CFO

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Job Requirements

10 roles finance chiefs have to master


Successful CFOs have
a secret weapon.

IN THIS ISSUE

February/March 2021
Volume 37, No. 1

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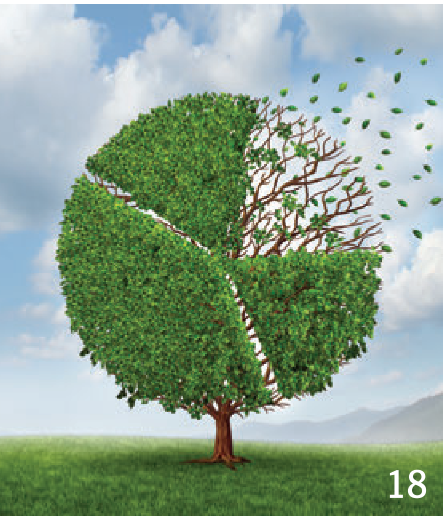

Up Front

By the Numbers

Getty Images (4)

FROM THE EDITOR

Who's a CFO?

Our cover story looks at the requisite competencies and skills for finance chiefs, but it leaves open the question of who gets hired as one. ¶ The annual Crist|Kolder Associates Volatility Report provides some answers. The search firm collects data on the turnover of C-suite executives and the most common career paths and backgrounds of the people who hold the CFO position.

The report tells us, for example, that Big Ten universities have produced the most finance chiefs for eight years running. Some other interesting facts for 2020:

- 43% of CFOs were hired from outside the company, up from the historical average of 38.7%.
- Only 30% of CFOs have public accounting experience.
- Of those promoted to CFO, 19% had a previous corporate finance position just prior. The second-most popular prior positions were corporate controller and chief accounting officer.
- C-suite promotions from CFO to CEO have fallen since 2016.
- The percentage of female CFOs has hovered around 12% for the past five years, but the percentage of ethnically and racially diverse CFOs has slowly risen (hitting 10% in 2020).

The central takeaway is that CFO turnover is still high among the Fortune 500 and S&P 500 companies studied—the industrial and services sectors had the highest rates, both north of 17%. Why so high? Part of that has to be the vast expectations boards and CEOs have for the finance chief. For that, see the cover story I mentioned, "10 Vital Roles for CFOs," on page 32.

A New Era

We can't let this issue of the magazine slip by without mentioning CFO Media Group's new owner—Industry Dive, a leading business journalism company.

Industry Dive publications offer in-depth coverage of more than 20 industries. One of its publications is CFO Dive. If you're a finance chief and haven't signed up for the CFO Dive newsletter yet, put it on your to-do list. It offers the best daily coverage of topics critical to the CFO position.

Teaming up with CFO Dive will allow us to focus on our core journalistic mission—market research, expert advice, how-to stories, in-depth executive interviews, timely commentary, and thought leadership. We're excited to be embarking on the next leg of the CFO brand's incredible journey.

Vincent Ryan
Editor-in-Chief

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EDITOR'S PICKS

GROWTH

In "**What U.S. Startups Get Wrong About Expanding into Europe**," venture capitalist Stephen McIntyre writes that a common misstep is "success amnesia." Because the average startup is six years old before it opens a European office, management often forgets "the dirty work required in the early days. Even the best products don't just take off on their own." Read more on the Harvard Business Review website.

VALUATION

During the GameStop trading frenzy, many investors and finance experts asked whether a company whose stock price and business is beleaguered can take advantage of such a price rise to make itself a more valuable firm. The "dean of valuation," NYU's Aswath Damodaran, addresses that question in "**The Price-Value Feedback Loop: A Look at GME and AMC!**" Read more at the Musings on Markets blog.

STRATEGY

"Do not assume you should change your competitive strategy only because something has changed and the knee-jerk, do-something alarm is roaring," advises Mark Chussil, who conducts business war game tournaments. In "**When to Switch Strategy in a Crisis**," he explores what his tournament simulations teach about the value of switching (or not switching) strategies in tough times. Read more on the HBR website.

Mark Bennington

"COVID-19: The Risk Management Part Is Unfinished" (page 26) discusses what actions senior risk managers and executive management should undertake to deal with the crisis and its aftermath.

"**Succinct and brilliant summary of how enterprises can and should address enterprise risk challenges** now and post-pandemic," said one CFO.com reader in response to the online version. "In addition to learning the lessons from this shock, organizations can take advantage of this particular crisis within their industries by reinforcing the synergies between enterprise risk and organizational strategy."

In response to **"A New Year's Resolution: The CFO Should Own Digital Transformation"** (January 7), one LinkedIn reader commented: "I would also stress a strong partnership with your CIO. Regardless of top-down or lateral structure, **this is an equal partnership that will benefit the strategic direction of the institution**. This will create a much more agile organization and save money on the front end."

Another LinkedIn reader agreed: "To maximize the value of the finance leader to an organization, they should wisely seek strong partnerships with all departments. **Finance leaders are the true business partners to all departments and senior leaders.**"

They continued, "The CFO has the best holistic, enterprise-level view. Departments are siloed across multiple, separate business units, resulting in islands of initiatives that don't connect. As the keeper of the coins and the data owner, **the CFO is best positioned to understand individual efforts and build the bridges necessary to align to a centralized strategy.**"

"Five Lessons for CFOs As We Approach 2021" (December 21) outlined the ways that companies can build resilience and weather future challenges.

"The role of the CFO is not easy," commented one reader. "**You need to balance risk and reward and ensure that the company is spending its money in the right place and on the right things**, which can make or break the company, especially in this current environment. Finding the right balance is critical."

Responding to **"The Board's Role in Crisis Response"** (January 19), one CFO.com reader said: "Today, virtually every public company board has these plans in place. The best private companies do, too. **Keeping plans current is crucial since complacency can occur.** The good news is that there have been so many crises lately that boards in general are on top of this issue."

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E-mail us at letters@cfo.com. Please include your full name, title, and company name. Comments are subject to editing for clarity and length.

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TOPLINE

STATS OF THE MONTH

FIRST STIMULUS

161 million
Total number of payments sent by IRS to households

$271 billion
Total amount of the payments

75%
Payments going to households with less than $100K income

122.5 million
Number of payments sent electronically

3.5 million
Number of payments sent via debit card

Source: Internal Revenue Service

AUDITING

Mixed Reviews for Auditors' Performances

Audit committee chairs found good and bad in 2020's public company audits. By Vincent Ryan

Big Four firms have been touting improvements in audit quality for a couple of years, and it's a top goal for the Public Company Accounting Oversight Board.

But have the Big Four and others put their highly visible recent missteps behind them? The Public Accounting Oversight Board discussed 2020 audits with 300 audit committee chairs of public companies. In a tumultuous year, audit chairs found strengths and weaknesses in auditor engagements.

Many of the audit chairs praised their auditors' efforts at client communications, describing them as "thorough, timely, and at the right level of detail," according to a PCAOB summary. Several audit chairs thought dashboards for tracking the real-time progress of their audits were particularly valuable. Other areas of strong performance by auditors, in the eyes of committee chairs, included their practical approaches to problem-solving and their maintaining continuity of audit teams.

But there were plenty of weak points. Audit chairs cited junior audit team members' understanding of the client's business, guidance about third-party vendor controls, "over-auditing" and "over-documentation," and visibility into and discussion around fee changes. Some chairs flagged audit partner rotation—a regulatory requirement—as also deserving attention.

While audit chairs embraced dashboards, emerging technologies presented some challenges, they told the PCAOB. For example, they said the technological capabilities of the client and the audit firm were sometimes at different levels, preventing the full realization of technology benefits. Audit chairs also called cybersecurity a concern, especially with the pandemic's shifting much audit work to remote. Audit firm implementations of internal controls over their own technology were also a worry.

In general, audit chairs appeared circumspect about some of the new tools. Auditors could become overly reliant on new technologies, which could lead to "less attention to or emphasis on preparer and auditor judgment, experience, or professional skepticism," the PCAOB said.

Audit chairs also noted that "while the benefits of emerging technologies are often immediately clear, the risks involved can take longer to become apparent or understood."

Those risks could become more visible once audit firms automate client work even further.

Today, auditors use client data to identify areas of risk, obtain deep insights about the business, and identify anomalies in processing activities. But "tomorrow's auditors will use even more data to obtain audit evidence and automate audit procedures," says Jen Wood, a partner in audit innovation at The Bonadio Group.

"That all sounds great, but it only works if the auditor appropriately assesses the completeness and accuracy of the data. Data reliability is a problem that many audit firms face, but few recognize," she says.

In areas unique to 2020, audit chairs seemed pleased by auditors' performance, particularly in how they handled compliance with the flurry of new accounting standards. The new disclosures of critical audit matters (CAMs) —material matters involving "especially challenging, subjective, or complex auditor judgment"—also caused fewer headaches than expected, largely due to dry runs and other auditor preparations.

With regard to the PCAOB's own auditor assessments, audit chairs cited an ongoing sore spot: the lag between when PCAOB's audit inspections occur and when inspection reports are issued. The PCAOB didn't release some of its 2019 inspection reports, for example, until December 2020.

Inspections continue to be controversial on another level. If the PCAOB really wanted to improve audit quality, it would change the focus of inspections, said departing PCAOB member J. Robert Brown, Jr., in a January speech.

Instead of fixating on issues like insufficient controls testing, Brown said, inspections should focus explicitly on financial reporting quality. Stated Brown: "Such an objective would entail greater emphasis on audits of issuers with potential departures from GAAP; on the areas of the financial statements deemed important to investors on a qualitative basis; and on the procedures used by audit firms to assess the risk of fraud and the reporting of illegal acts." CFO

PROFITS

Surprising Earnings Growth Seen for Fourth Quarter

The corporate profitability picture brightened in the fourth quarter, with earnings growth projected for S&P 500 companies for the first time since the end of 2019.

According to data from Refinitiv, S&P 500 earnings are expected to have increased 0.9% in the fourth quarter from a year ago, defying analysts' expectations of a 10.3% decline after a year of weakness due to the coronavirus pandemic.

"Upbeat fourth-quarter results would bolster expectations for a strong rebound in earnings in 2021 and help to ease investor worries that valuations are overstretched," Reuters said.

S&P 500 earnings are projected to increase 23.5% in 2021 compared with an estimated 12.6% drop in 2020, based on Refinitiv's data.

Stronger-than-expected earnings from high-profile companies including Alphabet and Amazon.com drove the fourth-quarter forecast, with Apple, Microsoft, Facebook, JPMorgan Chase, and Goldman Sachs among the other main contributors, Tajinder Dhillon, senior research analyst for Refinitiv, said.

About 83% of the S&P 500 companies' fourth-quarter reports released by early February had beaten analysts' earnings expectations, above the 76% average of the past four quarters, according to Refinitiv.

In early December, FactSet was forecasting a 10.1% decrease in S&P 500 earnings for the fourth quarter, which would have been the third-largest decline since Q3 2009.

Corporate earnings for the third quarter last year were far better than analysts had anticipated, with the average company beating its earnings estimate by about 19%, versus the 3% beat that is typically reported.

"Big business in America has learned how to manage through the [COVID-19] crisis," said Rick Meckler, a partner at Cherry Lane Investments in New Vernon, N.J. "It's the small companies, the family-owned businesses, restaurants, and some specific industries that have been badly hurt."

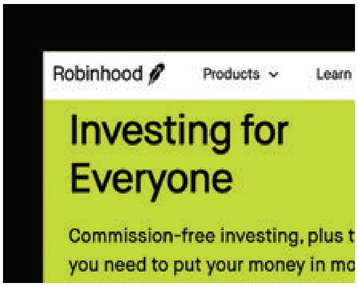
He added: "With technology in particular, businesses found a way to move work to home and a lot of those companies benefit from that. That's what's caused them to outperform so greatly throughout the crisis." | MATTHEW HELLER

Getty Images (2)

REGULATION

Robinhood Settles SEC Charges

The stock trading app firm Robinhood agreed to pay $65 million to settle charges from the Securities and Exchange Commission that it misled customers about its business model and failed to deliver on best execution of trades.



"Between 2015 and late 2018, Robinhood made misleading statements and omissions in customer communications, including in FAQ pages on its website, about its largest revenue source when describing how it made money—namely, payments from trading firms in exchange for Robinhood sending its customer orders to those firms for execution, also known as 'payment for order flow,'" the SEC said.

Robinhood advertised itself as a commission-free trading service, but "due in large part to its unusually high payment for order flow rates, Robinhood customers' orders were executed at prices that were inferior to other brokers' prices," the SEC said.

The SEC alleged that increased trading prices cost customers more than $34 million, even accounting for the zero commission fees.

"The settlement relates to historical practices that do not reflect Robinhood today," Dan Gallagher, Robinhood's chief legal officer, said.

On December 17, 2020, the Commonwealth of Massachusetts filed a complaint against Robinhood alleging it used "aggressive tactics to attract inexperienced investors" and "gamification strategies to manipulate customers."

The Massachusetts regulator said 68% of the company's customers were approved for options trading despite reporting limited or no investing experience.

A Robinhood spokesperson said the company disagreed with those allegations and planned to defend itself vigorously. | WILLIAM SPROUSE

IPOS

SEC Backs Primary Direct Listings

In a major move to encourage more companies to go public, the U.S. Securities and Exchange Commission has approved a New York Stock Exchange plan to allow issuers that choose a "direct" listing to raise new capital.

The rule change announced in December 2020 will give companies an alternative to the traditional public offering, enabling them to list their shares without having to pay hefty fees to Wall Street underwriters.

Previously, the SEC only allowed companies to sell existing shares through a direct listing, not raise new capital.

NYSE President Stacey Cunningham said the SEC had approved a crucial innovation for private companies breaking into public markets.

"Some of them will continue to choose a traditional IPO but others will have this as an alternative if they want to reduce their cost of capital and want to have democratized access to their company on the first day," she told CNBC.

The SEC rejected arguments by the Council of Institutional Investors, which warned that the new kind of direct-listing process would circumvent the investor protections of traditional IPOs.

Commissioners Allison Herron Lee and Caroline Crenshaw dissented, saying the SEC had "not candidly assessed the potential benefits and drawbacks of retail investor participation in primary direct listing IPOs. We should have engaged in a deeper debate and analysis to consider options for mitigating the risks to investors before approving today's order."

According to the dissenting commissioners, "investors in primary direct listings under NYSE's approach will face at least two significant and interrelated problems: first, the lack of a firm-commitment underwriter that is incentivized to impose greater discipline around the due diligence and disclosure process, and second, the potential inability of shareholders to recover losses for inaccurate disclosures" because in a direct listing it is difficult to trace a trade directly back to the issuer. | M.H.

REGULATION

U.S. Adopts Independent Contractor Rule

The Trump administration approved a regulatory change to make it easier for businesses to classify workers as independent contractors rather than employees.

The rule change defines independent contractors for the first time under the Fair Labor Standards Act, adopting an "economic reality" test that focuses primarily on whether a worker is economically dependent on an employer.

"This rule brings long-needed clarity for American workers and employers," former Secretary of Labor Eugene Scalia said in a news release. "Sharpening the test to determine who is an independent contractor under the Fair Labor Standards Act makes it easier to identify employees covered by the act, while recognizing and respecting the entrepreneurial spirit of workers who choose to pursue the freedom associated with being an independent contractor."

Under the economic reality test, the status of a worker can be determined, primarily, by looking at "the nature and degree of the worker's control over the work" and "the worker's opportunity for profit or loss based on initiative and/or investment."

"It's going to likely decrease the number of workers classified as employees, because at its core this makes it easier to classify workers as independent contractors rather than employees," Cozen O'Connor attorney Aaron Holt told Yahoo Finance, adding that businesses could see decreased costs because they won't have to provide contractors with benefits or equipment.

The new rule, however, doesn't take effect until March 8. A spokeswoman for President-elect Joe Biden has indicated that he would seek to halt or delay it.

Labor advocates contend it will make it easier for companies to misclassify workers.

"The rule gives license to employers to call most of their workers independent contractors," said Catherine Ruckelshaus, general counsel at the National Employment Law Project. "That would dramatically narrow worker protections...in the jobs that particularly need them, including construction, agriculture, janitorial, and delivery jobs." | M.H.

THE ECONOMY

Middle Market Firms See Recovery

Most CFOs of middle market companies believe the worst of the coronavirus crisis is over, with those in technology, life sciences, and health care particularly optimistic about growth this year.

As of September 2020, nearly three in four middle market companies had received pandemic relief assistance from the government, led by the retail, technology, and manufacturing sectors.

But the 2021 BDO Middle Market CFO Outlook Survey found that 60% of respondents expect an economic recovery this year, 56% see a revenue increase, and 63% forecast growth in profitability.

In the year-ago survey, 81% forecast a revenue gain.

"For some companies, growth may mean a return to pre-pandemic financial performance rather than reaching new records, but most believe the deepest hardship is over," the report said.

BDO noted that "life sciences companies are pivoting production and resources to develop COVID-19 therapeutics, technology companies are investing to enable better remote work collaboration, and apparel retailers are meeting the increased demand for facemasks and athleisure."

BDO said middle-market companies would prioritize technology in 2021 as they ensured their ability to meet changing customer demand, bolster security, and safely enable work-from-anywhere eligible employees.

Nearly half the CFOs said the pandemic has resulted in faster decision-making in their organization, which they are using to pursue growth opportunities that will further the middle market's path to recovery. One third said the pandemic has improved workforce culture and unity—even in a remote environment. | M.H.

Getty Images(4)

IPOS

7 SPACs to Play the Rise of Bitcoin, Crypto Stocks

The rise in the value of Bitcoin and media coverage of cryptocurrencies could make the industry ripe for initial public offerings in 2021. One of the methods for cryptocurrency companies to go public is through a merger with a special purpose acquisition company.

Coinbase is considering a 2021 initial public offering but could also be a candidate for a SPAC deal. Here is a look at some SPACs that could target cryptocurrency companies or have already announced a deal in the space.

GS Acquisition Holdings II. The Goldman Sachs SPAC raised more than $700 million in its offering. The blank check company has been linked to eToro after the cryptocurrency exchange talked to Goldman about a potential IPO.

Burgundy Technology Acquisition. Led by the former CEO of Hewlett Packard and SAP, Burgundy Technology Acquisition is targeting technology or enterprise software. The company has mentioned Israel as an area of focus, which could make eToro a potential target.

Lefteris Acquisition. Targeting the fintech space, Lefteris Acquisition could merge with a cryptocurrency-focused company.

Ribbit Leap. This SPAC from Ribbit Capital is aiming to do a deal in the fintech space. Ribbit Capital is an investor in several fintech companies yet to go public, including Coinbase and Robinhood.

Far Peak Acquisition. Led by former New York Stock Exchange President Tom Farley, Far Peak Acquisition could be a SPAC that goes after a cryptocurrency firm. The NYSE invested $75 million in Coinbase in 2015, which was the largest investment ever made in a Bitcoin company at the time. The NYSE also launched a Bitcoin index that same year. Farley called Bitcoin a "growth market" then and could still be bullish on the industry.

VPC Impact Acquisition Holdings. Shares of VPC Impact Acquisition Holdings surged on reports it was acquiring cryptocurrency exchange Bakkt. The companies formally announced the merger valuing Bakkt at $2.1 billion.

Diginex. A former SPAC, now trading as Diginex, is the first full digital asset ecosystem comprising a cryptocurrency exchange to be listed on the Nasdaq. | CHRIS KATJE, BENZINGA

THE ECONOMY

World Bank Lowers Forecast

The World Bank lowered its growth forecast for the global economy, reflecting the resurgence of the coronavirus pandemic and renewed restrictions on economic activity.

According to the bank's latest semi-annual Global Economic Prospects report, the global economy "appears to have entered a subdued recovery" but there is a "material risk" that setbacks in containing the pandemic could result in a much weaker rebound.

For 2021, the bank said the global economy is expected to grow 4% after contracting 4.3% in 2020—0.2 percentage point lower than it forecast in June.

Different outcomes are still possible, ranging from 1.6% growth in a downside scenario in which infections continue to rise and the rollout of a vaccine is delayed to nearly 5% growth in an upside scenario with successful pandemic control and a faster vaccination process.

U.S. GDP is forecast to expand 3.5% in 2021, after an estimated 3.6% contraction in 2020.

The collapse in global economic activity in 2020 was estimated to have been slightly less severe than previously projected, due in part to a more robust recovery in China. But the report also noted that "in advanced economies, a nascent rebound stalled in the third quarter following a resurgence of infections, pointing to a slow and challenging recovery."

The bank also warned that the pandemic had triggered a surge in debt levels among emerging market and developing economies, with government debt up by 9 percentage points of GDP—the largest one-year spike since the late 1980s. | M.H.

THE ECONOMY

U.S. Trade Gap Hits 14-Year High

The U.S. trade deficit widened to a 14-year high in November as retailers stocked up on imported consumer goods ahead of the Christmas holiday season.

The Commerce Department reported in January that the foreign-trade gap in goods and services expanded 8% from the prior month to a seasonally adjusted $68.14 billion—the highest deficit since August 2006.

Imports increased 2.9% in November to $252.3 billion while exports rose 1.2% to $184.2 billion.

Through the first 11 months of 2020, the deficit stood at $604.8 billion, 13.9% higher than the same period in 2019. "President Donald Trump insisted that his get-tough trade policies with the rest of the world would shrink the deficit and bring back American jobs," the Associated Press said in early January.

Michael Pearce, senior U.S. economist at Capital Economics, said the rising trade deficit would act as a drag on economic growth.

But Joshua Shapiro, chief U.S. economist at consulting firm Maria Fiorini Ramirez, said the deficit is "widening for the right reasons," with demand for imports in the U.S. improving and demand for U.S. exports also picking up, just not as much.

According to Politico, "Retailers stocking their shelves and warehouses ahead of the Christmas holiday appeared to be the major factors behind the sharp jump, pushing imports of consumer goods to a record high." Imports of capital goods used by manufacturers were the highest in two years.

The politically sensitive deficit with China rose 1.9% to $30.7 billion in November and totaled $283.6 billion for the first 11 months of 2020, a drop of 11.5% from the same period in 2019 that reflected in part the higher tariffs the Trump administration imposed on Chinese goods.

But U.S. exports to China continued to lag behind the goal set under Trump's "phase one" deal signed in January 2020. | M.H.

M&A

P&G Scraps Razor Deal

Procter & Gamble has called off its planned takeover of women's razor startup Billie, citing regulatory action to block the merger.

The Federal Trade Commission filed a complaint in December 2020 alleging the deal was "likely to result in significant harm by eliminating competition between the market leader and an important and growing head-to-head competitor."

P&G owns the Gillette razor brand while Billie has found a market niche by selling discounted women's razors and attacking the industry for its "pink tax" practice of charging more for women's products.

"We were disappointed by the FTC's decision and maintain there was exciting potential in combining Billie with P&G to better serve more consumers around the world," the companies said.

However, they added, "after due consideration, we have mutually agreed that it is in both companies' best interests not to engage in a prolonged legal challenge, but instead to terminate our agreement and refocus our resources on other business priorities."

P&G announced in January 2020 it would acquire New York-based Billie for an undisclosed sum. The consumer products giant said the subscription-based, direct-to-consumer brand complemented its own razor product portfolio dominated by the Gillette and Venus brands.

"The proposed acquisition came after years of declining market share for P&G as similar digitally focused discount razor competitors, such as Dollar Shave Club and Harry's, emerged to challenge the company's worldwide dominance in shaving," the Cincinnati Enquirer said.

But the FTC claimed the merger would likely harm consumers through higher prices for women's razors and "arrests Billie's progress, as it was on the cusp of expanding into brick-and-mortar retail." | M.H.

Getty Images(4)

THE CLOUD

Citrix to Buy Wrike Remote Work App

Enterprise software firm Citrix Systems is buying Slack competitor Wrike for $2.25 billion in a move to boost its collaborative work management offerings.

Wrike offers an all-in-one platform for remote workers that incorporates elements such as planning, workflow management, and project management and can be integrated with business apps such as Salesforce, QuickBooks and Workday.

Wrike's more than 20,000 customers include Walmart, Nickelodeon, Google, Dell, and Airbnb.

Citrix, which has been seeking to become a major collaboration player, said it had agreed to acquire the company from private-equity firm Vista Equity Partners, which bought Wrike only two years ago for a reported $800 million.

"The addition of Wrike's cloud-delivered capabilities will accelerate Citrix's business model transition to the cloud and strategy to become a complete SaaS-based work platform addressing the needs of various functional groups within the enterprise," Citrix said in a news release.

According to VentureBeat, both Citrix's core Workspace service and Wrike "are essentially built with the distributed workforce in mind." Demand for collaboration software has surged as the coronavirus pandemic has forced companies to shift to remote work.

The combined company would serve more than 400,000 customers, according to Citrix. Wrike's competitors include Slack, Trello, Asana, and Basecamp.

Wrike is expected to have about 30% stand-alone growth to between $180 million and $190 million in unaudited annualized recurring revenue in 2021, with the opportunity to accelerate growth over time under Citrix's ownership.

"Together, Citrix and Wrike will deliver the solutions needed to power a cloud-delivered digital workspace experience," Citrix CEO David Henshall said. | M.H.

REGULATION

Fed Lifts Freeze on Bank Share Repurchases

The U.S. Federal Reserve eased restrictions on capital distributions by banks after the latest stress tests of large financial institutions showed strong capital levels.

The Fed barred banks in June 2020 from repurchasing their own shares or increasing dividend payments to ensure they would preserve capital amid the economic disruption of the coronavirus pandemic.

But citing the results of the second round of stress tests, the U.S. central bank said in December that it would allow banks to distribute cash to shareholders through buybacks as well as dividends as long as the total amounts are no greater than the average of a bank's earnings over the past four quarters.

Within minutes of the announcement, JPMorgan Chase said it would buy back $30 billion of its shares during the first three months of 2021.

"With the current capital requirements and distribution restrictions in place, banks have built capital over the past year. The modified restriction will continue to preserve capital and ensure that large banks can still lend to households and businesses," the Fed said in a news release.

The second round of tests focused on the banks' ability to withstand severe downturns stemming from the pandemic. While the Fed found banks suffered more severe losses than under the previous tests, they remained above minimum capital requirements after taking those losses, reflecting months of building up reserves.

The results "confirm that large banks could continue to lend to households and businesses even during a sharply adverse future turn in the economy," Vice Chairman Randal Quarles said.

The Fed governors voted 4-1 in favor of easing the capital distribution restrictions, with Lael Brainard dissenting | M.H.

Citrix Systems

CFOs Faced Late Activism Surge, ESG Demands in 2020

Through the first three quarters of 2020, all was relatively quiet on the global shareholder activism front. Then, in the fourth quarter, activists broke loose. Fifty-seven new campaigns launched, including broadsides against Intel, Public Storage, ExxonMobil, and The Walt Disney Company. (See chart below.)

The Q4 rebound was most evident in the United States, which saw 30 new campaigns.

Despite the pandemic, 2020's final global campaign tally (182 new campaigns) was off only 13% from 2019. Non-U.S. activity saw an uptick for the year, with European and APAC campaign numbers up 21% and 11%, respectively, over 2019.

While many other trends from 2019 remained consistent, 2020 also produced some new wrinkles, according to Lazard's Annual Review of Shareholder Activism.

For example, investors, proxy advisers, exchanges, and governments alike called for greater diversity at public companies and a focus on environmental, social, and governance (ESG) issues, according to Lazard.

In particular, ESG activism gained momentum, Lazard said, with the launch of hedge fund Engine No. 1 in December. The small investment firm initiated a campaign against ExxonMobil though holding only a $40 million stake in the multibillion-dollar oil giant. It's calling for more disciplined capital allocation, a plan for sustainable value creation, board refreshment, and an overhaul of management compensation.

"The rise in the launch of ESG-related funds and campaigns focused on sustainability issues enables activists to improve perceived ESG weaknesses in businesses but also bolster fundraising by branding themselves as forward-thinking and socially conscious," Lazard directors wrote in their report. "This trend is likely to continue as more limited partners intensify their focus on allocating capital in a way that betters society."

Other ESG-focused activist initiatives represented only a slice of a campaign's theme. For example, Canyon Capital's targeting of Berry Global called for the plastic packaging products manufacturer to "get in front of [ESG] trends and correct market misperceptions about sustainability." But that was only third on the list of Canyon's demands, preceded by a demand to develop an accelerated deleveraging plan and measures to win an investment-grade rating.

Other interesting trends featured in the Lazard report:

- Private equity firms continued to use "activist-like" tactics at public companies. Examples included Cerberus calling for Germany's Commerzbank to cut costs, adopt a new strategy, and appoint two of its nominees to the board and New Mountain's demanding governance and operating improvements at small-cap IT firm Virtusa.
- Leading activist firms (such as Starboard, Pershing Square, and Corvex) embraced the market's strong appetite for SPACs as a new source of funds. However, Lazard pointed out, there has not yet been "spac-tivism," that is, using SPACs for activist campaigns.
- Amid depressed equity prices during the pandemic, the adoption of poison pills increased in the U.S. as companies tried to discourage hostile takeovers. There were 96 adoptions of the defensive tactic by U.S. companies in 2020 versus 30 in 2019.
- Activists won 131 board seats in 2020, but the ethnic and gender makeup of their appointees fell short of marketwide levels of diversity. While 22% of S&P 500's new directors were ethnically diverse in 2020, only 11% of activist appointees were. Gender diversity also lagged, with women making up 24% of new directors from activist campaigns, versus making up 47% of new directors in the S&P 500.

The Lazard report also raised some key questions for 2021: How will activists react to lofty equity valuations? How will the regulatory focus of the Biden administration affect the shareholder landscape? And will ESG-focused campaigns generate alpha or just attention? | V.R.

Activist Campaigns Rebound

After shareholder activists bided their time from April to September 2020, they got busy the last three months of the year.

August 2020	6
September	8
October	20
November	13
December 2020	24

Source: Lazard's 2020 Annual Review of Shareholder Activism

Getty Images(3)

M&A

IAC to Spin Off Vimeo

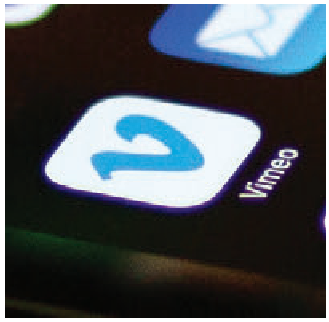
The board of IAC/InterActive has approved a plan to spin off its stake in the video app Vimeo into a separate, publicly traded company.

IAC said it plans to hold a stockholder meeting in the first quarter of 2021 to consider the proposal. If approved, the spinoff is expected to occur in the second quarter.

"The combination of Vimeo's remarkable growth, solid leadership position, and enormous market opportunity have made clear its future," IAC chief executive officer Joey Levin said. "It's time for Vimeo to spread its wings and become a great independent public company."

In January, Vimeo raised $300 million in equity from funds and accounts advised by T. Rowe Price Associates and Oberndorf Enterprises. The new funding round valued the company at $5 billion. In November 2020, Vimeo raised $150 million from Thrive Capital and Singapore's sovereign wealth fund GIC. That investment valued it at $2.75 billion.

In its third-quarter earnings, IAC reported Vimeo had



revenue of $75.1 million, an increase of 44% year over year. The company's subscriber base grew 21% to 1.46 million. It also reported an operating loss of $3.3 million, an improvement over an $11.2 million loss in 2019.

"We have long believed in the power of video to advance human expression and transform businesses," Vimeo CEO Anjali Sud said. "Our all-in-one solution radically lowers the barriers of time, cost, and complexity that previously made professional-quality video unattainable. We're ready for this next chapter and focused on making video far easier and more effective than ever before."

The Vimeo spinoff would be the eleventh by IAC. Last December, the company announced it had agreed to spin off the online dating company Match Group, which owns Tinder, Hinge, OkCupid, PlentyOfFish, and Match.com. That spinoff was completed last summer.

IAC said it expects the Vimeo transaction will entail reclassifying IAC shares to give its stockholders a proportionate amount of Vimeo stock. | W.S.

THE ECONOMY

U.S. Budget Deficit Climbs to $572B

The U.S. budget deficit ballooned by 60% to more than half a trillion dollars in the first quarter of fiscal 2021, reflecting spending on coronavirus relief programs.

According to a Congressional Budget Office estimate, the deficit rose to $572 billion from $215 billion in the year-ago period. Revenue fell 1.1% to $803 billion while outlays jumped 18% to $1.375 trillion.

The Committee for a Responsible Federal Budget, a watchdog group, has estimated that the deficit is on track to hit $2.3 trillion, or 10.4% of gross domestic product, this year after setting a new record of $3.1 trillion in 2020 as the economy reeled from the coronavirus pandemic.

"The final figure is likely to be significantly higher, as Congress is expected to pass further COVID-19 legislation and possibly additional big-ticket spending on issues such as infrastructure," The Hill reported.

In the first quarter, amounts withheld from workers' paychecks fell by $17 billion, or 3%, because of a decline in wages and virus-related legislation. The CARES Act allowed most employers to defer payment of their portion of the Social Security payroll tax on wages paid from March 27, 2020, through Dec. 31, 2020.

Individual income and payroll taxes together fell by $7 billion, or 1%.

On the spending side, almost 40% of the increase in the first quarter was in outlays for unemployment compensation, which rose from $7 billion during the first quarter of 2020 to $80 billion this year.

Spending by the Department of Agriculture increased by 36%, largely due to payments made to farmers to cover increased marketing costs associated with the pandemic.

"Economists largely agree that deficit-financed spending is a good idea during an economic crisis, but their estimates of how much is necessary vary dramatically" and many warn that "the accumulated debt will have to be addressed once the economy recovers," The Hill reported. | MH.

SUPPLY CHAINS

Rethinking Sourcing

Twenty-four percent of middle-market CFOs surveyed by BDO plan to relocate their supply chains to another country in 2021; 50% plan to identify alternative or backup suppliers this year to overcome disruptions wrought by the pandemic; and 22% report plans to address supply chain weakness by reshoring to the United States in 2021.

Companies weathered the struggles of 2020 by being agile and resilient, but they must remain vigilant in 2021.

"Everyone is more sensitive ... [with] a lot of decisions being made on short-term cash needs," said Eskander Yavar, BDO's national manufacturing practice leader.

Many companies are rethinking their sourcing because of tariffs and high shipping costs, Yavar said. For reshoring to the U.S., it may take time to see what impact the Biden administration will have before companies morph their supply chains to improve manufacturing and distribution capacity.

Many manufacturers are treading cautiously on implementing wholesale changes during the pandemic, according to Yavar.

One area the data shows they have not hesitated is in integrating technology into their supply chains. A December Institute for Supply Management report found 65% of U.S. manufacturers focused on reevaluating their use of data and analytics to stabilize processes during the pandemic.

Digitalizing the supply chain is a strategy companies see as an investment priority to ensure more agility and stability long term. More than half (52%) of manufacturers in the BDO survey say they intend to invest in supply chain technology this year to increase efficiencies, end-to-end visibility, and flexibility and responsiveness.

Still, with concerns about the economy, and some manufacturers struggling to pay debts, every company can't justify quickly making the technological switch. If the investment will not be covered in final product prices, there likely isn't a compelling business case, said Yavar. | A.B. BROWN, CFO DIVE

M&A

Higher Taxes Could Add to M&A Costs

M&A activity, already showing signs of a comeback after a long pandemic pause, could build to a crescendo in 2021 as private equity firms and owner-operators try to outrace any tax changes the Biden administration is considering.

Although deal volume at the end of the third quarter of 2020 was down 12% globally and 32% for deals involving U.S. companies, according to Refintive data, there are signs of a healthy pick-up in activity.

How much the Biden Administration, with support from the Democratically controlled House and Senate, will impact dealmaking through tax law and regulatory changes isn't clear, deal specialists say. But the new administration has proposed raising the top corporate tax rate to 28% from 21%, a move that will make future deals more expensive right off the top.

Just as significant, at least for founders and owner-operators looking for an exit, is a proposal to treat long-term capital gains as regular income, which would tax gains from the sale of a business at 37% instead of 20%. After 2025, the 37% would rise to 39.6%, the same as before 2017.

"Certainly the owner-operators, in an M&A transaction, would be subject to an additional 17% tax on the sale of their business," said LeighAnn Costley, a senior tax partner at Frazier & Deeter. The additional 17% tax would result from the difference between the 20% capital gains tax and the 37% regular income rate. The change would only apply to sellers whose income is more than $1 million and would not affect private equity limited and general partners.

Even if the changes to the capital gains and corporate tax rates don't curb deal volume, they could still impact pricing, by pushing owner-operator sellers to seek higher valuations to offset the higher taxes.

Given how Congress works and the competing priorities the Biden administration faces, there are few scenarios in which these and other tax law changes could take effect before early 2022, deal specialists say. That leaves 2021 as the year to get deals done if there's a concern over rising tax liabilities. | ROBERT FREEDMAN, CFO DIVE

Getty Images(3)

Shareholder Distributions vs. Reinvestment: The Gap Grows

Although dividends and buybacks have ballooned, the data shows that S&P 1500 CFOs are still mindful of the need to reinvest. By David Denis, Gaurav Jetley, and Laura Comstock

Cash distributions to shareholders via dividends and share buyback programs have kindled passionate debates about the focus of shareholder value. Some market analysts and observers express chagrin at what they believe is a widespread increase in shareholder payouts, led by companies such as Apple, which bought back $70 billion of stock in 2019. Why all the fuss? Critics view these distributions as occurring at the expense of companies' long-term value.

Buybacks and dividends are not necessarily detrimental. But do increasing amounts of shareholder payouts mean more companies are choosing short-term shareholder gains over reinvesting in their businesses for the long term? If so, what are the consequences for those trying to gauge companies' valuations and the drivers of their financial strategies? And are historical levels of payouts and reinvestment still useful indicators of the optimal level?

To shed some light on those questions, Analysis Group compiled historical data (1999-2019) on payouts (in the form of dividends and share repurchases), on reinvestment (in the form of capital expenditures and research and development), and on operating income for the S&P 1500. We excluded financial firms and regulated utilities. We then looked at the absolute levels (in real terms) of payouts and reinvestment for each company and in the aggregate at five-year increments (1999, 2004, 2009, 2014, and 2019). We also calculated each company's ratio of payouts and reinvestment to operating income.

Our analysis stops short of the unprecedented and anomalous impacts of the widespread business disruptions caused by the COVID-19 pandemic. However, although we end with a few thoughts placing our analysis in the context of the pandemic, we nonetheless gained insight into some of the structural changes that we believe will carry through to the new "business as normal," when that day comes.

Buyback Growth

Companies engage in buyback programs in particular for a variety of reasons and under many circumstances. In addition, it is assumed that different companies have different needs for capex and R&D. So, year-to-year changes in these measures are likely to be idiosyncratic and spiky, making it difficult to discern meaningful trends.

But we do see some data that confirms the widely held belief that companies see shareholder distributions as an increasingly attractive option for deploying excess cash. Overall, we found that total payouts for our sample of S&P 1500 companies tripled (in real terms) between 1999 and 2019, increasing from about $280 billion to $850 billion. (See the chart, "High-Payout Companies Ratcheted Up Rewards, page 19.)

Over the same period, operating income increased at just a little more than half that rate (162%), growing from $1.26 trillion to $2.04 trillion. In other words, in 2019 (just before the pandemic hit) S&P 1500 companies on average, distributed more of each dollar of operating income to their shareholders than they did 20 years before.

That was especially true for the "high-payout companies," or HPOCs. HPOCs generally are larger and have higher cash balances and more income.

Adobe Stock

They ranked in the top quartile of our S&P 1500 sample based on the share of operating income they distributed to shareholders. (In 2019, 254 companies comprised the HPOC group and 754 companies the non-HPOCs.)

In 1999, for HPOCs, the median value for the ratio of payouts to operating income was 47%; in 2019, the median shot up to 69%. In other words, the typical HPOC in 1999 paid out a little less than 50 cents of every dollar of operating income. Twenty years later, the typical HPOC paid shareholders 69 cents of every dollar of operating income.

In 2019, for example, Bristol-Myers Squibb spent $7.3 billion buying back its stock and distributed an additional $2.7 billion in shareholder dividends. In total, the company paid out $1.17 for every $1 of its 2019 operating income.

But we also found that, despite non-HPOCs' much lower payout ratios, even they increased shareholder distributions in recent years. Through 2009, the total level of distributions by non-HPOCs remained flat, while the median value for the ratio of distributions to operating income declined modestly. By 2014, however, both total distributions and the median ratio to operating income jumped substantially, remaining at about the same levels through 2019.

For both HPOCs and non-HPOCs, the buyback portion of distributions increased much more dramatically than the dividend portion.

Reinvestment Remains Strong

While dividends and buybacks rose, S&P 1500 companies continued to make substantial reinvestments in R&D and capex. Companies in both groups spent considerably more dollars on those two categories recently. For example, in 1999 the non-HPOCs, in aggregate, reinvested $575 billion, but that amount increased to $665 billion by 2019. For the HPOCs, the aggregate reinvestment increased from $180 billion to $355 billion over the 20-year period. On an aggregate basis, S&P 1500 companies invested over $1 trillion in capex and R&D in 2019.

Take Bristol-Myers Squibb again. The company spent $7 billion on R&D and capex in 2019, nearly 27% more than the $5.5 billion it spent on those items just five years earlier and 79% more than it did 20 years earlier. (Bristol-Myers Squibb remained in the HPOC group in each of the studied years.) For further context, that $7 billion reinvested in Bristol-Myers Squibb was equivalent to 82% of the company's 2019 operating income—not as high as the 117% rate it paid out to investors, but substantial nonetheless.

Overall, the median shareholder payout ratio for non-HPOCs has been slowly converging toward the reinvestment ratio. That suggests that shareholder distributions are becoming a more important element of capital allocation strategies, even for businesses taking a more conservative financial path.

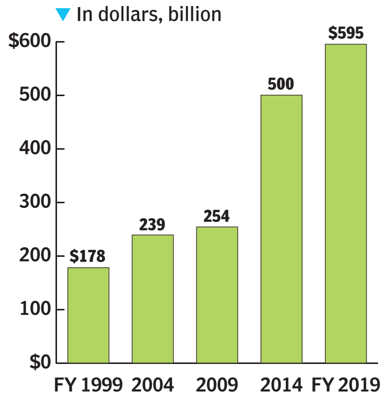
In contrast, for HPOCs, median payout ratios are larger than median reinvestment rates, and the gap is growing. (See the chart, "Shareholder Payouts Surpass Reinvestment," page 20.) In 1999, a typical HPOC spent 40% of its operating income on capex and R&D, while the median ratio of distributions to operating income was not much higher. In 2014 and 2019, the reinvestment rates' median values fell by a couple of percentage points for the HPOCs. However, the median values for the distribution ratio climbed to about 70% of operating income.

Value Creation Abandonment?

Despite reinvestment ratios remaining flat as shareholder payout ratios grew, market valuations on average have increased over the last 20 years. The Shiller PE ratio (S&P 500) has steadily risen since its financial-crisis low point. So, on average, it does not appear that

High-Payout Companies Ratcheted Up Rewards ...

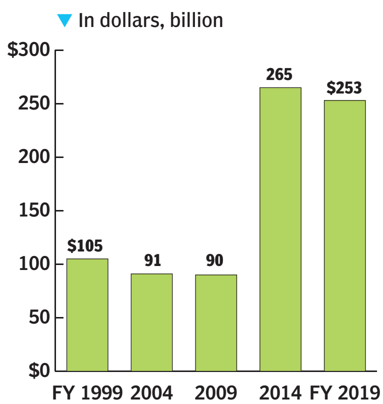
Over 20 years, high-payout companies (HPOCs*) more than tripled the amount of capital spent on shareholder distributions (buybacks plus dividends).



*HPOCs are companies in the top quartile of the S&P 1500 sample based on share of operating income distributed to shareholders.

... While Others Took Years to Boost Distributions

Shareholder distributions from non-HPOCs* remained relatively flat until 2014, when they took off.



*Non-HPOCs are those companies in the S&P 1500 sample not ranked in the top quartile for shareholder payouts.

Source: Analysis Group

companies are sacrificing long-term value in favor of short-term payouts to shareholders.

How does that reconcile with the observation that HPOCs, on average, distribute more and more of each dollar of operating income to shareholders?

Part of the story is that public companies increasingly reinvest in ways other than capex and R&D.

For example, companies incur substantial costs to build their "organizational capital," that is, things like talent base, product innovation, brand loyalty, customer relationships, and distribution systems. Expenditures on these items tend to be recorded as SG&A expenses. But for all practical purposes they are investments in the sense that, like capex and R&D, they represent costs incurred today to produce profits in the future. Many academic studies have shown that such expenditures on intangible capital have grown substantially recently.

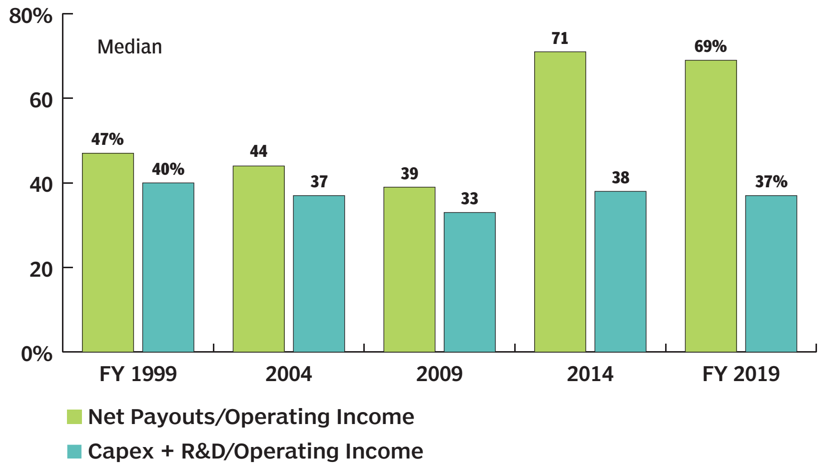
Moreover, shifts in the composition of the industries represented in our sample reinforce the importance of these trends in intangible investment. In 1999, nearly two-thirds of the HPOCs were traditionally capital-intensive manufacturing firms. By 2019, manufacturing firms comprised less than half of the HPOCs, while services firms comprised almost 25% of the group (up from 16% in 1999). Industry composition for the non-HPOC group remained largely unchanged from 1999 to 2019, perhaps reflecting the relative sizes of the two groups (where subtler changes in the much smaller HPOC group had larger relative impacts).

Given this shift, it is perhaps not surprising that we find a growing interest in distributions, as well as a shift in reinvestment: more companies favoring R&D over capex. That occurred for HPOCs in particular. Over the years studied, business services companies like eBay replaced capital-intensive companies like Kraft and Heinz (before their 2015 merger) and General Mills in the high-payout group. Service companies simply do not require the same rate of reinvestment in physical capital as manufacturing companies, but they do tend to invest heavily in intangible capital.

In addition, in the early 2000s other technology companies, such as payments company First Data, began creeping up the HPOC list, and the arrival on the scene of technology firms like Apple and Amazon—not to mention the continuing shift of traditional "brick and mortar" retailers to "bricks and clicks"—may have also contributed to a greater emphasis on R&D over capex.

Shareholder Payouts Surpass Reinvestment

By 2019, for high-payout companies in the S&P 1500, buybacks and dividends represented a much larger share of operating income than capex and R&D.

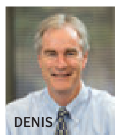


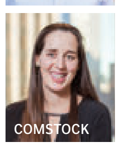
Source: Analysis Group

Left Vulnerable?

Historical measures of reinvestment may not be useful measures today, due to the shift in the composition of companies toward service- and technology-based industries. The high rates of spending on intangibles in these industries, coupled with high equity prices, suggest that increased rates of corporate payouts have not prevented companies from pursuing valuable investment opportunities.

It is still possible, however, that the increased payouts have left some companies vulnerable to economic shocks. When those shocks happen, they may limit the cash available to firms for necessary reinvestment. Time will tell whether the ability of companies to weather the global pandemic is a function of their past payout activity. In any event, the pandemic and its associated economic consequences will undoubtedly provide important lessons for how companies can strategically optimize the allocation of profits. CFO





David Denis is the Roger S. Ahlbrandt, Sr., chair and professor of business administration at the University of Pittsburgh's Katz Graduate School of Business & College of Business Administration. Gaurav Jetley is a managing principal and Laura Comstock is a vice president at Analysis Group, an international economics consulting firm.

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Moving Beyond Diversity to Foster Inclusion in Finance

The terms "diversity" and "inclusion" are often used synonymously. However, that notion couldn't be further from the truth. By Kimberly N. Ellison-Taylor

Diversity and inclusion in finance aren't new concepts. It's long been a priority for leaders in our profession, and in this year of uncertainty, we need new ideas and diversity of thought to re-imagine the path forward. The tragic events of 2020 have revealed the disparities that were hidden in plain sight—workplaces included. These events have challenged us to recognize that a checklist approach to diversity is not enough to achieve meaningful change.

As the first person of color to serve as chairman of the AICPA in its 133-year history, and the chair-elect for the AICPA's National Commission on Diversity and Inclusion, I have led my fair share of diversity and inclusion initiatives and discussions. "Diversity and inclusion," or D&I as it's commonly become known, is a two-part phrase, and this year has made it apparent that many organizations have only achieved the "D" with significantly less focus on the "I."

Diversity Does Not Equal Inclusion

The terms "diversity" and "inclusion" are often used synonymously. However, that notion couldn't be farther from the truth. Diversity is easier than inclusion—please note that I said easier, not easy. Diversity is a box that can be checked on a list or a target you meet for recruiting. Inclusion is a verb. It's a culture, and it's ongoing. It requires intentional effort, is constantly evolving, and the work is never "mission accomplished." While a few individuals can achieve workplace diversity on a recruiting team, inclusion requires all team members' involvement and doesn't allow us to rest on our laurels. Diversity alone is surface-level and does not get to the heart of what is needed—a sense of belonging, trust, and inclusion.

Inclusion's Direct Effect

In a year of natural disasters, recession, and a pandemic, we relied on finance professionals to continue performing the critical business processes required to keep organizations afloat: scenario modeling, risk management, financial reporting, managing expenses, and generating new revenue streams. Many organizations are seeking new opportunities to grow market advantage and meet evolving customer expectations. Inclusion is a strategic business imperative, and in these trying times, we must not lose sight of our goal of hiring and retaining an inclusive workforce to help achieve these goals. An inclusive culture is non-negotiable to compete in tomorrow's talent economy.

Every profession has had a similar experience: A diverse candidate is hired. After a few months, the employee realizes that the company isn't as inclusive as he or she was led

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to believe, doesn't feel included in the culture, and resigns. This vicious cycle repeatedly continues as the company recruits more diverse team members who experience the same issues. This leaves the company with low employee retention and gives it a poor reputation among diverse candidates. It also costs thousands of dollars to replace and retrain new hires. While it's easy to believe that diversity and inclusion are the same, that misunderstanding can have serious effects on an organization's success and profitability.

Kimberly N. Ellison-Taylor

True inclusion puts the onus on every person in the company—not just those in diverse segments. And when everyone plays a part, everyone benefits. Imagine how much more successful your business could be if everyone were comfortable sharing their different experiences, opinions, and ideas to tackle the issues at hand. What if an innovative or creative idea that you've never thought of yourself could generate additional revenue? Operational excellence, enhanced insights, and increased business influence require the synergy of many ideas across a diverse set of people, processes, and technologies. The business case for inclusion is undeniable.

Four Steps

Achieving inclusion isn't an easy feat, and it requires a very different approach than achieving diversity. To begin the process of fostering inclusion within your organization:

1. Listen and learn. Inclusion requires teamwork and trust, and trust is reinforced through authentic and compassionate attempts to understand one another. To achieve inclusion, we must listen and learn, no matter how uncomfortable or challenging the conversation may be. More than that, we must be willing to reflect on our own belief systems and challenge those biases—both conscious and unconscious. Otherwise, any change will only be lip service, and initiatives won't last past the current leadership.

2. Use data to create a plan of action. Finance is a data-driven profession, so why should our inclusion efforts be any different? Use data to assess where your company currently stands with its D&I initiatives, especially around recruitment, promotions, and retention. Then, review the disparities between the majority and minority segments. Is one segment more likely to get promoted than another? Which segments are experiencing low workplace satisfaction and have the highest turnover? Are there salary discrepancies between employees doing the same role? Once you've identified the areas of discrepancy, you can then use data to prioritize which challenges to tackle first and communicate the "why" behind your decisions using a data-driven approach.

3. Involve everyone—not just senior leadership. The number one rule in change management is to get buy-in from the top. With inclusion, that's not enough. It's not enough for a CEO to promote inclusion if middle management doesn't practice it, and the human resources team can't be the only ones with inclusion goals on their performance plans. To create a truly inclusive culture, you'll need active participation from every person in the organization. But how can you achieve this? By aligning inclusion initiatives with day-to-day job responsibilities. Include individual-level key performance indicators as criteria on annual performance plans. When each employee's job performance and promotion eligibility is tied to their success in advancing inclusion, it becomes top-of-mind even for those who have not experienced these challenges. Just as you would for a company-wide revenue goal—every person should be held accountable for fostering a culture of inclusion.

4. Promote much-needed connections via affinity groups. Affinity groups in the traditional sense—those that bring together allies on race, religion, and gender—are important. But, to foster belonging on a fundamental level, we also need affinity groups that remind us that we're all humans who want to feel included. Non-traditional affinity groups, such as dog lovers, weekend hikers, or movie enthusiasts, can enhance the sense of comradery, improve employee retention, and help us realize that we're all more alike than different.

The Future Is Inclusive

The future of finance will be defined by the companies that move beyond diversity and foster true inclusion in the workplace. It will be uncomfortable at first, as is any major change that goes against business-as-usual. It will require commitment, communication, and accountability on all levels, not just senior leadership. But if my story as the first person of color to chair one of the world's largest finance organizations has taught me anything, it's that we succeed not despite our differences but because of them. And every minute that you put inclusion on the backburner is a lost opportunity to tap diversity of experience and thought that could lead to your company's next billion-dollar idea. CFO

Kimberly N. Ellison-Taylor has a diverse background in finance and technology; she is currently an executive director at Oracle and the chair-elect for the AICPA's National Commission on Diversity and Inclusion.

Courtesy of the author

CREDIT

Startup CFOs: Consider Adding Debt to the Funding Stack

Could startups and VC investors be better served by capital structures that mimic private equity? By Gordon Henderson

Private equity and venture capital have a lot in common. Both involve acquiring or investing in promising companies, creating value, and then exiting on predetermined timelines. A key difference between those investing strategies is that while venture deals have historically been funded with equity, PE transactions typically use material amounts of debt in the funding stack.

In part, that's because the two strategies invest in different kinds of companies. Private equity buyers look for mature companies with substantial assets and operating cash flows. Those businesses can support servicing large amounts of debt, so the buyers can fund the bulk of the purchase price and thereby maximize their equity returns.

Venture capitalists, traditionally, take a different route. They are backing startups, most of which are unsuitable for traditional leverage. Instead of generating cash that can be used to pay down debt, they consume cash to drive growth. Plus, they have few or no tangible assets. That rules out traditional loans as a funding strategy and leaves equity as VCs' default capitalization source.

But is that really the best option? Could startups and VC investors be better served by capital structures that more closely mimic the ones that private equity professionals use? And, more specifically, what could they gain from using debt in their capital structures?

Why Debt

Debt is cheaper. First, its claim on a company's cash flows is senior to equity holders, making it less risky than an equity investment. That lower risk means that a borrower doesn't have to pay as much for senior funding as it does for equity capital. On top of that, most tax codes favor debt-servicing costs relative to equity, since interest payments are generally tax-deductible. Dividends, in contrast, come from after-tax earnings.

Because debt is a senior, contractual obligation, while equity is a residual claim on cash flows, under normal circumstances the cost and value of a given debt instrument are fixed. In other words, regardless of whether the value of the business rises or falls, the value of the debt is constant.

That means that if a CFO were to fund 80% of a $100 million business with debt, and the value of that business doubled, the company would still only have to pay back $80 million. Meanwhile, the $20 million equity investment would now be worth $120 million, a six-fold return. Even after adjusting for interest and other costs, the increase in the value of owned equity would have gone up dramatically.

Of course, if a buyer funded the entire cost of a purchase with equity, it would still have made a substantial nominal profit. It's just that the change in the value of the company

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would have to be shared with all the other shareholders that contributed capital to the business. If a business is 100% equity-financed, then doubling the value of the business doubles the value of the equity. And while that's pretty good, it's certainly not as good as the levered investment described above.

Venture Equity Cost

The technical way to calculate the cost of equity is to combine a number of inputs, including the risk-free borrowing rate, the equity risk premium, and the correlation between the stock in question and the broader market. Those aren't easily obtained for private companies, but we can use the returns to the buyer as a proxy for the cost of equity to the seller.

As a starting point, venture capital firms typically target annual returns of 25% for a fund with a 10-year term. But the cost to the issuer is much higher than that because of the dynamics of venture capital fund management.

First, a significant percentage of a VC's available funds don't actually get invested. Instead, they're used to pay a variety of expenses, such as audit and legal fees, which can add up to 15% of a fund's assets. That 25% return on each dollar of assets has to be earned off the 85 cents of each dollar in the fund that is actually invested in portfolio companies. That implies that each dollar an entrepreneur receives has to nearly triple in value over a decade to meet the VC's target.

Of course, nobody expects to earn uniform returns across a portfolio; a venture portfolio will generate a wide range of outcomes. Knowing that some percentage of their portfolio will produce a total loss, venture investors look for outsized returns on the investments that do work.

Since VCs have no way of knowing which investments will be winners, they prefer to invest on terms that leverage their initial commitments if a thesis develops positively but minimize their losses if it doesn't. Attaching warrants to an equity round is an example of this approach. But, in general, VCs will try to structure each investment so that they can capture an outsized return from if it works while overcoming the drag on the portfolio from the investments that inevitably fail.


Gordon Henderson

The bottom line is that venture capitalists can't invest 100 cents of each dollar that their investors give them, and some of the dollars that they do invest will be completely lost. That suggests that they need very high returns on their successful investments, which in turn implies that the cost of those investments for the shareholders (business owners) selling them is very high. It could be as much as 100% per year, and certainly well in excess of the 10% to 15% that venture debt might cost.

Historical Barriers

Historically, young businesses haven't been able to borrow. Companies with negative earnings before interest, taxes, depreciation and amortization (EBITDA) and negligible assets weren't very attractive to potential lenders. Plus, since the business risks of startups are so high, few founders wanted to compound them by adding financial risk in the form of debt.

But once a company has proved that it can meet a real market need and experiences rapid growth—even if it's not yet profitable—then its business risk reduces materially. And, as the business risk recedes, the relative costs of capital should be a larger consideration for the company: it can consider adding debt as a permanent part of its capital structure.

Today's specialist lenders understand that business risk isn't just a function of how long a company has been operating or how old its chief executive is. That understanding has allowed venture lenders to engineer new tools that let young, rapidly growing businesses borrow.

For example, the advent of the sofware-as-a-service business model has spurred recognition of the value of having an installed client base, even if that value doesn't show up on a prospective borrower's balance sheet. Practitioners have also developed analytics to understand the risks and qualities of companies they might lend to. Meanwhile, sector specialists cultivate and forge deep relationships with founders and managers that yield a qualitative overlay to their numerical analyses.

As debt has become more widely available, so too have its benefits become more widely understood. Venture debt can serve as a tool to fund working capital and mergers and acquisitions, to add resources to research and development, and to bridge to better terms for equity raises. As noted above, it can also be a far cheaper way than equity to fund these kinds of initiatives and investments.

Debt also solves for a number of other issues that can arise in terms of equity financing, such as having to give up board seats and managerial flexibility.

Private equity partners have benefited from these dynamics over a long period. Now that the option is open to them, perhaps more VCs and entrepreneurs will look at the lessons they could learn from their peers in private equity. CFO

Gordon Henderson is the managing director, portfolio management, at Espresso Capital, a provider of venture debt and growth financing solutions.

Courtesy of the author

RISK MANAGEMENT

COVID-19: The Risk Management Part Is Unfinished

What actions should senior risk managers and executive management take to deal with the remainder of the crisis and its aftermath? By John R.S. Fraser, Rob Quail and Betty J. Simkins

To control the spread of the disease, economic and social activities worldwide have been severely curtailed. Governments and organizations struggle to manage through the situation and strike an appropriate balance between mitigation of harm to public health and economic well-being. ¶ What actions should senior risk managers and executive management undertake to manage through the remainder of the crisis and its aftermath?

Immediately: Dependencies and Risks

We've had many conversations with risk managers and executives about the short-term and immediate-term risks of COVID-19 concerning external dependencies and conditions: e.g., the supply chain, outsourced services, access to a flexible or seasonal labor pool. Most of our questions were met with reassuring answers regarding what is expected, such as, "We think our supply chain is going to be OK," or "Our offshore data center is managing well through this."

But these are answers to the wrong question. The relevant question for risk managers to be asking in the short-term is not "What is expected?" but "What are the risks?" The pandemic is happening at a time of tremendous global interconnectedness. Organizations should be evaluating all of their third-party dependencies for vulnerabilities and conducting near-term risk assessments. This is a time when overdependence on limited supply chain channels or specialized, single-party services in support of mission-critical business processes is an especially acute source of risk.

We recommend that risk and business managers revisit their third-party dependencies and associated risks, and take steps to reduce single-point vulnerabilities through the one- to two-year time horizon during which the pandemic is expected to continue.

Short-Term: The Second Crisis

Leaders and public health officials acknowledge that the pandemic will be with us until late 2021 at least. Meanwhile, it is a fact of corporate life that from time to time, even in normal circumstances, all large organizations experience surprises. Given the timeline, it's likely that for many organizations, some other unrelated risk event is going to happen, too: perhaps a labor disruption, a technology failure, or an asset performance issue; that is, some other "shock" unrelated to the pandemic.

So, the question that risk managers and executive leaders should be asking themselves is, "if and when this 'second crisis' hits us, how will we cope?"

Many organizations have been placed in a weakened state by the prolonged crisis, financially or in terms of human resources; crisis management resources have been fully deployed for many months. Are we watchful for other risk events that could occur, or are we so busy managing the impacts of COVID-19 that we may have developed blind spots? When something new breaks, will we be able to work through it? Or could a second crisis represent a "tipping point" with disproportionate negative impacts on the organization?

We recommend that organizations conduct a specialized, immediate-term review of their risk profile with a particular focus on agility and capacity to endure worst-credible scenarios, should any occur while the pandemic is still in full force.

Medium- To Long-Term: Scenario Planning

There is no question that the pandemic and our response to it will have lasting effects on many aspects of business and society. Early in the crisis, the United Nations' trade and development agen-

Thinkstock

cy projected that the global economy's slowdown caused by the COVID-19 outbreak would likely exceed $1 trillion. There are downward pressures on national GDPs, and governments are accumulating public sector debts while coping with the incremental costs. These pressures and actions will have massive impacts on many aspects of the business environment for years to come.

There are tremendous implications for risk management. The long-term impacts and aftershocks of the COVID-19 crisis represent a source of unprecedented uncertainty; there are many ways in which the economic, social, political, environmental, technological, and regulatory environments could be affected by these events. These possible future scenarios could represent tremendous vulnerabilities and opportunities for organizations. We believe that this is a circumstance where "risk management as usual" is inadequate; explicit exploration of the impacts of COVID-19 on the top-level strategic environment is necessary.

We recommend that executive leaders, risk managers, and strategic planners examine the long-term strategic implications of COVID-19 and the associated risks and opportunities. One well-established tool that seems particularly well-suited to this need is scenario planning, of the type that was first widely adopted as a tool by Royal Dutch-Shell in the 1970s.

Downward Counterfactual Analysis

Coping with the pandemic has been a challenge for most organizations, experienced in very different ways across industry sectors, jurisdictions, and markets. For some, the main challenge has been mobilizing a remote workforce. For others, where working remotely is not feasible, the focus has been on ensuring that employees were able to work safely. There have been cybersecurity challenges. And of course, there have been potentially catastrophic revenue and margin impacts brought about by the economic curtailment.

Managing through these challenges

When something new breaks, will we be able to work through it? Or could a second crisis represent a "tipping point" with disproportionate negative impacts on the organization?

has tested many aspects of organizations' agility and crisis management capabilities. Once the crisis starts to recede, organizations would be well-served conducting a lessons-learned exercise.

However, merely retracing the sequence of events and evaluating the response is not sufficient. It is doubtful that the same chain of events as occurred in the COVID-19 pandemic would play out in the same way. In any case, the goal of the lessons learned should not be "How did we cope with this circumstance?" but instead should be "What have we learned that would allow us to cope with another unexpected shock?"

Several characteristics of the COVID-19 crisis were unusual.

First of all, it has had a global scope. Most of the typically postulated crises that organizations use as the basis for their response planning assume localized occurrences, such as severe weather events within limited geographic areas. On the other hand, COVID-19 is a genuinely borderless, global crisis: the mitigations planned by using backup centers, the geographic dispersal of work centers, or offshored operations were of little or no value.

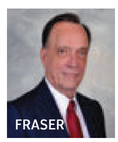
A second unusual thing about this crisis has been its duration. Optimistically, by the time this crisis starts to recede, it will have lasted at least 18 months. We are simply not accustomed to managing through such long-lasting emergencies.

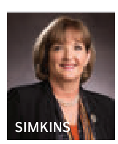
Third, one aspect of the crisis that worked in our favor was its velocity. From the time when the virus was first identified until its impact became truly global was a period of months. This allowed organizations time to mobilize emergency preparedness plans.

Downward counterfactual analysis is a risk management and planning "what if" thought process. Participants imagine what would have happened and how they would have coped if the events played out differently. For example: What if the epidemic had rolled out more quickly? What if the epidemic's impact was less evenly distributed—with some geographic regions much more seriously affected than others?

We recommend that organizations undertake an extensive "lessons learned" exercise, perhaps employing downward counterfactual "what-if" analysis, to improve resilience and preparedness for the next extreme event.

Many organizations appear to be holding their breath and waiting for the COVID-19 crisis to subside. That may be a mistake. We feel that more focus and energy needs to be brought to bear on anticipating and preparing for any further potential impacts during and after the crisis. CFO





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TECHNOLOGY

Finance Bots: Overcoming The Hesitation

Striking the right balance of innovation and risk can curb the unintended consequences of an RPA implementation. By Scott Szalony and Valeriy Dokshukin

Many finance and accounting teams, under immense pressure and facing resourcing challenges stemming from the pandemic, are turning to automation for answers. The automation space, which grew at a compound annual rate of 30% from 2017 through 2022, must now also contend with COVID-19 as an accelerant.

While intelligent and cognitive automation is now on the scene, robotic process automation (RPA, or “bots”) remains an essential steppingstone in bringing automation into an organization’s operations—and one that stands to yield significant advantages and benefits.

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Specifically, RPA can help reduce inefficiencies and streamline mundane processes, enabling CFOs and finance teams to focus on more strategic priorities that demand their attention: more frequent forecasting and analysis and heightened communications with investors about shifting market risks, to name two.

There are many recognized benefits to RPA. Adopting companies report cost savings, greater worker productivity, and the ability to scale operations faster. But many finance departments have expressed hesitancy about leveraging bots despite great interest in the technology. The hesitation is primarily due to concerns about unintended consequences that could impact implementation and create a host of other issues, such as restatements and regulatory violations.

Companies must be aware of the risks associated with redesigning, digitizing, and automating a process. They also have to be mindful of the need for an internal controls system to achieve the desired quality and governance needed to leverage bots effectively.

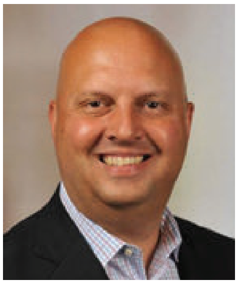
To that end, CFOs need a well-rounded strategy that can bring about RPA’s full potential. Striking the right balance between innovation and risk is key to long-term success. Fear of the unknown should not outweigh the benefits RPA can provide, especially when unintended consequences can be anticipated and minimized. That can be done by evaluating and creating a response to common RPA risks and challenges.

The following are guidelines that can help CFOs and their business and technology teams work through some more common RPA challenges.

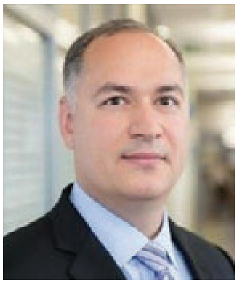
Controlling User Access

RPA involves giving users access to bots and assigning bot management to humans—a concept related to the segregation of duties (SOD). If not managed carefully, organizations can unwittingly introduce weaknesses in user access that can, in turn, create fraud and exploitation opportunities. This is particularly concerning when a human manager’s system access conflicts with the bot’s system access or when a human manages multiple bots with conflicting system accesses. Gartner predicts that through 2020, 25% of large enterprises will experience insider fraud due to the lack of proper SOD controls around RPA.

As bots are developed and



Scott Szalony



Valeriy Dokshukin

granted system access, finance organizations—in coordination with their CIOs and IT teams—can follow an identity access management framework (IAM) and questionnaire to circumvent user access risks. For finance professionals, questions like, "Which controls are required to detect and protect exploitation of bot credentials?" and "Can bots be misused to trigger attacks on partners?" are important for effective bot management, especially as it pertains to establishing sound financial controls and managing related fraud risks.

Bot identity management frameworks ultimately help executives anticipate and remove some of the critical conflicts of interest that may arise for humans and bots in the system as well as risks related to security, password management, and user access certification.

Enhancing Controls

Once a bot begins operating, control activities must ensure that the bot continues to function correctly. Even though bots can automate the execution of tasks and business activities faster, more consistently, and with minimal error, they cannot replicate human judgment. Bots that are not properly designed, operate in changing business processes, or lack adequate monitoring controls run the risk of inadvertently impacting existing controls or introducing errors. For example, unintended Sarbanes-Oxley (SOX) compliance violations could result.

Therefore, it is critical that companies review existing internal controls and make updates or create new controls that may be needed to ensure that bots monitoring transactional logs or other important finance processes function properly. Thankfully, IT and finance can pinpoint red flags in the early stages of RPA development, testing, and deployment to assess the risks associated with implementation and to maintain an effective control environment.

Managing a Changing Environment

Of course, evaluating the controls environment is never a once-and-done exercise, regardless of whether it is for RPA or something else. There are many factors, both internal to organizations and external in the operating environment, that can impact controls. Changes like new accounting standards updates or shifts in service providers may affect existing bots. For this, organizations will need to determine that processes are in place to track and quickly address any new inputs that can have a downstream effect on how bots function within the business.

Technology aside, the introduction of digital technologies also frequently signals changes to structures and teams. For finance teams, this means that many of the manual tasks they used to do are likely to be automated. From a human capital perspective, finance leaders must outline their digital transformation strategies and help employees understand how their new digital co-workers will impact their roles. In most scenarios, bots won't eliminate jobs, but rather allow CFOs to redirect their teams toward more value-added tasks.

The appetite for RPA is no doubt growing, and the pandemic may be the unintended nudge finance teams needed to kickstart this part of their digital transformations. Automation technologies continue to change while providing a solid foundation for organizations to reap the benefits of the future of work rapidly. Companies that have not yet implemented RPA into their financial processes should note the successes their industry peers are experiencing and consider adoption to aid in efforts to achieve long-term growth and resiliency. And when they do, adhering to smart and tactical planning may help them avoid unintended consequences and find success. CFO

Scott Szalony is a leader of Deloitte's digital controllership and finance transformation support. Valeriy Dokshukin is a Deloitte risk & financial advisory leader in digital controllership and intelligent automation.

Editor's Choice

EPICOR SOFTWARE NAMES NEW CFO

Austin, Texas-based Epicor Software appointed a new finance chief in the wake of its purchase by private equity firm Clayton Dubilier & Rice last year. Samuel Monti, former CFO of Khoros, will be joining Epicor's executive team. Monti has more than 25 years of experience in corporate finance. He replaces David Mehok, who spent two-and-a-half years at Epicor.

Courtesy of the authors

OPERATIONS

They Don't Teach Pandemics In Business School

How a professional services firm shifted its operations and culture overnight. By Jim Peko

When COVID-19 hit, no business or working household was spared. All of us had to quickly adjust to the new reality of working from home and keeping ourselves safe. It was a monumental challenge, and many struggled, even contending with personal loss, financial hardship, and depression. As a firm focused on client engagement we didn't know how we would succeed without on-site interactions. Our professionals spend a lot of time with our clients understanding their businesses and with each other collaborating.

As the firm's chief operating officer, I had to help develop alternatives that allowed our almost 8,500 home-bound professionals to thrive when the lockdown happened. And, critically, I had to help find ways to meet clients' needs and generate new business for our firm.

There was no playbook to follow. Let's face it; they don't teach you about pandemics in business school.

Go Small to Go Big

The first thing I discovered is that the best approach to an unforeseen crisis is to strip down the number of people who have to make decisions. This is hard to do. Many organizations are used to large, collaborative, and inclusive management structures, and for a good reason. It's vital to have a strong web of leaders who are part of decision-making and are accountable for execution.

However, we found that having a focused team dedicated to always-on information-sharing and decision-making was an enormous strength in a crisis. We established a COVID-19 project-management office that allowed us to share information and act swiftly in areas such as information technology, cybersecurity, and client outreach.

And somewhat to our surprise, we found that we could serve our clients exceptionally and even win new business without traveling and face-to-face contact.

All I Saw Was People

We also had to worry about keeping the critical gears of a professional services firm functioning. You'd think my focus would be on things like financial details, IT, security, and workspaces. But as it turns out, when I looked at any operations issue, all I saw were people.

Whatever the issue, the first and most essential step was to protect our people's safety and well-being and build out from there. All the metrics that executives track—quality, performance, productivity, innovation, client experience—are human outcomes. They depend on people.

It was so simple: We could not weather the storm without first tending to our people.

To be sure, our firm took steps to cut costs and ensure our balance sheet was strong; the partners and principals at our firm made sacrifices, and we made the hard decision to forgo offering our usual year-end bonuses and raises to employees. But when we did it, we practiced what I would call radical transparency: we told people what we knew about the virus, how it was hurting our business, and what we would have to do to react. A lot of our messages were tough. But we felt our people needed to know the good alongside the bad so everyone could be on the same page.

It soon became apparent that many employees felt skipping a raise was worth it if it meant others could keep their jobs. It turns out most people also want to put people first.

The 'Long Tail'

As the pandemic wore on, we faced what I would call the "long tail" of the COVID crisis—what happens to people when they're working remotely for months on end.

We continued to focus on keeping our people safe by keeping them at home. Our auditors found ways to conduct on-site audit functions virtually. In the few instances where in-office

Getty Images

Jim Peko

work was necessary, members of our firm's partnership structure handled that work instead of employees. And we saw that our people received the additional equipment they needed, beyond their laptops, to work comfortably at home.

But keeping people safe is not the same thing as keeping people happy and sane, especially when you factor in daily challenges such as childcare, home schooling, caring for elderly relatives, and glitchy home Wi-Fi.

Sometimes what is best for people's health and safety is not best for their wellbeing. So we are finding ways to help people connect. And we've rolled out additional benefits, such as enhanced childcare resources, subsidized meal-delivery services, and tutoring benefits for those parents with children at home.

These gestures have been widely appreciated and have gone a long way to letting our people know their sacrifices and continued engagement matter.

Three Ways to Succeed

Businesses should do three things as they continue to wrestle with the pandemic.

First, communicate with radical transparency. The biggest risk in a crisis is that misinformation and rumors will fill the void if you don't flood the zone with facts. By telling our teams what we knew about the virus and our business, we had one thing going for us: We weren't hiding anything. It won us the trust and dedication of our people.

Second, don't sugarcoat bad news. We found that people were ready for it. We told them what they needed to know to plan their own lives.

Third, businesses need to adapt and then adapt again and again. Accept that you are going to make some mistakes. People will accept mistakes if you own up to them and correct them immediately. The key is not to make the same mistakes again.

So, while they may not teach you about pandemics in business school, it's undoubtedly true that experience is the best teacher. And we've all learned a lot. CFO

Jim Peko is the chief operating officer of Grant Thornton LLP.

Airlines Expect Turbulent 2021

Last year's falloff erased two decades of passenger growth.

Travel analytics company Cirium said in a report that "the pandemic and its consequences wiped out 21 years of global passenger traffic growth in a matter of months, reducing traffic this year to levels last seen in 1999."

A press release about the report added that passenger traffic in 2020 fell 67% year-over-year, with only 2.9 trillion global revenue passenger kilometers, or 1.8 trillion miles, recorded. COVID-19 hit the airline industry hard as countries closed their borders in a bid to contain the disease spread.

Airlines operated 16.8 million flights from Jan. 1 to Dec. 20, 2020, compared with 33.2 million in the comparable period in 2019.

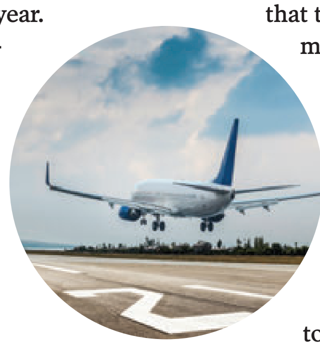
Per CNBC, more than 40 airlines have completely ceased or suspended operations, and experts predict more pain.

Recovery Path

Asia-Pacific and North America were the fastest to recover. The recovery trends showed that airports with domestic flights saw higher traffic compared with those flying international.

International travel fell 68% compared with 2019, while domestic travel was down 40% year-over-year.

Domestic air traffic in China returned to pre-pandemic levels in October, down just 1.4% year over year.



Air traffic recovery showed no correlation to a country's ability to contain the pandemic. Australia has lowered the number of new COVID-19 cases to almost zero, but domestic traffic remained down 89% in September. In contrast, Brazil has been one of the worst affected countries but has seen a steady recovery in domestic flights and traffic since July.

Airlines predict that the coronavirus vaccine will reignite air travel demand in 2021.

Here are some predictions from airline executives:

- Delta Air Lines CEO Ed Bastian expects improvement starting in spring.
- Alaska Air Group president Ben Minicucci expects travel demand to reach 80% of pre-pandemic levels by summer.
- United Airlines CEO Scott Kirby said that travel would not get back to normal in 2021 unless vaccines are widely distributed.

In 2021, the competition will be fierce. Less international travel means airlines will have to compete for a smaller pie. Legacy international airlines such as United, Delta, and American Airlines Group have a tough road ahead.

JetBlue Airways is adding new routes and announced service to new cities, including Miami and Key West. Southwest Airlines is adding new domestic routes as it seeks to expand its reach. CFO | MOHIT MANGHNANI, BENZINGA

Courtesy of the author

10 VITAL ROLES FOR CFOs

To ascend to (and remain in) the office of CFO and be great at the job, you will have to master these responsibilities.

BY SANDRA BECKWITH

If CFOs have learned anything in the past year, it's that they must be agile and innovative leaders skilled at predicting and planning for a future that is anything but predictable. The essential skills for CFO success go far beyond mastery of the financial basics, the ability to adopt popular management practices, or even the intuitiveness to know what the CEO is thinking. Those are just table stakes.

The differentiators that make for an effective CFO take place in a far wider arena: for example, the ability to provide strategic business advice, communicate effectively in new ways and to more audiences, and deploy the latest technologies for maximum efficiency and minimal risk.

But what competencies and skills do CFOs, board members, and others list as the requirements for corporate and career success as a finance chief? We found that the answers clustered in 10 major areas.

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1 STRATEGIST

Think a finance chief can just slipstream behind a larger-than-life CEO? Think again. "Boards want a CFO who is the right-hand of the CEO," says Sheila Hooda, a board director of multiple public and private companies. "A CFO at the highest level moves from someone who is an accounting and finance expert with technical skills to someone who is a multidisciplinary strategist," she says.

Toya Lawson, a partner at executive recruiter Bridge Partners LLC, agrees, saying that her clients want more than a CFO who can deliver data. "The CFO needs to think not just about the numbers that help the CEO make decisions, but also about bringing the right people to the table to help make those decisions," she says.

This ability to be a trusted strategic adviser is crucial during the COVID-19 pandemic, according to one industry veteran."The current crisis is fundamentally a financial one and, as companies change their business models, the CFO has to be front and center in that decision-making process," says Jack McCullough, president of the CFO Leadership Council.

"You need a CFO who is a strategic adviser focusing on value and growth rather than just crisis management and mismanagement," adds Anthony Coletta, CFO of enterprise application software company SAP North America.

2 CROSS-FUNCTIONAL EXPERT

Mere familiarity with operations isn't good enough.

Steven Springsteel, CFO of Betterworks, a human resources technology company, started developing broader expertise when he worked on various finance projects in several divisions of a major corporation as part of a management

10 Vital Roles for CFOs

training program. "That set the tone for me going forward—my career has always been focused on driving the business and looking at the operational side of things. It taught me that the finance function sits at the center where all information comes together," he recalls.

Now executive vice president and CFO of specialty pharmaceutical company BioDelivery Sciences International, Terry Coelho was general manager and president of Mars Brazil earlier in her career. Her responsibilities included building the company's first Brazilian candy factory and launching a brand. Through the years, that position and others allowed her to bring a deep understanding of disciplines outside the finance silo—from supply chain to marketing—to her current role.

While general manager experience isn't realistic for many CFOs, there are other ways to learn more about and understand other areas of the business, Coelho says: "Go out with a sales rep to see what challenges they're facing and hear what customers are saying. If you manufacture goods, walk the production line and learn more about the logistics challenges."

3 DATA STORYTELLER

Interpreting data goes beyond throwing up graphics on a Powerpoint slide.

Stakeholders want CFOs to not only report the numbers but also share the story behind them. This is particularly important, says board adviser and former Procter & Gamble CFO Lars Sudmann, because digital dashboards now make a company's financials more widely available internally.

"The key skill will be to make sense of that data. For that, the CFO needs to be able to walk people through the meaning behind data so that they understand the implications and next steps on the journey," he says.

"The key skill will be to make sense of the data ... The CFO needs to be able to walk people through the meaning behind data so that they understand the implications and next steps on the journey."

—**Lars Sudmann,** former Procter & Gamble CFO

McCullough suggests CFO storytelling won't necessarily mimic the marketing department's narrative: "It's a different kind of storytelling because, with CFOs, there can be no spin, no exaggeration. People are making decisions on this."

Coelho says good storytellers are innately curious. "It's not stopping at the obvious. They ask, "Why? And then what?" she says.

CFO Job Market

Most finance chiefs stay less than five years, and the initial hiring age is falling.

19%
2020 CFO turnover in industrials, highest for any industry*

43%
Percentage of CFOs hired from outside the company

14%
CFOs promoted from coporate controller or chief accounting officer

4.86 years
Average tenure of a CFO

56 years
Most common age of a CFO

49.2 years
Average age of hire for a CFO

*Fortune 500 and S&P 500 companies
Source: Crist|Kolder Associates Volatility Report. Data is as of December 31, 2020.

4 CRYSTAL BALL READER

Boards and CEOs want analysis to not only be accurate but also fast.

"It's a bit unfair but CFOs and their teams are tasked with forecasting more quickly and with fewer mistakes than before. The days when forecasting could take several weeks are gone," says McCullough.

According to Robert Rostan, CFO of Training the Street, an organization that educates junior finance professionals, the aftermath of the 2020 election poses all sorts of forecasting challenges. "Taxation will probably change but will interest rates? How do we drop those unknowns into a model and perfectly forecast what's going to happen? You have to move on because business requires decisions—and often quick decisions," he says.

Chermaine Hu's crystal ball looks like a newspaper. The CFO of fintech company Episode Six uses the media to monitor global news and developments both inside and outside her industry. "All of these moving parts might not feel directly relevant but staying in touch with what's going on in the world helps me think through how it applies to the business," Hu says.

5 DRIVER OF DIGITAL

Digital fluency is more important as finance departments increasingly use technology to streamline and automate processes.

"More and more forward-looking organizations are looking to the finance department to be less focused on reporting historical numbers and trends and more focused on collecting and analyzing data and predicting trends," says Steve Gallucci, who leads consulting firm Deloitte's

U.S. CFO Program. "CFOs must have the wherewithal and knowledge to put systems in place to get real-time information analyzed and distributed to stakeholders."

This isn't something that can wait, says Coletta at SAP. "You can't delay investing in technology or question why it does or doesn't matter. You need real-time data," to guide decisions, he says.

Board member Hooda expects a CFO to be extremely knowledgeable about technology and how to use it to both advance the business and protect it against cybersecurity and data privacy risks. Says Hooda: "If the CFO isn't going to have a handle on this, he or she is going to be a bird that's trying to fly with one wing."

6 TECHNOLOGY RESEARCHER

Former CFO Sudmann recommends CFOs become more digitally fluent by forming a team that researches finance technology. "It's important to truly commit time and resources toward constantly exploring and testing new things," he says.

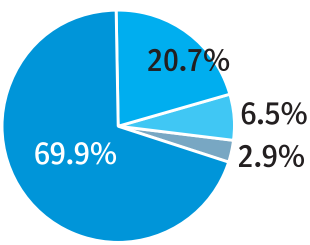
In addition to assigning this "R&D" responsibility to specific individuals, CFOs could schedule a monthly finance leadership team meeting for exploring and testing new tools and applications. "From what I've seen, what makes the difference with a lot of CFOs is diving in and trying things out themselves," Sudmann says.

Understanding the latest technology options was particularly important to Coelho when she joined BioDelivery Sciences in the startup stage and had to build an infrastructure she could scale. "Talk to colleagues at other companies about what they're implementing," she says. "It's important to invest the time, not to become a systems guru, but to understand the solutions that are possible."

At Episode Six, Hu addresses this need in part by filling non-developer positions with younger, less experienced digital natives who are solidly connected to current technology and trends. "Bringing young people into the organization is an easy way to access the latest and greatest about new technology and learn what people care about in general," she says.

School Days

The most popular undergraduate majors for CFOs.



Source: Crist | Kolder Associates Volatility Report. Data is as of December 31, 2020.

7 AGILE PERFORMER

It didn't take long for "pivot" to become the buzzword of the pandemic. As any personal trainer knows, though, you can't pivot quickly and easily if you aren't agile.

Nobody knows what's coming next, points out Coelho. Because of that, she says, CFOs need "a mindset that's open to doing things differently. It's about bringing multiple options to the table that are strategically sound but also feasible."

"Get comfortable with the unknown; with moving forward by conferring with your experts, trusting your gut, and learning from your mistakes."

—**Robert Rostan**, CFO, Training the Street

"CFOs need to be able to cope with the rapid pace of change. They have to become leaders and mobilize teams as change accelerates," agrees SAP's Coletta.

To update plans and strategies quickly, consultant and former P&G CFO Sudmann advocates using his rapid strategy creation method, which relies on an already-created strategy framework or template, speedy planning, and tapping into the organization's internal wisdom. "Two-month planning-cycle thinking needs to be adjusted and replaced," he says.

The need for agility in a fluid business environment resonates with Training the Street's Rostan, who pivoted to become far more knowledgeable about commercial real estate because of the pandemic. "Considering the uncertainty, we're looking at our leases and thinking about ways to optimize them going forward," he says.

Of course, agility may mean making decisions with less-than-perfect information. "Get comfortable with the unknown; with moving forward by conferring with your experts, trusting your gut, and learning from your mistakes," Rostan advises.

8 TEAM BUILDER AND LEADER

While finance team hiring is typically managed by human resources, many CFOs play an active role because they believe it's important to get the right fit for the corporate culture generally and the finance team specifically.

That process can be time-consuming, Coelho notes, but she believes it's time well-spent. The cultural fit is as important as technical skills, she believes. "It's taking the time, being patient, and not feeling like you have to hire the next candidate to fill a slot. I spend a lot of time working to understand the person, what motivates them, and how they work best," she says.

Hu's company uses LinkedIn to fill junior to mid-level positions and personal networks for more senior roles. She focuses not only on acquiring top talent but keeping it. "It's also about giving them what they're looking for in their career," she says. That often means using technology to free employees up from "the boring tasks" and offering more opportunities to learn and acquire new skills.

9 EMPATHETIC MANAGER

Though some CFOs have impressive technical backgrounds, that generally is not their key to success. The soft skills are what make a great executive, according to Gallucci of Deloitte. "It's about empathy, compassion, openness."

Springsteel of Betterworks singles out empathy. "Employees who work from home with children have it the hardest of anybody" and deserve empathy during the pandemic, he says. At the same time, he believes that empathy must extend beyond employees to customers, as well.

"If a customer is having a tough time and says they need more time to pay the bill, show them some empathy," he adds. Discuss how you can work together to solve the problem.

Springsteel knows firsthand how this not only helps both parties during difficult periods but also solidifies relationships. "When COVID-19 hit, we went to every vendor to renegotiate our agreements. They didn't have to do it but they said they were there to help," he says.

10 COMMUNICATOR

Being a great communicator has never been more important because CFOs are talking to more stakeholder groups than ever, says Hooda. In the past, she says, CFOs might have been focused on communicating with investors and shareholders. Today, they're sharing company messages and information with employees, customers, suppliers, and the community.

"Both the outside and inside world look to the CFO as the voice of truth ... Recognize that you're that voice. Be the one to speak up."

—**Steven Springsteel**, CFO, Betterworks

"Both the outside and inside world look to the CFO as the voice of truth," says Springsteel. "Recognize that you're that voice. Be the one to speak up."

McCullough of the CFO Leadership Council points out that CFOs are typically the most trusted executive both internally and externally because they are obligated to focus on the facts without spin. Because CFOs have to be in constant communication with all of an organization's constituents, he believes that "those with exemplary communications skills are an extraordinary asset to any company."

Checking the Boxes

Do you come to the position with all of these skills? Perhaps not, but many can still be acquired, says Gallucci, by making professional development a priority. "Seek out stretch assignments, participate on a steering committee, get involved in a technology-enabled transformation," he recommends.

And what is someone who recruits CFOs looking for? "Strategic thinking skills separate the old CFO from the new," Lawson of Bridge Partners says. "It's one thing to see the numbers. It's another to use them to get you where you want to go." CFO

Sandra Beckwith is a freelance business writer.

CFO Training Programs

There's a wealth of external training for CFOs and potential CFOs to tap into.

The Emerging CFO: Strategic Financial Leadership Program
Stanford Graduate School of Business' program teaches finance executives how to make better strategic financial decisions, build strategic partnerships with key stakeholders, and develop a more effective leadership style.

Advanced Controller and CFO Skills
AICPA's self-study course outlines best practices for controllers and CFOs and identifies ten skills that help add value to an organization and boost an executive's career.

The CFO: Becoming a Strategic Partner Course
The Warton School's course offers a strategic toolbox to help CFOs become better advisers and decision-makers for their companies.

The Executive Program for Prospective CFOs
The University of Chicago School of Business' program helps finance executives sharpen analytics, build strategic leadership and communication skills, and broaden their experience to grow their careers.

The Chief Financial Officer Program
Deloitte's CFO program offers finance chiefs and aspiring CFOs resources for personal career development and helps address growing challenges as the role evolves.

Will Cryptocurrencies Play By The Rules?

Institutional interest in Bitcoin may finally force regulators to come to terms with digital money.

BY RAMONA DZINKOWSKI

Nearly seven years ago, *CFO* asked finance chiefs an accounts receivable question: Would you allow a customer to pay in bitcoin? Now, the issue is one of cash management: Would you allow your treasury team to invest excess corporate cash in Bitcoin?

Tesla and MicroStrategy have. In early February, Elon Musk's carmaking company changed its short-term investment policy to allow it to invest an aggregate $1.5 billion in balance sheet cash in Bitcoin. MicroStrategy, headed by crypto uber-evangelist Michael Saylor, did the same, storing more than $1 billion of the business analytics' firm's reserve dollars in the cryptocurrency.

What's going on? Bitcoin was supposed to be a secure and anonymous medium of exchange via blockchain technology that didn't need the involvement of fractional-reserve banks. As a peer-to-peer decentralized currency, some early disciples claimed it would lead to democratization and disintermediation of the global financial system. That hasn't happened.

Digital currencies' extreme price volatility prevented all except those with the strongest stomachs from allowing customers to buy things with it. And now, skyrocketing digital currency prices have turned them into speculative assets, more like commodities or securities or gold.

Retail and institutional investors have a sustained and growing interest in the likes of Bitcoin. The launch of CME Bitcoin futures in 2017 and options in 2020 has helped spark that institutional interest.

But there's a major stumbling block to widespread adoption—when it comes to regulation, cryptocurrencies are still the Wild West. When digital coins are used as cash, for example, it's often by bad actors. Some estimates suggest that one-quarter of all Bitcoin users are involved in illegal activity, to the tune of $76 billion per year, or 46% of all bitcoin transactions. Many experts believe, however, that the days of that kind of activity are numbered.

"Investors are increasingly handling the assets as they would any other asset in the portfolio—sometimes profit-taking, sometimes reinvesting, using the volatility to their

Getty Images

Will Cryptocurrencies Play by the Rules?

advantage, and using these alternatives to help with all-important diversification," says Nigel Green, CEO of financial consultancy DeVere Group.

With these strategies becoming mainstream, he says "cryptocurrencies must come into the regulatory tent and be held to the same standards as the rest of the financial system."

T. Paul Rowland, a former CFO of Brane, a Canadian-based fintech focused on blockchain technology, agrees: "Technically speaking, crypto can be used to completely circumvent the rules. I would argue if you want to play in this game, be legitimate, and get institutional investors involved, bring crypto from the dark into the light and play by the rules."

Regulators Struggle

U.S. lawmakers have been regulating digital currencies for a while with limited success.

Most of the efforts have been patchwork and tentative. As attorney Josias N. Dewey, a partner at Holland & Knight, sums up in his book, *The Blockchain: A Guide for Legal and Business Professionals*: "Policymakers and other officials have often struggled to apply laws crafted decades ago, in many cases, built on assumptions now being challenged by the technology."

> **"Cryptocurrencies must come into the regulatory tent and be held to the same standards as the rest of the financial system."**
>
> —**Nigel Green**, CEO, DeVere Group

Numerous U.S. states are taking very different approaches to the technology, while the federal government has relied on its agencies to float regulatory proposals.

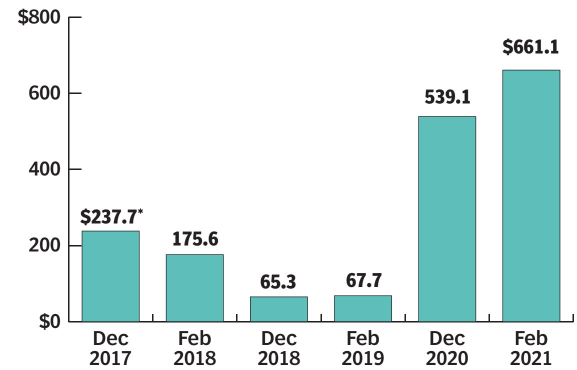
But jurisdictions aren't well defined: The Securities and Exchange Commission claims federal power over virtual currencies insofar as they have the properties of a security. The U.S. Commodity Futures Trading Commission has oversight of derivatives transactions (cash, spot, and futures) related to a virtual currency to the extent it is considered a commodity. The Financial Crimes Enforcement Network (FinCEN) regulates money services transmitters and has issued interpretative guidance for virtual currency exchanges. And the U.S. Treasury and federal banking regulators have oversight powers.

Progress in dragging cryptocurrencies out of the shadows has been slow. But in December 2020 and January 2021, U.S. regulators proposed two new rules for cryptocurrency transactions that could have wide-ranging effects.

The first rule is intended to stifle the activities of bad actors by requiring virtual currency exchanges to remove their customers' cloak of anonymity. The second rule allows banks to form their own blockchains, exchange currency tokens for fiat cash, and conduct other kinds of cryptocurrency transactions and payment activities.

Taking Off

Bitcoin's surging market capitalization gives it a 68% share of the cryptocurrency market.



*In $1 billions
Source: Statista

These measures are a significant step forward, according to former CFO Rowland. "I think it's something that the industry has been calling for," he says. "Regulators are now beginning to come to grips with the fact that cryptocurrencies aren't going away."

Know Your Customer

In the first proposed regulation, FinCEN would require banks and money service businesses to identify and keep records of certain kinds of transactions that occur on cryptocurrency exchanges. The federal regulator also wants exchanges to abide by bank reporting rules that require a filing when customers make cash withdrawals or deposits worth more than $10,000

The reaction to the proposal has been mixed. Backers point to the potential to expose bad actors and increase comfort for institutional investors, but ardent crypto-evangelists and industry players see it as stifling the essence of cryptocurrency.

The Global Digital Asset & Cryptocurrency Association (GDCA) representing more than 110 organizations (including, for example, spot and derivative exchanges and custodians) argues that the decentralized and privacy-centric infrastructure inherent in cryptocurrencies means reporting rules may have the unintended effect of pushing participants to the gray markets, outside of effective U.S. jurisdiction. That would hinder law enforcement, says the GDCA.

Square's CEO Jack Dorsey echoed that point. He said that the proposal creates "perverse incentives for cryptocurrency customers to avoid regulated entities for cryptocurrency transactions" and pushes them into foreign jurisdictions. He adds, "FinCEN will actually have less visibility into the universe of cryptocurrency transactions than it has today."

For now, the battle is at a standstill. On January 22, President Biden froze all rulemaking carried over from the Trump administration, pending reviews. That included FinCEN's proposal.

Enter Banks

The second rule, from the Office of the Comptroller of the Currency, gives the go-ahead for federally chartered banks and thrifts to use independent node verification networks (INVNs, also known as blockchain) and stablecoins to participate in digital currency transactions. (See box, "Defining the Terms.") While some banks were already making inroads in that space, the ruling signals that transacting in digital currency is a reasonable extension of traditional banking, experts say.

OCC-regulated banks will be able to issue digital coins and exchange existing coins for fiat currency. Those capabilities come with custody responsibilities, requiring the validation, storage, and recording of payment transactions on the blockchain.

In the OCC's public statements, it's apparent that what it likes about blockchain is its resiliency (due to its decentralized nature) and the fact that it limits tampering with the transaction database. Of course, the OCC also warned banks that they need to protect against money laundering activities by adapting Bank Secrecy Act compliance programs to address cryptocurrency transactions.

What does all this mean for banks and their customers? As long as the new head of the OCC backs the rule, "it's a new dawn for digital currencies", says Rowland. "It's so important for the crypto custody infrastructure side of the digital asset business to be able to provide investor and customer confidence."

"Banks want to be in this space; they're also now getting pinged by their existing customers who are holding crypto assets or want to hold crypto assets."

—**T. Paul Rowland**, former CFO, Brane

In addition, "banks want to be in this space; they're getting pinged by their existing customers who are holding crypto-assets or want to hold crypto-assets."

Against this backdrop, some financial market players are plunging in. For example, in early 2021 the OCC granted conditional approval for the conversion of state-chartered Anchorage Trust Company to Anchorage Digital Bank, National Association, a crypto-based bank. Card giant Visa, a series B-round investor in Anchorage, is working with it to allow customers to buy and sell digital currencies. It also is experimenting with open application programming interfaces to allow other banks to access Anchorage's digital infrastructure.

The OCC also gave a green light to Seattle-based Protego Trust to use a federal charter to provide custody services for clients to hold digital currencies. Users of Protego's platforms will also be able to engage in person-to-person lending and trading.

The proposed regulations may not suit every cryptocurrency firms' agenda, but digital currencies are slowly being brought under the umbrella of financial regulators. Will more corporate treasury departments join the rush for digital gold as a result? Having been burned in the past by new investment instruments, most may take a pass for now.

But clearer rulemaking frameworks will certainly attract more institutional money. The other thing they will do is help cryptocurrencies live up to what they were originally viewed as—as a medium of exchange for goods and services around the world. CFO

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

Defining the Terms

Cryptocurrency
A digital currency in which transactions are verified and records maintained by a decentralized system using cryptography rather than a centralized authority.

Cryptocurrency wallet
An app that allows cryptocurrency users to store and retrieve their digital assets.

Cryptocurrency (digital) exchange
A cryptocurrency exchange allows customers to trade cryptocurrencies for other assets. It may accept credit card payments, wire transfers, and other forms of payment in exchange for digital currencies. Some exchanges are market-makers that take the bid-ask spread as a transaction commission.

Independent node verification networks
A shared electronic database, such as a distributed ledger, where copies of the same information are stored on multiple computers. Participants in an INVN, known as "nodes," validate transactions, store transaction history, and broadcast data to other nodes.

Stablecoin
A kind of cryptocurrency whose value is tied to an outside asset, such as the U.S. dollar or gold, to stabilize the price.

Sources: Wikipedia, Coindesk, Bloomberg

Cloud Control

Keeping a lid on cloud-based services spending requires constant vigilance and attention to detail. **By Bob Violino**

The COVID-19 pandemic has been an accelerator of cloud services adoption. According to a report by International Data Corp., total worldwide spending on cloud computing, including hardware, software, and supporting services, will surpass $1 trillion in 2024, sustaining a compound annual growth rate of 16%.

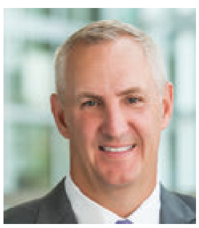
Of course, most of those dollars are being sucked out of the budgets of small and large enterprises at a sometimes astonishing pace. After all, the cloud delivery model for all kinds of IT resources is one of the pillars of the digital transformation underway at many organizations. More significantly, in many companies, new cloud service purchases aren't closely tracked.

Finance executives, previously more familiar with budgeting for server hardware and software licenses, have a new IT-related challenge: How to get a handle on and best manage the costs of burgeoning cloud services.

If that isn't a high priority for a CFO, it should be. A 2020 study by International Data Group and IT services provider Insight revealed that public cloud cost overruns are strikingly common. The study was based on a survey of 200 U.S. business and IT executives. About 70% of the respondents said their organizations had experienced public cloud costs as much as 62% higher than initially anticipated.

A separate survey of senior enterprise IT professionals by Pepperdata found that cloud spend for 2020 was expected to be over-budget by between 20% and 40%.

Unplanned cloud adoptions, lack of merger and acquisition integration, and data egress charges (for removing data from a cloud service in a large file transfer) were the top reasons cited for cost overruns. When asked to identify the top three IT modernization challenges, nearly one-third of the executives cited the need to optimize their current cloud environment to manage cloud costs. That included the aim of leveraging cloud services more "natively"—running cloud applications that are purpose-built and tailored to take full advantage of the cloud's benefits.



"Public cloud costs can easily grow when uncontrolled and are difficult to reduce without significant business or customer impact."

—**Kurt Ishaug**, CFO, Entrust

Lacking Limits

The nature of cloud services and how they're deployed make controlling costs inherently tricky. Many organizations have adopted a multi-cloud strategy—acquiring business applications, software development capabilities, and infrastructure components from more than one provider.

Moreover, many employees and contractors potentially have access to cloud resources, which can quickly expand as needs grow. After all, the cloud, by its nature, has virtually limitless capacity, which can mean overspending if there's no one watching.

"We've seen this [struggle] accelerate since the pandemic," says Tracy Woo, a senior analyst at Forrester Research. The pandemic compressed timelines for cloud adoption and forced enterprises to provide on-demand data-access and applications to remote employees in days or weeks, not months. For some organizations, that meant spending money on the cloud without going through an exhaustive review of other vendor options and the all-in costs of oper-

Getty Images

ating in the cloud. That lead to the underestimation of things like security and compliance-related expenses, which are significant factors in cost overruns.

"Overestimation of product usage and architecture type contribute to uncontrolled cloud costs as well," says Kurt Ishaug, CFO at Entrust, a provider of data protection technology.

Deciphering cloud vendors' invoices after-the-fact requires substantial effort. "Even though cloud providers claim transparency with their line-by-line billing, what the charges mean can be very confusing," Woo says. Bills can contain hidden fees for such things as storage for deleted or stopped instances, application programming interface (API) gateways, and undetected workload configuration changes.

Finally, adding to the lack of controls are the expectations executives have for cloud services. Even this late in the game, organizations still have the mistaken belief that moving to the cloud will lead to cost savings. "So, the focus on managing costs isn't there," Woo says. "We tell clients that shifting workloads from the data center to the cloud doesn't mean cost savings, but rather should be seen as a tool for innovation."

importance of cloud services to the business, CFOs need to be involved.

"Public cloud costs can easily grow when uncontrolled and are difficult to reduce without significant business or customer impact," Ishaug says. CFOs should work closely with the chief information officer and IT team to carefully manage resources, purchase approvals, and other elements.

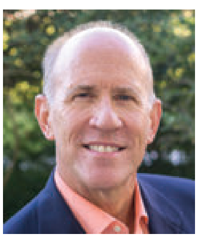
One area in which CFOs can make a valuable contribution is in fleshing out the real costs of available cloud options, says James Meadows, managing partner and CFO of law firm Culhane Meadows. Often, the cloud offers a temporary benefit in the form of lower 'per transaction' costs," Meadows says. The CFO, rightly, will expand the discussion to include the full lifecycle of the cloud service, including the initial conversion, operations, and end-of-term implications, along with a consideration of the operational risks.

Besides CFO involvement, critical to any cloud optimization strategy is governance. Governance is important because analysis of cloud services should not end with evaluating and selecting a cloud provider.

"Business needs and strategies evolve—organically and in reac-

"Part of the issue is the mistaken belief that moving to the cloud will lead to cost savings; therefore, the focus on managing costs isn't there."

—**Tracy Woo**, Senior Analyst, Forrester Research



"The sourcing process will maintain visibility, especially financial, across the organization's cloud solutions and will provide that information up to the top governance level."

—**James Meadows**, CFO, Culhane Meadows

Counting Everything

Cloud services deployment is typically managed and maintained by IT or business line executives. But (and it shouldn't require mentioning) given the rising expenses and the

tion to 'emergencies'—and the cloud solution needs to evolve with those needs and strategies," Meadows points out. As workloads in the cloud are scaled and become increasingly complex, proper governance policies

for the use of public, private, and hybrid clouds are essential.

Governance should happen on two levels. At the organizational level, it is used to manage the overall cloud optimization strategy. At the solution level, it is used to manage each cloud service and each service provider relationship. Solution-level governance enlists a sourcing or procurement department to oversee all cloud contracts and consolidate the cloud payment process.

"The sourcing process maintains visibility, especially financial, across the organization's solutions, and will provide that information up to the top governance level," Meadows says.

The sourcing process also provides a contract management function, serving as an interface or clearinghouse of input from constituencies throughout the company, including the risk management, IT, and legal departments.

The success of governance efforts relies on a tight feedback loop between application developers, cloud managers, and business leaders. Says Woo, "Cloud managers and app developers must have a strong collaboration, to help guide developers to the cloud platforms and services best suited for each application."

SLAs and Separations

Any worthwhile cloud cost-management program requires diving into the nitty-gritty of contracts. For already deployed applications or new ones, cloud managers should monitor performance, availability, and compliance to maximize cloud spending and ensure that service-level agreements (SLAs) are met. Woo says the performance metrics should be reported back to the business to guide the next phase of cloud development.

SLAs require particular attention upfront. Organizations should aim to negotiate customer-specific SLAs and reach an agreement on price protection and termination language, Meadows says. "Contractual protections are critical, in part to ensure that remedies are available if needed," he says. But even more important, they ensure that service providers pay an appropriate level of attention to the company.

Termination language tends to be the most overlooked area of the contract, Meadows says, and poses some of the greatest risks. At the end of term, when a vendor is losing the organization's business, simple cooperation language is rarely enough, he says. Specific obligations and associated cost protections are required to ensure that this does not become, at

Pandemic Spending

COVID-19 brought an initial burst of investment, but then buying moderated.

Total business spending on cloud computing services rose at the onset of the pandemic. However, fluctuations occurred over time, and organizational size played a big role. Enterprise organizations analyzed by VMware's CloudHealth unit increased cloud spending levels by only 3% in March 2020, but in May 2020 showed a 23% increase in cloud investment. According to CloudHeath, that was because many suppliers offered discounts on on-demand service rates in exchange for long-term usage commitments.

On the other hand, after upping spending 7% in March, the hard-hit small business segment showed a consistent drop in cloud spending levels. By May, spending had fallen 5% compared with January. CloudHealth attributed that to cost-cutting efforts among a segment "with the least financial stability to withstand the pandemic's economic uncertainty."

Younger organizations with IT systems 'born in the cloud' tended to have processes for scaling usage efficiently before the onset of the pandemic, enabling them to stay on course.

Spending by midmarket companies showed the least volatility, rising 1.7% in March and changing within a small band through September. At that point, midmarket cloud investment was up 11% over January. According to CloudHealth, the segment "contains younger organizations with IT systems 'born in the cloud.'" These organizations tended to have "processes for scaling usage efficiently before the onset of the pandemic," enabling them to stay on course.

CloudHealth is one of a large group of companies offering cost management tools for cloud spending. The tools' primary function is reducing costs by optimizing efficiency and cloud resources, says Tracy Woo of Forrester Research. An important secondary function is their role as a collaboration platform that acts as a mediator between application developers, IT or cloud centers of excellence, finance, and executives, she says.

Cost management tools can provide the right level of granularity on the use of infrastructure resources and their effect on cost, Woo says. For instance, they can indicate that cloud costs have escalated due to a particular new application that requires significant resources to run.

Egnyte, a provider of content collaboration systems, has begun using a software tool to manage cloud-based applications costs, says CFO Suzanne Colvin. The product monitors the quantity of services purchased and actively used. It also helps with provisioning and de-provisioning cloud services to ensure that they're only turned on where needed, says Colvin. | **B.V.**

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best, the vendor's last opportunity to make a profit, or at worst, a nightmare for the customer trying to leave the relationship.

Finally, a good cloud cost management and optimization plan should include regular communications and training.

Reviewing the Contract

When going through a new cloud services contract, pay particular attention to these five areas.

Data Privacy

Various statutes govern the privacy and confidentiality of specific kinds of information. Whatever those requirements may be, the privacy and confidentiality of customer data must be protected. Any such requirements or desires should be set forth expressly in the contract, or they may not be enforceable.

Data Security

If a contract addresses the issue at all, it is likely to promise to provide only "reasonable" data security, or perhaps to adhere to "industry standard" security practices. While such promises sound good in the abstract, they are open to considerable interpretation and argument. It is preferable to specify an actual, specific, independent security standard and require that it be updated, and perhaps audited, regularly.

Service Level Agreements

The amount of guaranteed "uptime," the process and timeline for dealing with "downtime," and the consequences for any failures to meet those requirements should be spelled out clearly. In the context of a "free" service, additional "free" service may be of no great customer benefit and no great disincentive to the provider.

Data Ownership

The contract should expressly make clear that all data belongs to the customer (and/or its users) and that the provider acquires no rights or licenses, including without limitation intellectual property rights or licenses, to use the data for its own purposes by virtue of the transaction.

Suspension and Termination of Service

Contracts typically give the cloud provider the right to suspend the service or to terminate it altogether upon certain events or conditions. Such provisions may not be unreasonable in the abstract, but they should be limited in scope to only truly significant matters, provide for an opportunity to cure the alleged violations or some form of escalation rather than instantaneous implementation (except in the case of true emergencies), and give the customer an adequate time to make alternative arrangements for its data or service.

Source: The CommLaw Group

This information does not, and is not intended to, constitute legal advice.

A good cloud cost management and optimization plan should include regular communications and training.

Says CFO Ishaug: "Determine the cloud expertise your business needs, ensure the appropriate executive-level support is involved in decision-making, and develop and require continuous training, so employees are equipped with the skills they need to be successful as the business scales."

Effective cloud cost management requires all of the above. But, points out Woo, CFOs should make sure management teams understand that cost management also fills the operational gaps created when using cloud service providers.

"Cloud providers present abstracted and standardized services for consumption and offer basic metrics to monitor those services, she says. But "it remains a cloud consumer's responsibility to understand whether the services rendered meet the company's operational requirements."

Cloud costs can be hard to see. But amidst a rapid shift to cloud platforms, CFOs need to find the time to make them visible and hold managers accountable for them. CFO

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

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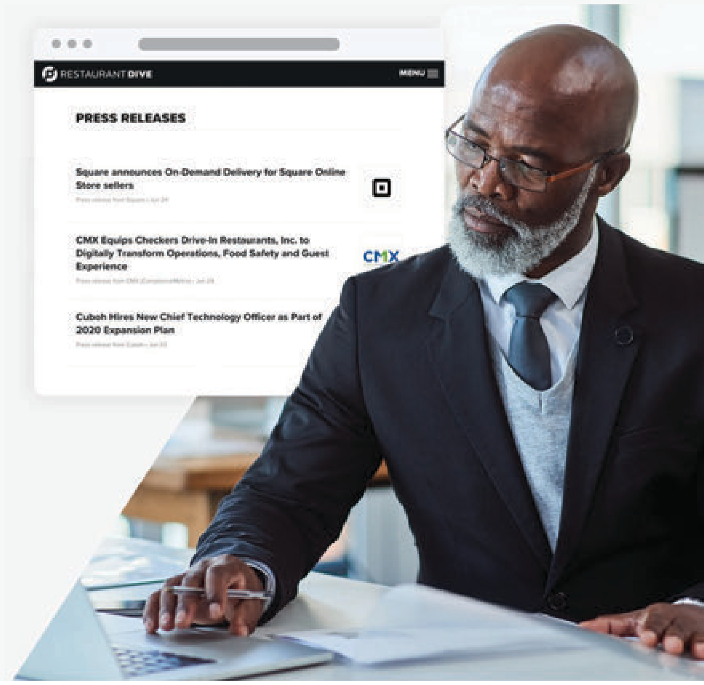

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THE QUIZ

Early Days

A new presidential administration and a new political party holding a voting majority in the U.S. Senate heighten the uncertainty for U.S. executives. While it's unlikely Congress will pass any new taxes during the pandemic, the situation deserves watching. How closely have you been following the early days of the Biden administration?

1 Janet Yellen is the first person to be chair of the Federal Reserve, Treasury Secretary, and which other post?

A. Secretary of the Commerce Department
B. President of the World Bank
C. Chair of the White House Council of Economic Advisers
D. President of the New York Federal Reserve Bank

2 When does the four-year term of Federal Reserve Chair Jerome Powell end?

A. December 2021
B. September 2021
C. February 2022
D. June 2022

3 Which of the following White House jobs does NOT require Senate confirmation?

A. Chief of the Small Business Administration
B. National Security Adviser
C. Surgeon General
D. Director of the National Economic Council

4 Which one of these is NOT one of President Joe Biden's stated economic goals?

A. Raise the top corporate income tax rate
B. Tax capital gains and dividends at ordinary rates for high earners
C. Tax profits earned from foreign subsidiaries at 39%
D. Impose a 15% minimum tax on book income

5 Which one of these proposals is in Biden's emergency economic plan?

A. A third iteration of the Paycheck Protection Program, for midsize companies
B. A $200 per month Social Security increase
C. Two weeks paid leave for all heath care workers
D. Temporary income tax relief for all low-income workers

6 Whom did President Biden nominate as U.S. Trade Representative?

A. Katherine Tai
B. Ngozi Okonjo-Iweala
C. Amy Celico
D. Michael Kantor

7 The Biden Cabinet nominations included three former governors and two mayors. Who is not one of those five nominees?

A. Marty Walsh
B. Gina Raimondo
C. Jennifer Granholm
D. Gretchen Whitmer

8 Which of the above nominees co-founded a venture capital firm?

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

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