think, which is helpful," Bass, a stock analyst at independent research provider Autonomous Research, tells *CFO*.

But without missing a beat, the analyst adds that "it's also been helpful to him that MetLife has reported two good quarters since he's been CFO."

**John D. McCallion**
EVP, CFO, & Treasurer, MetLife

When McCallion was named MetLife's finance chief on May 1, however, the company was just starting to extract itself from an accounting scandal related to missing pension beneficiaries. In its December 2017 annual report, it disclosed that chief executive officer Steven Kandarian and CFO John Hele had identified material weaknesses in MetLife's internal controls over financial reporting.

> **"I know they were getting a lot of pressure from shareholders to make a change at the CFO level."**
> –**Erik Bass**, Autonomous Research

The company had failed to find 600,000 annuitants who "have moved jobs, relocated, or otherwise can no longer be reached via the information provided for them." In its defense, MetLife estimated that the most-affected beneficiaries represented less than 5% of all its group annuitants and tended to be owed less than $150 per month.

In the fallout from its system failures, MetLife's auditor, Deloitte and Touche, expressed an adverse opinion on the company's internal controls. The Securities and Exchange Commission and the New York State Department of Financial Services launched investigations of the company's annuity payments. MetLife mentioned the controls problems in its proxy statement, reporting that Kandarian cut Hele's annuity incentive compensation by 25% (or $500,000).

The glitches CFO Hele had helped find went a long way toward sealing his fate with the company. That was the "final straw of a few events over the past few years," says Bass. "I know they were getting a lot of pressure from shareholders to make a change at the CFO level."

### Stepping In

Just two days after the company's announcement of Hele's dismissal and McCallion's appointment as finance chief, the new CFO was tasked with reporting MetLife's results during its second-quarter earnings call. He offered investors a fresh face, since, as Bass observes, McCallion was treasurer (a title he still holds) when the controls mishap and a subsequent controls weakness in a Japanese annuities joint venture surfaced.

Those were "line-of-business issues" not related to corporate treasury, the analyst notes.

McCallion's debut was no doubt smoothed by MetLife's positive first half of 2018. In the first quarter, its net income was $1.2 billion compared to $867 million in the year-ago period. While net income for the second quarter was $845 million compared to $865 million in the same quarter of 2017, CEO Kandarian and McCallion were able to explain the difference as stemming from costs associated with the Brighthouse Financial spinoff. They were also able to report solid insurance underwriting and growth in investment income.

Even better, perhaps, was McCallion's indication that the company was putting its internal controls woes largely behind it. "While an observation period is required, we continue to work towards clearing the material weaknesses during 2018," McCallion said.

Acknowledging that investors and analysts have only a few months on which to assess McCallion's performance, Bass observes that the CFO "has come across as confident and well prepared."

The next big challenge for McCallion will be to provide the company's financial outlook in December, according to Bass. "They have a history of not doing a good job of setting investor expectations," the analyst says.

"How do you deliver an outlook that is appropriately conservative, but at the same time deliver a constructive message to investors as to why they'd want to own MetLife?" he adds. | **DAVID M. KATZ**

**CFOs TO WATCH 2018**

## Mastering Media

**To say that Hulu has gone through an eventful phase of its** 10-plus-year history in the last few months would be an understatement.

The premium streaming service, which offers access to live and on-demand channels, original series, and films, as well as a library of TV shows, has experienced a whirlwind of activity.

Hulu began 2018 by announcing it had closed its fiscal year 2017 with more than 17 million total subscribers across its subscription video on demand (SVOD) and live TV plans in the U.S., an increase of more than 40% from the last publicly reported total in 2016.

Hulu's total audience grew to 54 million total unique viewers in 2017, and the company expanded its on-demand library to more than 75,000 episodes of television across 1,700 titles—more than twice the number of episodes available on other streaming services. And the company's advertising revenue reached $1 billion for the first time.

**Elaine Paul**
CFO, Strategy and Business Development, Hulu

As CEO Randy Freer noted, 2017 was a momentous year, as Hulu took several major steps toward becoming a "21st century direct-to-consumer media company."

In the midst of all this activity is Elaine Paul, who serves as Hulu's CFO and leads strategy and business development.

**"Hulu is at the white-hot nexus of media and entertainment," says Paul.**

"Hulu is at the white-hot nexus of media and entertainment," Paul tells *CFO*. "It is a really exciting time for over-the-top [OTT] video players. Consumers are rapidly shifting their viewing and dollars to OTT. And marketers are rapidly moving their dollars to digital video, where there is an opportunity to do very specific targeting."

Hulu is well-positioned to take advantage of all these trends, Paul says. "We have a dual revenue model of advertising and subscription, which gives us a business model advantage over competitors."

Prior to joining Hulu in 2013, Paul served as senior vice president of corporate strategy, business development, and technology at Walt Disney. In that role, she led various acquisitions, new business initiatives, and strategic investments, including Disney's original investment in Hulu in 2009. Prior to her positions at Walt Disney, Paul worked as an associate at McKinsey and a financial analyst at Morgan Stanley.

At Hulu, Paul has emphasized the strategic role of the CFO, acting as a partner to the CEO and fellow operating executives. That will be important, as a strategic reorganization in June brought in a new chief technology officer and Hulu's first chief data officer. The reorg is intended to align executive management around several strategic priorities: the "subscriber journey"; technology and products; content; and advertising. The new structure is designed to bring more agility,

Photo courtesy of the company

technical stability, and "alignment on the customer throughout Hulu."

It's no wonder, then, that Paul is focused on how Hulu can drive subscribers and top-line revenue as rapidly as possible. "And with subscribers on our ad-supported products comes the opportunity to monetize through advertising, which can be increased through personalization, targeting, and capitalizing on ad tech such as programmatic buying," she says.

For 2018, Hulu announced in May that it is investing more in content as well as in technology and data. That includes new measurement technology that the company's leaders say will bring the future of television to the advertising business. In addition, the company is adding the capability to dynamically insert advertising within its Hulu With Live TV product, which allows brands to reach the audience that's streaming live sports, news, and entertainment shows.

Paul's role? A relentless focus on "maximizing the efficiency" of all of those investments, she says. | **BOB VIOLINO**

# Following a Big Name

**What would be more difficult for a first-time CFO,** heading finance at a well-funded startup still running on QuickBooks or securing the mantle at a 132-year-old consumer giant that is at a crossroads? It's a tough call.

Joseph Wolk, new finance chief of Johnson & Johnson, is in the latter position. And if his new job isn't tough enough, he's also trying to fill the shoes of Dominic Caruso, the company's longest-serving CFO and one who presided over three of J&J's largest acquisitions.

**Joseph Wolk**
EVP & CFO, Johnson & Johnson

Wolk is no tenderfoot, though, having headed up an award-winning investor relations team at J&J. He has also been CFO of the company's North America pharmaceuticals group, a critical growth engine. And he has served in J&J's medical devices unit.

As head of investor relations, Wolk has had to explain to investors why J&J has lagged the S&P 500 the last six months. In an interview on the J&J website, Wolk attributed the lagging stock to a decline in the price-to-earnings ratio of pharmaceutical stocks (half of the company is valued through the high-performing pharmaceutical business); higher interest rates that make dividend stocks less attractive; and the strong U.S. dollar, which is shaving some points off the multinational's results.

**"The nice thing about the transition between [Caruso] and I is that there doesn't need to be an upheaval of policies or company protocol," says Wolk.**

Now it will be up to Wolk to get the stock going in the right direction. There's no panic at J&J. It has substantial cash flows and regularly plows capital into research and development. It also sports a "AAA" credit rating.

And the high-growth pharmaceuticals business continues to bang away, scoring 11% operational revenue growth in the second quarter, with its immunology and oncology drugs performing above market. As Wolk pointed out in his interview, J&J also has some notable pipeline drugs: a medication targeting treatment-resistant depression, for example, and a drug for bladder cancer.

## Split Ahead?

The larger question confronting Wolk and the rest of the C-suite is J&J's other divisions, especially its consumer unit. J&J products like Band-Aids and Tylenol are icons of drugstore shelves, but their stature is waning.

On the second-quarter earnings call, Wolk said the company plans to accelerate consumer growth in the back half of 2018 with a relaunch of its baby brands and "many new product introductions."

But analysts are wondering whether it's time to bid goodbye to consumer or one of J&J's other units. On the earnings call, an analyst asked if there was "an appetite internally, with the recent underperformance of the stock [and a new CFO], to rethink [the] conglomerate structure."

Don't expect Wolk or J&J to make a hasty call on a potential spinoff or divestiture. The sense is that it suits J&J to have diverse business units that can cushion each other when one or two go through a downcycle.

As Wolk has said, when the company's pharmaceuticals outfit hit a patent cliff at the end of the last decade, the unit lost almost $3 billion in revenue in 15 months. But J&J's medical devices unit came to the rescue, allowing the company to continue to invest in pharmaceutical R&D.

In addition, for the past few years, J&J has been hiring more finance people from outside the organization, to get some perspectives from companies that are more subject to economic cycles, Caruso told *CFO* in May 2017.

Since Wall Street is rewarding simplification, a spinoff is not totally off the table. But, for now, Wolk is emphasizing stability. "The nice thing about the transition between [Caruso] and I is that there doesn't need to be an upheaval of policies or company protocol," he told analysts.

At the same time, Wolk recognizes the stock needs a catalyst. "An organization the size of J&J should be financing efficiencies to enable better bottom-line performance, which is what investors value," he said. | **VINCENT RYAN**

CFOs TO WATCH 2018

## Shaping the Story

**"Bitcoin—really?"**

When Jim Cramer, the host of CNBC's "Mad Money" asked Square CFO Sarah Friar that question last November, he was referring to Friar's own background as well as the news that the mobile payments company was testing cryptocurrency transactions on its payments platform.

Before leaving Salesforce.com to become Square's finance chief in 2012, Friar spent 11 years as a Goldman Sachs managing director. To Cramer's point, Goldman CEO Lloyd Blankfein had recently expressed discomfort with bitcoin, not to mention the widely reported dismissal of the cryptocurrency by JPMorgan's Jamie Dimon as a "fraud."

Friar responded, however, that working within a company was a whole lot different than "sitting on the other side, watching." There's no time to do academic papers at companies, she noted. "The only way to get people invested in figuring out what is the 'what' about something new is to actually create a product."

**Sarah Friar**
CFO, Square

Fast forward seven months, and the experiment has become a minor financial success. Taking a small profit on each transaction, Square made $37 million in bitcoin revenue through the three months ending June 30. True, the bitcoin sales figure ran only $420,000

**"The narrative of our company will be economic empowerment," says Friar.**

ahead of the program's costs, and bitcoin revenues represented a very small part of Square's $815 million in sales. But because cryptocurrency has been such a hot story this year, the company's bitcoin efforts have become closely associated with Square's overall success, which includes five straight quarters of accelerating revenue growth.

Friar and Square chief executive Jack Dorsey have thus been struggling to portray support for bitcoin in what they see as the proper context within the company's broader strategy—and, maybe, to lower the market's expectations of Square's future cryptocurrency earnings.

In that light, another question Cramer asked Friar last year sounds prophetic: "Are you ... afraid that bitcoin will become the narrative of Square?"

The CFO replied in the negative. "The narrative of our company will be economic empowerment," she said, noting that Square has enabled small businesses to get paid in digital currencies in a way they were never able to do before. Via Cash App, the company has also empowered small banks to make mobile payments and "to make use of bitcoin if they want to," Friar added.

### Doubling Down

Square and Friar are about more than bitcoin, though. The company now lends to small businesses through Square Capital. And Friar's performance has put her in the upper echelon of tech CFOs. She sits on the board of directors of Walmart and Slack, and is a headliner at conferences.

Her focus for the remainder of 2018, though, is likely to be internal. A priority is maintaining the company's profit margins. Square's leaders want to achieve that largely by investing in three major areas: the ability to operate on all major communication channels (i.e., "omnichannel"); financial services; and international growth.

In terms of omnichannel, the company plans to invest in the integration of acquisition Weebly, a platform for e-commerce and integrated marketing. On the financial services side, the company plans outlays aimed at developing Cash Boost, a rewards program that lets customers earn cash back instantly when they make purchases from Square merchants. And the company wants to continue to expnd inernationally, with Canada, Japan, Australia, and the United Kingdom its priority markets.

"The right balance" for Square involves "really doubling down on our investment, but making sure that we're doing it while staying mindful of operating leverage in the business," Friar has told analysts. How she will manage to pull that off at the ultra-hot company will be something to watch in coming months. | D.M.K.

## Return to the Fishbowl

**For Tom Sweet, everything old is new again.**

In 2014, a year after Sweet helped take Dell private, he told *CFO* that the new experience of "trying some different things without having to worry about public perception or impact per quarter" was "liberating."

**Tom Sweet**
CFO, Dell

Well, if CEO Michael Dell and CFO Sweet have their

**Rather than do a traditional initial public offering, Dell aims to back into publicly held status.**



Photo courtesy of the company

way, they'll be back in the chains of public ownership soon.

Michael Dell is unquestionably and firmly in control of all things Dell. But when an enterprise is engaged in the sort of financial machinations that the 34-year-old computer company is betting on, its CFO is squarely in the eye of a storm, even if it's behind the scenes.

The company is taking a complex path. Rather than do a traditional initial public offering, Dell aims to back into publicly held status.

For those who haven't been following the company's saga, in 2016 Dell took a giant step toward realizing its strategy to become a more modern computing company by buying data storage and information security software firm EMC (renaming the combined company Dell Technologies).

Dell thereby also acquired the 82% stake in VMware, the publicly held cloud computing and platform virtualization provider, that privately held EMC owned. It was a massive deal, worth $67 billion.

To help finance it, Dell EMC issued a tracking stock—a specialized equity offering that tracks the performance of a subsidiary or unit. The Class V stock is also called Dell Technologies (ticker symbol DVMT), although it merely tracks the performance of VMware and confers no voting rights.

In July of this year, after long and tense negotiations between Dell financial adviser Goldman Sachs and VMware financial adviser Lazard over the value of the Dell equity, Dell announced its plan for going public.

For each share of the Dell Technologies stock—which on the afternoon of Aug. 13 was trading around $94—its holders can choose to be paid $109 in cash or get 1.3655 shares of Class C common stock to be listed on the New York Stock Exchange.

### Getting Reacquainted

The deal requires shareholder approval, and Dell is working to convince investors to back it. Toward that end, in early August the company rolled out a glowing financial forecast, projecting that from 2018 to 2022 revenue would jump by 23%, to $89 billion from $72 billion, and operating profit by 69%, to $9 billion from $5 billion.

Some were skeptical of the projections, pointing to discrepancies in the financial analyses that had been respectively performed by Goldman and Lazard and the fact that the tracking stock has consistently traded at a large discount to the publicly listed VMware shares.

With Michael Dell and his equity partner Silver Lake opting to retain their majority stake, the sense is that investors will view the move as credible and approve it. Regardless how many investors take the stock deal, Dell and Silver Lake will still own 70% to 80% of Dell Technologies.

Inside the finance department, CFO Sweet will undoubtedly be rethinking the financial metrics he's been tracking since Dell went private. As he told *CFO*, when out of the public's eye, Dell's finance team was focused on cash flow and cash management down to the business-unit level, and the company was pursuing "profitable growth, not empty-calorie growth."

But as a listed company, Dell is going to have to return to hitting revenue targets. And Sweet may be grilled about the timeframe for chipping away at the company's substantial long-term debt.

How investors receive Dell's performance, and how deftly the C-suite handles its message to Wall Street, will be big determinants in the future of this longtime computing industry giant. | D.M.

## A Cloudy Forecast

**The digital world has seen an enormous amount of change** over the decades, and IBM has lived through all of the transitions, transformations, and turmoil. The same company that was predominantly selling mainframe computers in the 1960s is now leveraging fast-growing areas such as artificial intelligence (AI), blockchain, and the internet of things (IoT).

And like many other technology companies, IBM has faced—and continues to face—its share of challenges in doing so. Inconsistent revenue growth, a slow move to the cloud, and rising competition all have dented its financial performance.

**James Kavanaugh**
SVP and CFO, IBM

IBM is also struggling to gain a dominant position in the market for cloud services such as infrastructure as a service and platform as a service. Amazon Web Services, Microsoft, and Google are cleaning its clock in those areas. However, not all is doom and gloom: the company has seen a 20% or more quarterly increase in IBM Cloud revenue this year.

> **"The challenge is that IBM faces massive competition, and fast-growing cloud competitors are a major force in the market [and are] difficult to combat."**
>
> –**Daniel Ives**, GBH Insights

A key player in IBM's attempts to sustain and build on that growth is James Kavanaugh. The CFO, just appointed to the position in January 2018, is definitely one to keep an eye on this year and beyond. He has a solid finance background, serv-

# Ten More To Keep an Eye On

**Even in a robust U.S. economy, these CFOs will have their hands full.**

● **Tim Bensley,**
*Blue Apron Holdings*

An early success, the still-youthful meal-kit delivery firm may be in an existential crisis. Hit by new competition from within and outside its niche, Blue Apron saw revenue plunge this year (along with its share price), with fewer customers placing fewer orders. New CFO Bensley is challenged not just to plug the holes, but perhaps to create a radically different business model.


BENSLEY

● **Andrew Bonfield,**
*Caterpillar*

Presumably, Bonfield, whose tenure began Sept. 1, knew what he was getting into. Caterpillar's tax strategies have been under scrutiny for years, and the company is fighting an IRS demand for $2.3 billion in taxes and penalties over an alleged tax-avoidance scheme. It's not a terribly material sum for the $45 billion company, but can Bonfield ably deal with the distraction?

● **Michael Cavanagh,**
*Comcast*

Might Cavanagh still have to justify his $40 million pay package upon joining Comcast in 2016? The conglomerate pulled out of the bidding war for 21st Century Fox assets. The winner, Disney, is now neck and neck with Comcast for second-biggest media company behind the merged AT&T-Time Warner (assuming it holds up). How will Cavanagh and Comcast respond?


CAVANAGH

● **Ryan Cameron Courson,**
*Seaspan*

At 29, Courson is among the youngest CFOs at a global, non-technology company. His employer has slowly started turning around, thanks to a better container shipping market. A looming oversupply of ships could quell demand for Hong Kong-based Seaspan's fleet of 55 for-lease container vessels. In the meantime, Courson is focused on deleveraging and finding capital allocation opportunities.


COURSON

● **Sara Furber,**
*IEX*

It's a hot CFO seat Furber was promoted to in May. The new stock exchange, approved last year to begin listing companies, said it would do so in early 2018. As of August, it was still on the sidelines. The former Morgan Stanley executive is trying to convince already-listed companies to ditch the NYSE and Nasdaq, and grappling with a Nasdaq lawsuit alleging patent infringement.


FURBER

● **John Hartung,**
*Chipotle Mexican Grill*

An 18-year company veteran, Hartung has worked since February under just the second CEO in Chipotle's history. The finance chief, who had toiled in crisis mode for a few years following a high-profile E. coli outbreak, is happily presiding over much-improved financials. But there's no room for complacency. Chipotle remains highly vulnerable to food-quality scares, the latest occurring in July.

● **Jamere Jackson,**
*Hertz Global Holdings*

Jackson might put to the test the notion that finance skills are easily transferable across industries. Slated to join rental car company Hertz on Sept. 10, he spent the last four years running finance at audience measurement giant Nielsen Holdings. Still, he may feel at home, as he's jumping from one troubled company to another. Hertz's revenue and profits have been sinking, and it's vastly underperforming its peers.


JACKSON

● **David Knopf,**
*Kraft Heinz*

It's a confusing picture for the food conglomerate at present: Its stock price has tanked by 50% over the past year, even though operating margins are expanding for the food sector. Much may ride on what Knopf, a year into his CFO tenure, does to trim a high debt-to-EBITDA ratio of 4.2. On the other hand, a higher priority may be finding some tasty, reasonably priced acquisitions.

● **Teri List-Stoll,**
*Gap*

How much is riding on Gap's pricing decisions? Amid heat over what many regarded as a confusing discount policy, the company fared poorly in its April-ended first quarter, reporting a 4% dip in same-store sales. What will List-Stoll have to say about continuing to offer large discounts—an often-deadly mistake for retailers—when most of the ailing sector is heading the other way?


LIST-STOLL

● **Jamie Miller,**
*General Electric*

Has a week gone by in 2018 without big news from GE? While most finance chiefs strive to grow their companies, Miller is presiding over finance at a steadily downsizing enterprise. Among businesses the company has retained, GE Power is a notable sore spot. But with GE's troubles seemingly having resulted from decades of bad decisions, a steely focus on overall strategy is paramount. | **D.M.**


MILLER



Photo courtesy of the company

ing as IBM's controller for seven years.

But he also previously served as senior vice president, transformation and operations. In that post he was responsible for enabling IBM's transformation to a data-driven, cognitive enterprise, redesigning the company's operating model to align with fundamental market shifts.

These shifts continue to affect the company's product strategy and show no signs of letting up as more companies move their IT infrastructures and applications to cloud-based services.

"IBM continues to see headwinds in its legacy hardware and services business, with more [enterprise] budget dollars heading to the cloud," says Daniel Ives, chief strategy officer and head of technology research at GBH Insights. Cloud computing remains front and center as opportunity, given the company's massive customer base, analytics stronghold, and potential cross-selling opportunities, Ives says.

"The challenge is that IBM faces massive competition, and fast-growing cloud competitors are a major force in the market [and are] difficult to combat."

### Reclaiming the Enterprise

The market will be a tough one for IBM's management team to navigate. Part of IBM's go-forward strategy is to capitalize on emerging technologies that are catching the eyes of enterprise customers. Blockchain is one example. Early in 2018 IBM announced it was teaming with shipping company Maersk to establish a blockchain joint venture to provide more efficient and secure methods of conducting global trade.

AI is another area where IBM hopes to secure a leadership spot. In March, the company unveiled a new data science and machine-learning platform and an "elite consulting team" to help organizations accelerate their AI strategies.

What should Kavanaugh and his fellow C-level executives be doing to restore IBM's luster?

"It's about the balance of looking for acquisitions versus organic growth opportunities in the cloud market," Ives says. "Also cutting costs and restructuring the legacy businesses while growing the faster areas such as cloud computing, security, analytics, AI, and Watson."

IBM's unparalleled distribution, customer base, and product footprint places it in a position to convert legacy customers to its next-generation cloud offerings in 2019 and beyond, Ives says. So far, however, overwhelming successes like the ones in IBM's past have been elusive | B.V.

## Taking a Shot

**If you were finance chief of Snap, the developer of** Snapchat, it would be probably impress your teenage daughter, but what about your peers? In the company's current state, they might be far from envious.

**CFOs TO WATCH 2018**

However, Timothy R. Stone, Snap's new CFO, appears to be right where he wants to be. Replacing Drew Vollero, a former Mattel executive, in May, Stone sees opportunities to drive growth initiatives and operational excellence at the seven-year-old tech company, and views Snapchat's global audience as a big asset.

Analysts greeted Stone's arrival positively. After all, he is a 20-year veteran of Amazon, overseeing financial planning and analysis and investor relations, but also heading up business units. Those included Amazon Web Services & Digital Content and the company's physical stores.

Snap's operational efficiency and communication with Wall Street should benefit from Stone's experience, say analysts. And it is indeed Wall Street that has been the thorn in Snap's side since the company's IPO, considered a notable 2017 flop. The company's shares breached $20 earlier this year, but by mid-August were back down below $12.

**Tim Stone**
CFO, Snap

Not that Snap hasn't earned the beating. Massive user growth the past few years disappeared the last two quarters. The second quarter saw Snapchat daily active users shrink 1.5%, to 188 million. The company's previous worst quarter, the opening one of 2018, saw DAUs rise 2.9%. Snapchat is fighting other social media outlets for eyeballs and attention, but meanwhile it's dealing with industry-wide price declines in the advertising business.

**For the first time, Snap shared sales and adjusted EBITDA projections on an earnings call.**

From a finance perspective, Snap had a good second-quarter story, beating expectations for revenue (48% year-on-year growth) and posting a slightly lower net loss than analysts projected. How long can Snap keep losing money, though, especially now that its all-important DAU metric is headed south?

Stone clearly has his head down working on that problem. He's particularly focused on driving operating and engineering efficiencies in infrastructure as well as operating cost structure. In the second quarter, the company saw a 26% year-over-year increase in cost of revenue, but sequentially that cost dropped 4%. Infrastructure costs experienced a similar dynamic.

Stone is also taking a microscope to operating expenses, as the company's headcount is down by about 200 this year.

The miscommunication with Wall Street requires some quick fixes. For the first time, Snap shared quarterly revenue and adjusted EBITDA projections on its August earnings call. It's expecting revenue to climb between 27% and 39% year-over-year in the third quarter, and adjusted EBITA losses to fall. But Stone also reminded analysts that historical DAU growth rates for the third quarter "have trended down."

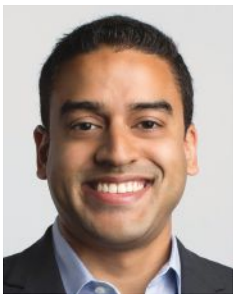
The continuing EBITDA losses worry, but the company had $1.5 billion in cash and short-term investments on its balance sheet at second-quarter's end, helped by a $250 million investment from Saudi Prince Al-Waleed Talal.

That gives Stone some runway to optimize the company's operations. Although other CFOs may not envy the challenges he faces, they may covet his compensation. He's drawing a salary of $500,000 and he received restricted stock units of $20 million when he joined in May. It will be hard for investors to complain. If Stone gets Snap headed in the right direction and revives its share price, it will be an astounding achievement. | V.R.

## Good Things in Storage?

**It was Dropbox's first earnings call last May, and CFO Ajay** Vashee had good news. The CFO of the subscription-based, cloud storage provider, which had made a splashy debut on the Nasdaq two months earlier, provided guidance that the company would record $328 million to $331 million in second-quarter revenue. He underestimated.

In fact, Dropbox's revenue hit $339.2 million last quarter, marking a tidy 27% increase from the same period in 2017. Adjusted profits increased to $48 million (11 cents per share). Both figures were better than analysts had expected, yet the value of the company's shares plunged nearly 10% the next two days.



**Ajay Vashee**
CFO, Dropbox

In fairness, shares had risen 9% before and during the earnings call, so the pullback wasn't earth shattering. And longtime chief operating officer Dennis Woodside had stepped aside. Still, no investor—or CFO—likes volatile stock swings. Fortunately for Dropbox and Vashee, the company's share price has traded in a tighter range of late.

**"In the next five years, you'll see us continue to build and integrate products that streamline team workflow and collaboration," says Vashee.**

Vashee stepped into the CFO seat in September 2016, appointed to succeed Vanessa Wittman, herself a former CFO to Watch in 2015. (Wittman left the job for health reasons.) The circumstances put Vashee in the driver's seat alongside co-founder and CEO Drew Houston in gearing up for the company's 2018 initial public offering. Vashee's background was well-suited. Earlier in his career he was an investment banking analyst at Morgan Stanley and, later, a senior associate at venture firm New Enterprise Associates. The Dropbox IPO did well, producing a 35% pop on a day when the Nasdaq index fell 2.4%.

While its share performance has been up and down since, Dropbox is seen as having a better future than other startups of its generation. Started 11 years ago as a free service for sharing and storing photos, music, and other large files, Dropbox competes against Google, Microsoft, and Amazon. But even against such heavy hitters it has done well.

The company has about 500 million registered users for its online storage and sharing services, giving it significant "word of mouth" clout. And Dropbox hews to a "freemium" business model: users are given a free account with a set storage size, with paid subscriptions available for more capacity and additional features. By providing value to these nonpaying members, Dropbox turns them into paying members, as well as de facto salespeople telling good tales, helping to expand the company's 11.9 million paid user base.

"We're focused on continuing to drive growth by converting more users to our paid plans, and increasing average revenue per paying user," Vashee tells *CFO*.

### A Rising Tide

Fortunately, the cloud, Dropbox's domain, is hotter than hot. Worldwide spending on cloud services and infrastructure is expected to grow at a 22% average annual clip, IDC estimates, reaching $277 billion in 2021. Assuming Dropbox gets a decent piece of this pie, its long-term growth could be astonishing.

"Only a few years ago, we were a team of just over 100 people, generating less than $50 million in revenue," Vashee says. "Today, we have a robust and scalable business with more than $1 billion in annual revenue and 12 offices worldwide."

Optimism runs high at the company, which announced last year that it had signed a lease for its future home in San Francisco's Mission Bay neighborhood. The LEED-platinum four-building complex is under construction to provide 736,000 square feet of office space for Dropboxers.

Vashee says Dropbox is on a mission to "unleash the world's creative energy by designing a more enlightened way of working." More practically, he aims to keep Dropbox innovating and growing.

"In the next five years, you'll see us continuing to build and integrate products that streamline team workflow and collaboration," Vashee says. "Ultimately, we believe these products will deliver even more value to our users, and we're excited about the road ahead." | R.B.



Photo courtesy of the company

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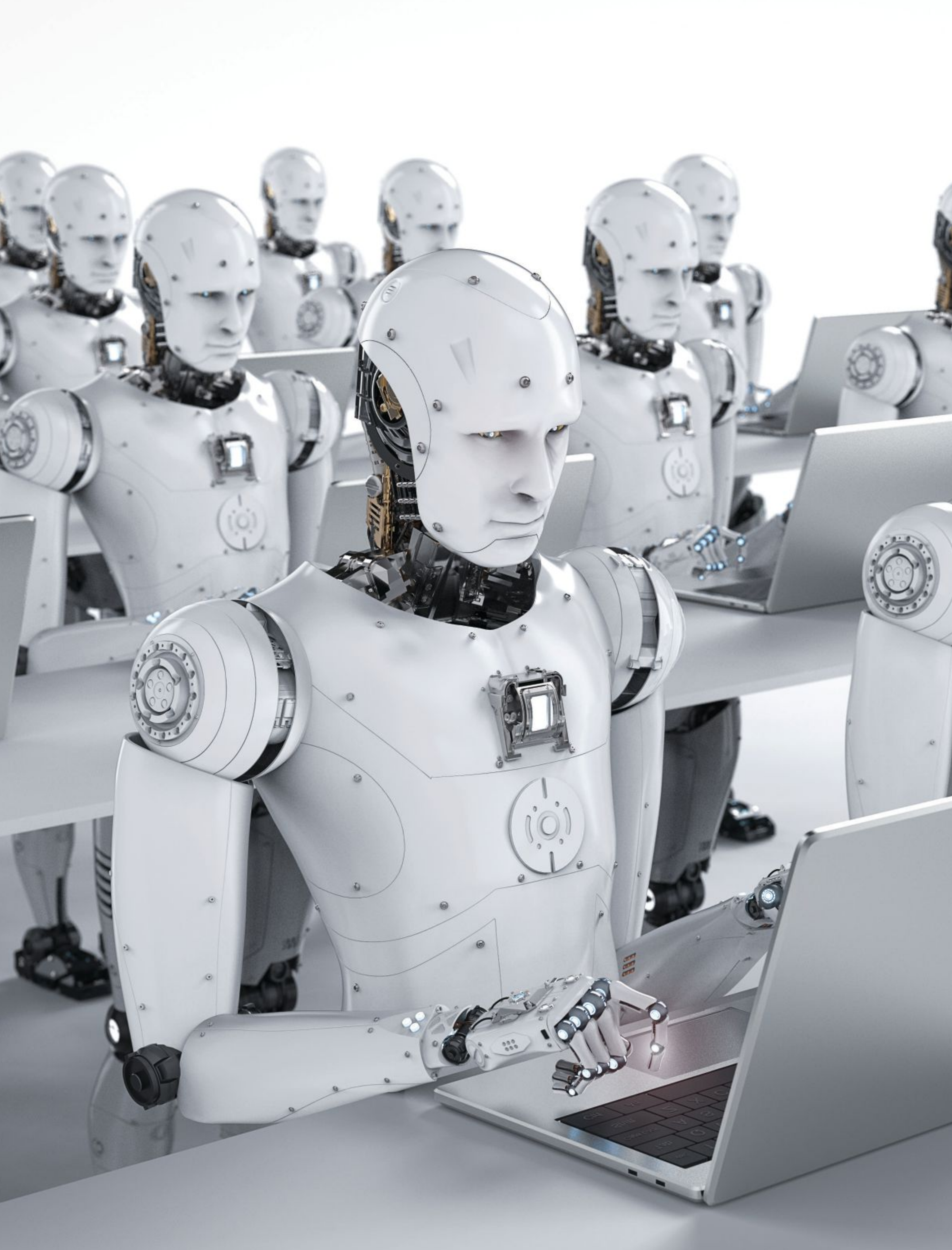


SPECIAL REPORT

Robotic Process Automation

# The New Digital Workforce

## Robotic process automation emerges from the back office to take on core finance tasks. **By David McCann**

In a few years, robotic process automation may very well merge with or be rendered moot by artificial intelligence. But for now RPA, as it is known, commands the attention of enterprises and their finance teams to a degree few relatively new technologies have.

Management consulting firm McKinsey says that more than 80% of companies it has spoken with are experimenting with, implementing, or broadly scaling the technology. And the activity is not confined to large companies—businesses across the size spectrum are piloting this flexible, promising software, according to Brandy Smith, of McKinsey's automation-at-scale practice.

As has been true since RPA's birth a few years ago, it's most commonly found in the back office, automating workflows like procure-to-pay, order-to-cash, and record-to-report. The common link among such processes and others suited to RPA: they are business-rules-based, non-subjective, repetitive tasks. Effective implementation can result in greater efficiency and productivity, fewer errors, and higher workforce productivity.

But now robotic software appears ready to move to a more visible position in the enterprise: companies are increasingly applying it to core finance processes.

Based on a survey of 64 corporate controllers at companies with greater than $1 billion in revenue, as well as other quantitative and qualitative research, Gartner found that 50% of controllers and their teams are either in the process of implementing RPA (31%) or are in what it calls "operational" mode (19%). And within just two years, Gartner expects 88% of such controllership functions to be in one of those two buckets.

Many companies, concerned about financial-reporting risk, had paused before expanding their use of RPA to core finance from shared services, notes Johanna Robinson, a finance practice leader at Gartner. But now that the technology has amply demonstrated its reliability, the move to core applications is in full swing.

**"I've told them, 'Look, if you keep yourself current in capabilities and learn how to use robotics to make yourself more productive, why would I cut your job?'"**

—David Turner, CFO, KPMG

### Hours of Savings

Use of RPA now runs the gamut in finance, automating aspects of financial closing and consolidation; account, bank, and inter-company reconciliations; general-entry posting; cash flow-statement preparation; fixed-asset accounting; inventory accounting; and tax reporting, among other applications.

"If you're not investing in RPA for core finance functions, you're missing a lot of opportunities," Robinson says. And, ultimately, as AI becomes more available, mainstream, and useful, enterprises that haven't built the requisite automation skills and knowledge will be that much farther behind the curve, she adds.

As an example of the efficiencies to be gained from just error reduction, Gartner estimates that 70% of the accounting rework performed to fix errors before a financial close is necessarily manual. The rest of the rework is avoidable using automation.

For an accounting team with the equivalent of 40 full-time employees at an average annual salary of $75,000, that would amount to about 25,000 hours and $900,000 wasted on work that could be automated, Robinson estimates. "Our conversations with CFOs suggest that the real numbers could be twice that much," she adds.

Enterprises may expect to pay a lot

iStock



for such savings. But developing bots is generally inexpensive. "The cost of building them is much lower than what I'm used to from a technology-investment standpoint," says Deanna Strable, CFO of Principal Financial.

Still, few companies delving into RPA intend to use the technology to cut headcount. "We didn't go at this because of cost efficiency," Strable says. "We'll monitor that over time, but it's more because we're a growing organization. We need to support that and also reduce the chance that we'll have to increase staff."

Gaining knowledge about RPA programming, maintenance, and tracking—as a needed first step toward taking full advantage of intelligent automation—is a priority for the finance team at KPMG.

The Big Four accounting and professional services firm is about 55% of the way toward achieving an initial goal of creating 200,000 hours of workforce capacity savings. And the importance of that mission is not something that CFO David Turner plans to let his charges overlook.

He says it's important to convince existing staff that "creating capacity and scale" really is the top payoff. "I've

## What RPA Costs

**Typical recurring annual costs per individually purchased bot: $12,000 - $16,000**

**Typical recurring annual costs per bot, enterprise agreement (minimum 10 bots): $10,000**

**All-in, year-one costs per bot, including solution scoping, process re-engineering, programming, implementation, and testing: $40,000 (estimated)**

Source: Gartner

## Seeing Is Believing

**A financial services company finds early success piloting RPA in treasury and tax.**

Shortly after Deanna Strable was promoted to CFO at Principal Financial in February 2017, she attended a conference for finance executives. While networking, she found that about half of the group was talking about robotic process automation.

"To be honest, I didn't even know what RPA was at that time," Strable says.

But the use cases her co-

**"Just what we have in production right now should save us 75,000 hours annually."**

—Deana Strable, CFO, Principal Financial

attendees had already found, mostly in accounts payable and finance operations, were eye-opening. She went back to the office and got to work, enlisting the aid of an IT executive to create a pilot program.

The processes identified as being ripe for automation "were maybe not the most complicated ones or those with the most potential benefits, but rather those we felt we could get up and running quickly and start to give people some exposure to what could be done with robotics," Strable recalls.

One bot was deployed in treasury, to run a daily process of reconciling cash and liquidity positions across a number of accounts.

When Strable viewed a demo of the bot in action, the process had to be slowed down so the human eye could follow it.

"It was just amazing, seeing it log into different systems, export data into Excel worksheets, format the worksheets, and identify outliers that needed to be emailed to a person."

Another pilot bot was programmed to automate data collection for a set of tax reports and streamline some of the manual tasks related to producing the reports. While the bot was built to handle a certain type of report, "we built it in a way that makes it very easy to replicate the coding to work for other types of reports," the CFO says.

A third bot performs daily reconciliations of bank accounts to the balances showing in Principal's ledger systems. Previously, a person spent four hours per day on the task; that's been greatly reduced.

While Principal's RPA journey has barely begun, it's already viewed as a big success. "Figuring out the ROI is easy," says Strable. "Just what we have in production right now should save us 75,000 hours annually." | D.M.



iSock



told them, 'Look, if you keep yourself current in capabilities and learn how to use robotics to make yourself more productive, why would I cut your job?'"

Turner intends to train the entire staff on how to program and leverage bots. "I then will set them loose on their own work flow," he says, "because I think they will find out what to do better and faster than we could."

## Mindset Adjustments

How can organizations optimize the use of RPA? Gartner's Robinson offers some key thoughts.

First, to gauge the cost and produc-

# Not the First Choice

**For the finance chief of Zebra Technologies, RPA is "just part of the toolbox."**

**Zebra Technologies creates augmented reality technology that helps increase productivity in warehouse environments, featuring optical-based wearable devices.**

Not all CFOs are brimming with enthusiasm about RPA or think it heralds a vast improvement in productivity.

At Zebra Technologies, a manufacturer of barcode scanners, data-tracking systems, and information management tools, finance chief Olivier Leonetti isn't expecting an automation revolution until AI capabilities become more mainstream.

Zebra employs robotics for some repetitive transactional processes, but only "at the fringe," Leonetti says. "For major operations, we believe we are better off hard-coding new automation processes into our ERP." Leonetti says his ERP offers a higher level of robustness and rigor than RPA.

However, some business automation experts are skeptical that Zebra's approach would work for most companies.

While many of the processes for which RPA is best suited can indeed be programmed into some ERP systems, "clients tell us it's hard to get the business case approved" unless a new ERP is being installed, says Weston Jones of Ernst & Young.

The issue is cost. While RPA is relatively inexpensive, programming process automation into an already-installed ERP often requires additional software, custom development activity, and IT resources, says Jones.

**"For major operations, we believe we are better off hard-coding new automation processes into our ERP."**

—Olivier Leonetti, CFO,
Zebra Technologies

But for Leonetti, automation, wherever it's sited, ranks fourth on the priority list for realizing back-office process efficiencies, behind elimination, standardization, and centralization.

Even with respect to automation, "RPA is just part of the toolbox, as are ERP enhancements," Leonetti notes.

In fact, Zebra ultimately decided not to automate some processes that it identified as candidates for RPA a year ago.

"Just putting a process through a funnel and looking at the way it was being deployed allowed us to identify simple process improvements that drove benefits without going through automation," says Leonetti.

For the processes that the company did apply robotics to, there were some bumps in the road, he adds. For one, "we were too ambitious. We started with complex processes that included many manual and repetitive actions but that also required creating a lot of decision trees. We weren't ready for that."

Second, Zebra took on too much of the RPA management activity, realizing only later that its finance organization couldn't handle it. So Leonetti hired a third party, Tata Consultancy Services, to program and manage the company's bots. | D.M.



Images courtesy Zebra Technologies

tivity impact, organizations need to focus on hours of work displaced, rather than the number of bots or variety of processes automated.

A caveat there is that while today's bots can be programmed to execute multiple processes, a single bot can handle only one task at a time. That requires careful scheduling of the bot's time to ensure that the more important tasks are completed first.

Second, although standardizing processes before automating them is ingrained in finance professionals and works for ERP and other big enterprise technologies, "with RPA you can standardize as you automate," Robinson says.

Change happens naturally, she adds. Coding the bots involves a logical set of "if-then" steps for replicating very granular actions. While going through the steps, the programmer likely will find some places to improve the logic and skip steps that humans usually take.

Third, with RPA there is no need to automate a process from end to end. Organizations can pick individual steps to automate. "That's very different from the traditional finance mindset, where you're always thinking about end-to-end," says Robinson.

In fact, today's RPA tools aren't actually able to fully automate most end-to-end finance processes—even procure-to-pay, order-to-cash, and record-to-report, says Weston Jones, Ernst & Young's global leader for intelligent automation.

"The tools do a really good job with work packets, but most of the end-to-end processes are too complex," says Jones. "The tools don't fully automate all the handoffs between procurement, finance, and other silos, and you still have to have people involved when there are exceptions."

That's why, although more companies are using RPA and finding new use cases, Jones characterizes its penetration as still very low. "There's a lot of cherry-picking—bits and pieces of processes being automated."

The ability to program bots for a plethora of small tasks and run them on desktop computers poses a risk for companies, especially multinationals, Jones notes.

That's because bots break. Any time an update is made to any software that a bot interacts with, or to a web page that incorporates bot-controlled processes, the bot will typically cease to function until its code is reworked.

"Common things like Adobe Acrobat and Microsoft Word are always updating," Jones notes. A company that deploys hundreds or thousands of bots across operating units worldwide faces a serious change-management issue.

The problem is not insurmountable. A bot that runs on a desktop computer must be individually recoded every time there's a software change. But if all bots reside on centralized servers, those affected by a particular software update can be recoded all at once.

## What to Use Bots For

### Ideal Candidates

- **Accessing web enterprise applications**
- **Collecting data from various applications**
- **Copying and pasting**
- **Extracting structured data from documents**
- **Following if/then rules**
- **Opening email and attachments**

### Poor Candidates

- **Creating annotations for data variance**
- **Making subjective decisions**
- **Performing exploratory data analysis**
- **Translating handwritten notes to digital text**

Source: Gartner

### A Mere Stepping Stone?

What will RPA look like in a few years? The major vendors are working to enhance their bot-building platforms with the pattern-recognition capabilities that drive machine learning. That would allow bots to get smarter over time, rather than just following their programming.

RPA occupies a lower position on a spectrum of what's generally called intelligent automation. Machine learning is a step up from there, and full-blown artificial intelligence is beyond that.

For all the hype over AI, surprisingly few companies are doing anything with AI-enabled technologies except conducting small pilot tests. But some think it won't be a matter of years but mere months before RPA begins linking up with the more advanced capabilities in ways that will be meaningful to a large swath of companies.

"We think that the lines between RPA, machine learning, and AI are going to start to blur within just 12 to 18 months," says McKinsey's Smith.

According to Gartner, while 56% of companies are evaluating AI for accounting and finance automation, only 5% of them are in the implementation phase. But by 2020, 31% of companies are expected to be in the implementation phase and 26% in "operating" mode.

For vendors, those trends could lead to either a war for survival or a softer merging of robotics and AI players, marked by a significant phase of consolidation.

"The big technology players are starting to place bets and have relationships with the automation and AI players," Smith observes. "You could see them using their influence and R&D investment dollars to shape what the new solutions are going to be." CFO

BUSINESS OUTLOOK

Duke University/*CFO* Survey Results

# Data Security, Talent Scarcity Preoccupy CFOs

**Still, U.S. finance chiefs are no less optimistic about the economy and predict robust 12-month growth for hiring, earnings, and capital spending.**

**By David McCann and Vincent Ryan**

If only CFOs could fully get back to doing their day jobs setting and executing on company strategies and overseeing financial reporting activities. Instead, they're stuck spending way more time than they'd prefer on keeping criminals at bay. But that hasn't dimmed their outlook on the U.S. economy in the next 12 months.

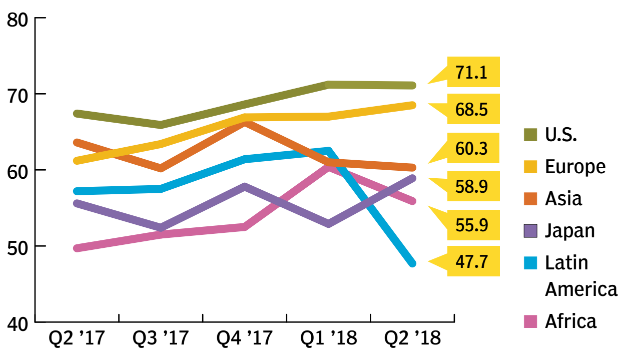
Concern about data security is at an all-time high among finance chiefs, according to the June 2018 Duke University/*CFO* Global Business Outlook Survey, which polled about 600 CFOs, including nearly 250 from North America.

Finance chiefs at one in five U.S. companies that participated in the quarterly survey admitted that hackers have breached their computer systems. And "there are probably many more who don't know that their company's systems have been breached," said Cam Harvey, a founding director of the survey and a professor at Duke University's Fuqua School of Business.

"Companies are defending themselves from near-continuous denial-of-service attacks and critical data breaches," Harvey said.

**Economic Optimism Highest in U.S., Europe; Latin America Plunges**

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




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

Most U.S. companies are moving to reduce data security and risks and system vulnerability points. In the survey, 71% of the organizations represented have installed anti-penetration features like two-factor authentication or more stringent password protection. Also, 54% of the companies have upgraded employee training, and almost half have hired outside data security experts.

## Higher Rates and Wages

Because of the constant drumbeat in the media about higher interest rates and actions taken this year by the Federal Reserve's Open Market Committee to keep the economy from overheating, the survey asked U.S. executives about their companies' cost of borrowing.

In general, finance chiefs expected interest rates on their debt to increase over the next year. The typical firm projected its long-term borrowing rate would increase to 5.8% from the current 5.2%.

Higher interest rates next year would lead a typical firm to reduce capital spending growth from about 8.3% this year to about 7.1% in 2019, the survey found. Extremely high interest rates that pushed long-term borrowing rates to as high as 7.5% would force companies to cut capital spending growth to 5.4%, according to the survey.

"Rising interest rates dampen companies' incentive to borrow and spend, slowing economic growth," noted John Graham, a finance professor at Duke and director of the survey.

The greatest proportion of finance chiefs (27.6%) indicated the environment for bank borrowing was still "somewhat attractive." About one quarter of them (24.4%) described it as "neither tight nor attractive," and 21.2% called it "very attractive."

If higher interest rates did not crack the list of top-five management concerns in the second quarter, what did? The top concern was difficulty attracting and retaining qualified employees, followed by government policies, the aforementioned data security, and regulatory requirements. Rising wages and salaries was fifth.

The proportion of companies indicating they were having difficulty hiring and retaining qualified workers remained close to a two-decade high. More than 4 in 10 surveyed finance chiefs (41%) listed that matter as a top concern.

U.S. finance chiefs don't seem to be expecting any letup on this front. Overall, executives said their companies would boost employment by a median of 3% in 2018 and hike wages an average of 4%. Wage inflation is expected to be strongest in the technology, transportation, and service/consulting industries. Perhaps concomitantly, U.S. companies expected the prices of their firms' own products to increase by close to 4% over the next year.


**71%**

**U.S. finance executives who said their organizations have installed anti-penetration features like two-factor authentication or more stringent password protection**

## Sunny Outlook

Despite worries over the security of data and the hiring and retaining of talent, the level of optimism among U.S. CFOs remained at an all-time-high in the second quarter. (The survey has been performed for 89 consecutive quarters.) Optimism was measured at 71.1 on a 100-point scale.

In addition, U.S. CFOs' optimism about their own companies' financial prospects reached 71 in June, up from 70.1 at the end of the first quarter and 69.2 in the second quarter of 2017.

U.S. finance executives projected earnings growth of 9.5% over the next 12 months and average capital spending increases of 8.3% (with a median of 5%). Revenue growth expectations remained the same from the first quarter, at 6.9%.

The high level of optimism has also increased expectations for merger and acquisition activity, as more than 70% of CFOs said they expected more mergers and acquisition deals to be reached in the next 12 months.

In most of the rest of the world, the outlook was not as bright.

CFO optimism fell in every other region the Duke survey covers except Japan and Europe. In Europe, economic optimism inched up to 68.5, from about 67 in the previous two quarters and 61.2 in June 2017. CFOs of European firms forecast less earnings growth than their U.S. counterparts, predicting a rise of slightly over 3%. Capital spending growth was forecast at 6.2%.

Still, European executives projected a 2.9% increase in full-time employees in the next 12 months and a 3.1% bump in salaries and wages. The rise in prices of their own firms' products, however, was much less than expected in the United States, at 1.1%.

In Latin America, where some countries are experiencing political and economic upheaval, economic optimism plunged, to 47.7 from 62.5 in the first quarter. The lowest scores came from executives in Ecuador, Brazil, and Peru.

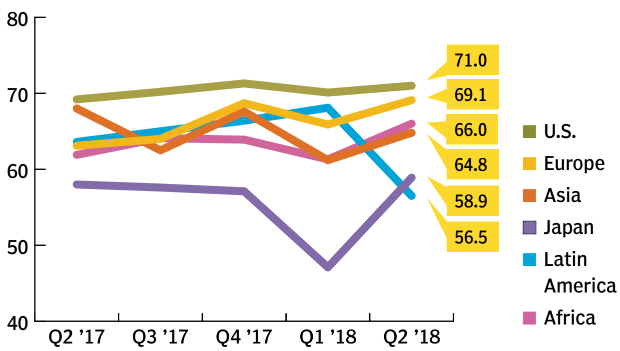
Region-wide, executives expected capital spending to grow only 2.5% at Latin American companies in the next 12 months, and full-time employment to grow 2.2%. With the rampant inflation hitting parts of the region, Latin American finance executives projected wages and salaries to rise an average of 4% in the next year, just slightly below robust general inflation expectations of 4.1%.

Meanwhile, economic optimism in Asian countries (except Japan) fell to 60.3, from 61 in the first quarter. Last June, optimism in Asa was 63.6. Asian finance executives projected 12-month earnings growth of 5.7%, capital spending growth of 7%, and revenue growth of 4.8%. They indicated they expected wage and salary increases of 4.1% and general inflation of 4.3%.

Given the projections of finance chiefs around the world, rising wages and prices are likely to be persistent problems heading into 2019. CFO

### Company Confidence Highest in U.S., Europe, Africa

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




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

Source for all charts: Duke University/*CFO* Global Business Outlook Survey of finance and corporate executives. The survey concluded June 8, 2018, and generated responses from about 600 CFOs, including nearly 250 from North America, 62 from Asia, 99 from Europe, 151 from Latin America, and 32 from Africa.

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# From Archivist to Strategist to ... Futurist

**Digital transformation represents a new direction for businesses, but it's also a transition for the CFO. By Chris Schmidt**

As organizations face an onslaught of fast-moving, high-impact technological advances—artificial intelligence and blockchain, to name two—it falls to finance leaders to lay the groundwork for their companies' transformations to fully digitized business models.

A recent survey conducted by CFO Research, in collaboration with Tata Consultancy Services (TCS), sought to measure to what extent finance executives have begun to prepare their organizations for a new era that TCS calls "Business 4.0."

The online questionnaire from CFO and TCS drew 689 responses from senior finance executives in the United States and Europe. The majority of respondents, representing a variety of industries, held the titles director of finance, CFO, CEO, president, and managing director.

As digitization spreads throughout the economy, the most successful CFOs will be those who consistently figure out how best to integrate the new technologies to deliver added value.

The path to Business 4.0 requires finance leaders to make strategically selective investments, balancing leading-edge technologies with those that are sufficiently dependable to produce visible improvements in operational and financial performance.

In addition to technological issues, there are also managerial challenges associated with continuously enhancing digital capabilities. They include effectively allocating people resources; recruiting and incentivizing the necessary talent; and aligning functions such as marketing and product development.

## Laying the Foundation

For starters, finance chiefs need to evaluate their companies' capabilities, zeroing in on six specific areas that constitute the core of any digital strategy: analytics and measurement; agility and efficiency; business architecture; governance, risk management, and compliance: shared services/business process outsourcing; and organizational alignment.

In the survey, respondents most frequently ranked their finance functions' digital capabilities in the six areas as "moderate." For example, 37.5% said their organization's business architecture was neither ad hoc (a score of 1) nor completely streamlined and integrated (a score of 5), but somewhere in the middle of those two.

"Analytics and measurement" and "agility and efficiency" were slightly less frequently graded as "moderate" and drew more respondents to the lower end of the scale.

On the other end, "governance, risk management, and compliance" most frequently ranked high, with 29.5% of respondents giving GRC at their companies a 5, meaning it is "well controlled." (See Figure 1.)

The relatively lackluster scores in some areas could suggest complacency. But having watched digital "disruption" turn many an industry upside down, respondents were clearly aware

**FIGURE 1**

About a quarter of companies ranked their organizations in the highest tier across six capabilities that underpin digital strategy.

**% of respondents giving their companies the highest or lowest score**

| | Highest score/ Lowest score | Scores defined as: |
|---|---|---|
| **Governance, risk mgmt., & compliance** | 29.5%/2.8% | Well controlled/Not controlled |
| **Organizational alignment** | 23.7%/3.7% | Integrated and centralized/ Distributed |
| **Analytics & measurement** | 23.5%/4.3% | Use of analytics, big data/Local GAAP |
| **Business architecture** | 21.8%/4.0% | Streamlined, integrated/Ad hoc |
| **Agility & efficiency** | 21.3%/4.0% | Customer-centric, cost-optimized/Simple, cost efficient |
| **Shared services/BPO** | 20.6%/5.2% | Centralized, leveraging RPA/No shared services |

that a wait-and-see approach is not an option.

As evidence, 56% of respondents that ranked their organizations in the lower tiers of agility and efficiency plan to move to a higher tier, becoming more customer-centric and cost-optimized, in the next 12 to 18 months.

## Transformation Imperative

The senior finance executive must serve as catalyst, shaping a company-wide environment that engenders and supports real-time decision-making and collaboration.

For finance to draw a realistic plan for achieving such goals, it needs to assess how digitally astute the company is—including evaluating finance's own capacity, and potential, for providing leadership in such a dynamic situation.

**59%**

**Finance executives who said they plan to increase their total spending on digital transformation initiatives by at least 5% in their next annual budget**

Now, with technologies like artificial intelligence and robotic process automation (RPA) arriving on the market, digitization can also be applied to processes. In the survey, senior finance executives rated their organization's performance in four different areas of digital competency.

The four areas, vital to creating a business that supports growth in a digitized organization, are:

- Digital enablers—technology-based architectures, platforms, apps, and interfaces required to build and achieve digital goals
- Digital strategy—defined and measurable vision, goals, and objectives in place to drive digital business outcomes for the short and long term
- Digital leadership—accountability for, and ownership of, those goals, objectives, and vision
- Business structures, ecosystems, and culture—the business, operating, organizational, and capability models supporting execution and sustainability of the digital strategy

A good number of executives that took the survey assigned a 1, defined as "cautious follower," to their companies for the digital enablers category. (See Figure 2.) That suggests these companies have yet to master the implementation of real-time, available, and integrated solutions or to enable multi- or omni-channel distribution.

A majority of respondents who ranked their companies highly—assigning them a 4 or 5 ("industry leader") across the four dimensions of digital competency—shared a common goal. More than three-quarters, 77%, plannned to increase their total spending on digital transformation initiatives by at least 5% in their next annual budget. (Only 59% of the total survey population planned to do the same.)

That high percentage (77%) suggests that investing in digital technology is the best argument for continuing to invest in it. Respondents that have successfully embarked on transforming their businesses digitally feel validated in continuing to follow that path.

Clearly, senior finance executives understand that adopting Business 4.0 and making the digital shift is essential to growing their organizations. The drive toward digital transformation is reshaping their work along with everyone else's. CFOs must juggle the twin challenges of keeping the existing business growing and leading the way to reinvent it.

Can they possibly do it all? An overwhelming majority of respondents to the survey, 86%, insisted that their finance function can effectively engage on digital topics, sponsor digital initiatives, and move the organization to the desired level of digital competency. The CFO's part in the digital transformation represents the culmination of the role's ongoing overhaul. Time will tell if finance chiefs are really up to the task. CFO

**FIGURE 2**

Respondents ranked their companies in four areas of digital competency; almost 25% indicated their company was an "industry leader" in digital strategy.

**% of respondents giving their companies the highest or lowest score**

| | Highest score/ lowest score | Scores defined as: |
|---|---|---|
| **Digital enablers** | 21.4%/8.0% | Use of real-time, available, and integrated solutions/Point solutions |
| **Business structures, ecosystems, culture** | 22.1%/6.2% | Digital is explicit in business model/ Digital is an add-on |
| **Digital strategy** | 24.6%/5.9% | Measurable objectives; innovation-based programs/ Wait-and-see approach |
| **Digital leadership** | 23.1%/6.8% | Specific digital accountabilities/Digital as an add-on to accountabilities |

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THE QUIZ


# A Month of Infamy

**Ten years ago was a dark time for finance and the global economy. The financial crisis did provide *CFO* with a rich vein of story angles, stemming from—just for starters—the bankruptcy of Lehman Brothers, a liquidity crisis for credit default swaps enthusiast AIG, and the subprime mortgage crisis. Test your memory of that stormy period in 2008 here.**

1 How much did Bank of America agree to pay to acquire Merrill Lynch?

A. $36 billion
B. $81 billion
C. $24 billion
D. $50 billion

2 Which of the following financial services firms did NOT become a bank holding company in 2008?

A. GMAC
B. CIT
C. Barclays
D. American Express

3 How much was the Federal Reserve Bank of New York authorized to lend to AIG?

A. $85 billion
B. $62 billion
C. $97 billion
D. $112 billion

4 What was the U.S. unemployment rate at the end of the first week of September 2008?

A. 6.1%
B. 7.2%
C. 6.6%
D. 7.5%

5 Which group was the target of temporary restrictions issued by the SEC on Sept. 18?

A. Ratings agencies
B. Investment bankers
C. Mortgage lenders
D. Short sellers

6 Which country closed its stock markets for two days in the middle of the crisis?

A. United Kingdom
B. Greece
C. Russia
D. Italy

7 Which eurozone country became, on Sept. 25, the first to officially fall into recession?

A. Germany
B. Spain
C. Ireland
D. Greece

8 How much did JPMorgan Chase agree on Sept. 26 to pay for savings-and-loan Washington Mutual, which had been seized by federal regulators?

A. $4.6 billion
B. $5.9 billion
C. $2.4 billion
D. $1.9 billion

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



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