JULY/AUGUST 2017 | CFO.COM

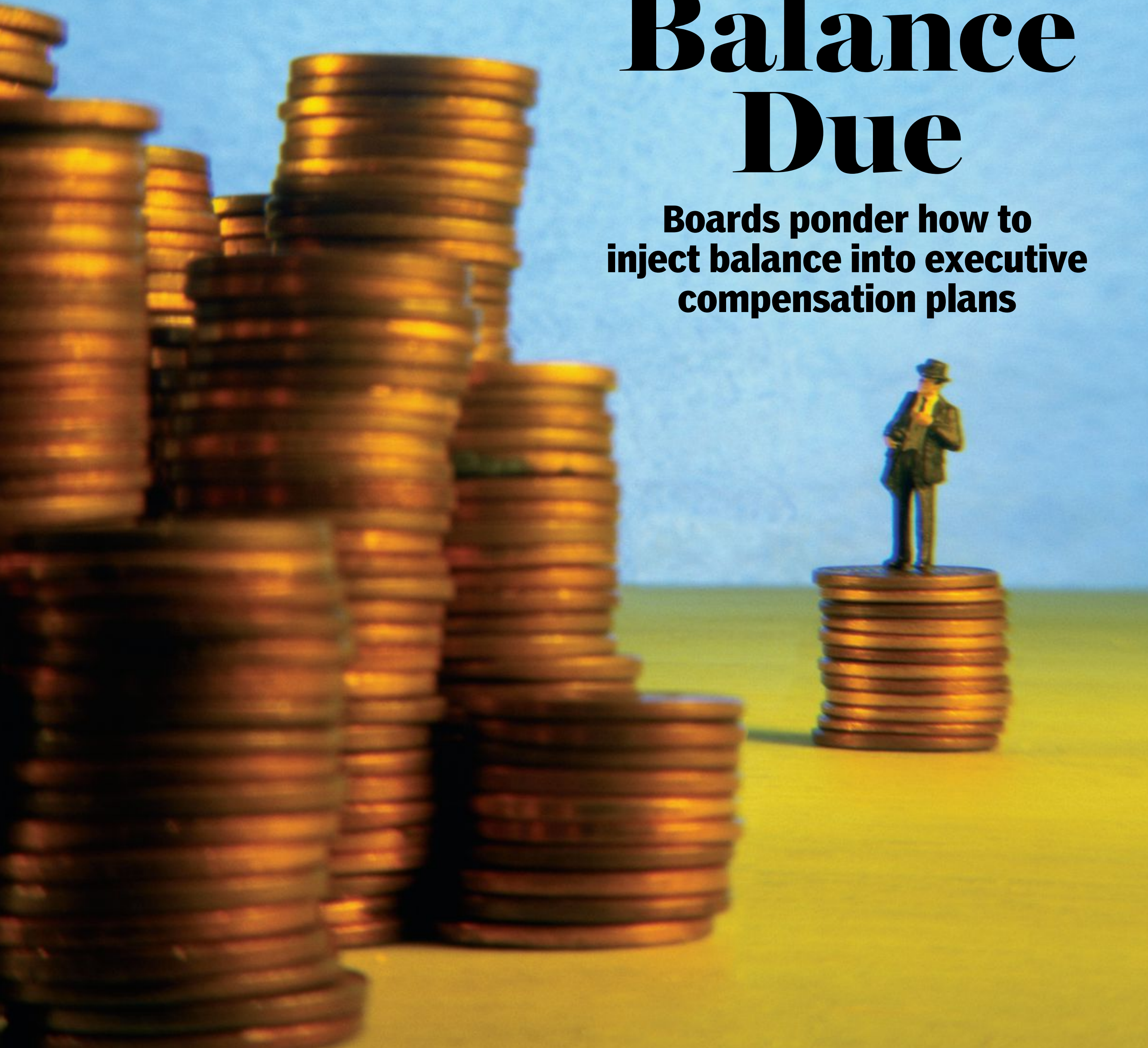
CFO

THE 2017 WORKING CAPITAL SCORECARD

SPECIAL REPORT: RETIREMENT BENEFITS

Balance Due

Boards ponder how to inject balance into executive compensation plans



IN THIS ISSUE

July/August 2017
Volume 33, No. 6

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Up Front

By the Numbers

Clockwise from top right: Thinkstock (2), Courtesy Betteridge, Thinkstock

FROM THE EDITOR

Payable Problem?

For several years, *CFO* has written about The Hackett Group's Working Capital Scorecard on 1,000 of the nation's largest companies (see this year's story on page 30). More often than not, the data show that the finance teams of publicly held companies are doing a poor job of working capital management: for example, the average days sales outstanding (DSO) of the group has been on the rise, hitting 38.2 days in 2016, the longest period since 2007. If you can't get your customers to pay you within 30 days, you're not managing cash very well.

Or are you? Another data point from the Hackett Group shows companies are paying their suppliers later and later. The average days payables outstanding (DPO) reached 53.2 days in 2016, also a 10-year record. The top-quartile companies stretched payables even longer—to 63.6 days. At that length, and with the leverage these firms have over smaller suppliers, that DSO is only at 38.2 days is actually impressive.

Negotiating longer terms with suppliers cuts the buyer's cash conversion cycle, the amount of time cash is tied up in working capital. And that's a good thing. Hackett, in a first, found this year that every seven-day reduction in total CCC adds as much as 1% to EBITDA margin.

But is keeping small suppliers dangling by lengthening payment terms the best way to improve working capital? I submit that it is not. Taking longer to pay an invoice has a negative effect on suppliers' cash flows and can harm business relationships. While many large companies have set up supply chain finance programs to limit the damage, those also have significant downsides, for both buyer and supplier. (Read the story to find out more.)

Unfortunately, I fear we are in a vicious circle with DPO and DSO. Companies get paid later, so they pay their own suppliers later, if they have the leverage to do so. The overall effect is that the smallest, weakest businesses get squeezed, and that's not good for anyone.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

FINANCE
CFO Rising Midwest is fast approaching, taking place September 7, 2017, in Chicago. This year's speakers include the CFO of global data and information management at HSBC, the VP of finance at Primerica, and the CFO of marketing at Farmers Insurance. Learn more at the Innovation Enterprise website.

SALES
In **"Landing the Megadeal: Seven Keys to Closing Big Sales That Make Money,"** three McKinsey consultants provide tips on how to land the big sale on the right terms. Tips include pricing first, aligning incentives with shareholder value, and rethinking the role of the CEO. Read the entire article on the McKinsey Quarterly website.

PERFORMANCE
Is there a hotter topic than corporate performance management? At **CFO's Corporate Performance Management Summit** (October 16-17 in San Francisco), you'll hear from the directors of finance at Qualcomm and CBRE, the CFO of Denver International Airport, and the director of operations planning at Samsung. Learn more at the Innovation Enterprise website.

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INBOX

With boards of directors and management teams having grown rightly obsessed with information security, *CFO* has ramped up coverage of the topic as well—and audience members aren't shy to throw two cents into the pot.

In the June 23 edition of Square-Off, our monthly opinion forum, one article in the package was titled, **"Cybersecurity Demands a Military Mindset."** It drew a lengthy response from Robert Dietz, a college professor and, from 1998 through 2006, the National Security Agency's general counsel.

"I agree [cybersecurity] should be treated as warfare," Dietz wrote. "That takes flexibility, adaptation, and quick reaction to enemies and their tactics. But this is something the federal government cannot do. The size of [government] organizations, requirements for certifications and contractor past performance, multiple layers of contractors, [and] legally required open-solicitation periods prevent them from deploying and utilizing defensive technologies as fast as the enemy can deploy [offensive ones]. They have the money and government expertise to be bleeding edge, but not the laws and policies ... to take full advantage of that."

Responding to **"Why Cybersecurity Is Financially Undervalued,"** one reader told us exactly why, from her point of view. "Many organizations have the 'it can't happen here' attitude in the C-suite," she wrote. "While they can tell you to the dollar what shutting down the production line will cost, they can't tell you the cost of having emails talking about M&A activity hijacked."

Meanwhile, sometimes the shortest comments on articles are the most eye-catching, even if it's not always quite clear how seriously they should be taken.

One reaction to **"Anthem Agrees to Record Settlement over Cyberattack"** (June 26) noted that the article reported, "A spokesperson for the company said there was no evidence that the compromised information was sold or used to commit fraud." To which the reader pointedly responded, "Really? Then I wonder why the hackers went to all that trouble."

Another audience member recently offered up a double dose of bite-size cynicism. Replying to **"Yellen Says Financial Crisis Unlikely in Her Lifetime"** (June 28), he stated, "Sounds like Yellen is trying to be reappointed. She remains clueless." A day later, after **"CFOs Saw Higher Salary Increases than CEOs"** was published, he opined that "CFOs should receive higher compensation increases than CEOs, as most are brighter and more competent." Enough said.

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www.argyleforum.com

PRESIDENT & CEO
Danny Phillips

CFO
Scott Kenerly

CFO MAGAZINE/CFO.COM

EDITOR-IN-CHIEF
Vincent Ryan
(vinceryan@cfo.com)

MANAGING EDITOR
Deana Colucci

DEPUTY EDITORS:
David M. Katz
(davidkatz@cfo.com)

David McCann
(davidmccann@cfo.com)

CFO MARKETING SERVICES

DIRECTOR, MARKETING SERVICES
Chris Schmidt

EDITORIAL DIRECTORS, CUSTOM CONTENT & RESEARCH
Joe Fleischer

Kim Zimmermann

ADVERTISING SALES
Brian Kleve, (646) 973-5114
Haley Moore, (646) 973-5111
Matt Moore, (646) 973-5112

EDITORIAL OFFICES
295 Devonshire St., Suite 310
Boston, MA 02110
(617) 345-9700

50 Broad St., 1st Floor
New York, NY 10004
(646) 839-0012

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STATS OF THE MONTH

4%
Year-over-year change in the number of worldwide M&A deals in the first half of 2017*

$1.6T
Value of M&A deals worldwide, up 2%

$631B
Value of cross-border M&A activity, the highest tally since 2007

-16%
Change in the value of U.S. M&A deals

33%
Change in the value of M&A deals targeting European companies

*All statistics are for the first half of 2017. Changes are year-over-year. Source: Thomson Reuters

TOPLINE

AUDITING

PCAOB OKs Big Change to Audit Reports

The first significant change in 70 years will require auditors to address issues "that kept them awake at night." By David M. Katz

Worrisome matters reported by an auditor to a board audit committee would be disclosed in the auditor's report under a new standard approved on June 1 by the Public Company Accounting Oversight Board. Although the standard would retain the current pass/fail model for audit reports, it is the first significant change to such reports in more than 70 years, according to PCAOB chairman James Doty. "The new standard will breathe new life into a formulaic reporting model," he said.

In particular, the standard would require auditors to include a discussion of critical audit matters (CAMs) that arise during a specific reporting period. A CAM is any matter communicated or required to be communicated to the audit committee that both (1) relates to material accounts or disclosures that are material to the financial statements, and (2) involves "especially challenging, subjective, or complex auditor judgment."

PCAOB member Steven Harris said in prepared remarks that the action is a response to calls from investors for audit reports to disclose the difficult aspects of audits, as well as information gained from audits that investors would like to know about—"basically what kept the auditor awake at night."

CAMs will likely stem from "areas that have historically been of particular interest to investors, such as significant management estimates and judgments, significant unusual transactions, and other areas that pose high financial statement and audit risk," Harris said.

PCAOB chairman James Doty

The standard is expected to be approved by the Securities and Exchange Commission following a comment period.

Besides CAMs, the standard makes changes aimed at clarifying the auditor's role and responsibilities, providing more details about the auditor, and making the report easier to read:

- **Auditor tenure.** The new auditor's report would include a statement disclosing the year in which the auditor started serving consecutively as the company's auditor.
- **Independence.** It would include a statement that the auditor must be independent.
- **New language.** Some standardized language in the auditor's report would be

Top left, Thinkstock; above, Bloomberg/Getty Images changed, including addition of the phrase "whether due to error or fraud" in a description of the auditor's responsibility under PCAOB to get "reasonable assurance about whether the financial statements are free of material misstatements."

•**Standardizing the form.** The auditor's opinion would be required to appear in the first section of the auditor's report. Section titles would be added "to guide the reader."

While the PCAOB unanimously approved the measure, individual board members expressed some qualms about it. Harris, for instance, was bothered by the "element of subjectivity" in defining CAMs under the standard. "Allowing auditors to decide what matters involved 'especially challenging, subjective or complex auditor judgment' grants them too much discretion," he said.

Board member Lewis Ferguson was concerned that CAM statements "will quickly deteriorate into boilerplate." He predicted there would be "an inevitable attempt, particularly on the part of large audit firms with many public company clients, to achieve some, and perhaps a very high degree of, uniformity in the disclosure of the CAMs."

"The new standard will breathe life into a formulaic reporting model." — PCAOB chairman James Doty

In framing the standard, though, the board has tried to curb that risk by requiring that CAMs "be tied to the factual situation of the particular audit engagement in which they arise," Ferguson said.

Board member Jeanette Franzel was skeptical about requiring auditors to disclose how long they've been auditing a public company. That may suggest there's a "relationship between auditor tenure and audit quality and/or auditor independence—assumptions that may not be valid."

Provisions other than those related to critical audit matters would take effect for audits for fiscal years ending on or after Dec. 15, 2017. Provisions related to critical audit matters would take effect for audits for fiscal years ending on or after June 30, 2019, for large accelerated filers. CFO

CAPITAL MARKETS

CFOs Still Spurning High-Return Projects

Despite low capital costs, the hurdle rates companies use to screen investments are still stubbornly high.

The "hurdle rates" of return that U.S. companies use to decide whether to invest in a project have remained stubbornly high, even as the cost of capital has fallen significantly, according to the second-quarter Duke University/*CFO* Magazine Global Business Outlook Survey.

The median hurdle rate U.S. companies use to evaluate investment projects was 12%, based on the 306 finance executives responding to the survey; the mean was 13.6%. Respondents' median weighted average cost of capital (WACC) was 9.8%, with the mean 10.6%.

Modern finance theory says that as long as an investment earns a rate higher than the cost of capital, it creates value for a firm. Thus, when the hurdle rate exceeds the cost of capital, a firm is passing up value-creating projects, explains Duke finance professor John Graham.

Given how the average hurdle rate has remained high while the cost of capital has fallen, this "problem" of passing up value-creating projects has gotten bigger in recent decades, he says. Finance chiefs of U.S. companies have plenty of reasons, though, for using hurdle rates higher than their cost of capital.

"WACC is fairly known, but investments have many forms of risk. An excessive premium is needed given the fundamental flaws in the calculations," says a manufacturing CFO whose company uses a hurdle rate of 11%.

Says another CFO: "We add a 200-basis-point spread to growth projects to account for incremental project risk and execution risk." Added a finance executive from the banking industry: "Our hurdle rate is equal to our cost of equity, which ensures we keep our eye toward making a good return to our shareholders."

Companies are even passing on projects that are expected to earn a return higher than their hurdle rate. Only 20.6% of finance executives responding to the Duke/*CFO* survey said that their companies pursue all such projects. What's preventing companies from doing so? "Shortage of management time and expertise" was the most popular answer, given by 50.9% of finance executives. | VINCENT RYAN

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CAREERS

Collaboration: The 'Magic Ingredient'

What drives company financial performance? It's a soup with a plethora of ingredients, of course. But key traits possessed by CFOs certainly correlate with revenue growth, according to SAP and Oxford Economics.

The firms surveyed 1,500 CFOs from around the world and divided the respondents into two categories: "finance leaders" and "others," based on their answers to a handful of questions. The leaders, who comprised only 11.5% of participants, were defined as having self-reported that they:

1. Have strong influence beyond the finance function
2. Drive strategic growth initiatives
3. Improve efficiency with automation
4. Are very effective at core finance processes
5. Collaborate regularly with business units across the company
6. Work closely with the governance, risk, and compliance teams and excel at handling regulatory change

While strategic and technological acumen are the CFO capabilities that garner a majority of the spotlight these days, the study identified something else as the "magic ingredient" for success: the ability to collaborative effectively. In fact, 46% of finance chiefs at companies with flat or negative revenue and profit growth said the finance function's isolation hinders achieving business goals. That percentage shrunk to 28% among respondents whose revenue grew 5.1% to 10%.

At the fastest-growing companies, 63% of respondents said finance has a strong influence over the supply chain and procurement, compared with 49% at companies with revenue growth of 0.1% to 5%. And 70% of the faster-growing companies reported that finance influences innovation and new product development, vs. 53% at slower-growth companies.

More financial leaders than nonleaders said their company provides business analytics and training programs to encourage different units to work together productively. | DAVID McCANN

AUDITING

PCAOB Targets Estimate Biases

The Public Company Accounting Oversight Board has proposed two measures aimed at minimizing the effects on audits from management biases in accounting estimates.

One proposal aims to stiffen auditors' skepticism when they audit such estimates. Specifically, it would extend a number of requirements in the current standard on auditing fair-value estimates "to all accounting estimates to reflect a uniform approach to substantive testing," the PCAOB says. "The subjective assumptions and measurement uncertainty of accounting estimates make them susceptible to management bias," the proposed standard states.

Further, accounting estimates are becoming more widespread and important "as financial reporting frameworks continue to evolve and require greater use of estimates, including those based on fair-value measurements," the PCAOB said.

Although current PCAOB standards address professional skepticism and management bias, "they are largely silent on how to address those topics in the context of auditing accounting estimates," according to the proposal. To help auditors with such issues, the proposal includes a special topics appendix that addresses auditing the fair value of financial instruments, including the use of information from pricing sources.

The 2008 financial crisis underscored both the importance of and potential challenges associated with developing and auditing certain accounting estimates.

The other proposal would amend the existing standard on auditors' use of the work of specialists, which "has grown in both frequency and significance as the use of fair-value measurements and other accounting estimates has increased," the board said in a press release. The proposed standard would provide auditors with factors for determining what evidence they need to support their conclusions when they use the work of a specialist to audit a company. | D.M.K.

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HEALTH CARE

Growth in Health-Care Consumerism Slows

Consumer-directed health plans (CDHPs), which allow participants to tailor their amount of coverage to their expected consumption of health-care services, have become a key strategy for managing both employee and employer costs.

But it appears that the CDHP "revolution," if you will, might not materialize to the extent some observers predicted a few years ago. It was thought that employers in droves might drop their traditional health plans and go exclusively to CDHPs, which in the case of most participants provide lower premiums in exchange for higher out-of-pocket costs.

That's not happening. In a Mercer survey of 1,692 employers with more than 500 workers, just 19% said they will offer only a CDHP by 2019 (see chart, below).

Growth in CDHPs continued in 2016, but at a slower pace than in recent years. Among those employers, 61% offered them—a small incremental gain from 59% in 2015, following a big increase from 48% a year earlier. The prevalence actually dipped last year among the 852 participating employers with 500 or fewer workers, to 25%, from 28% in 2015.

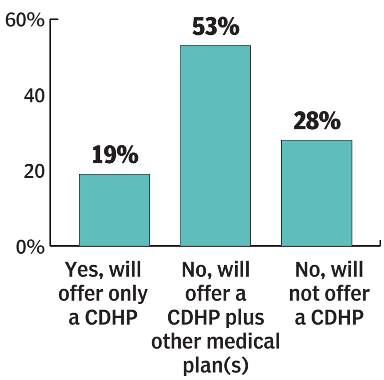
In contrast, among the largest organizations CDHPs are becoming universal, with 80% of those with at least 20,000 employees offering a CDHP in 2016, up from 73% the previous year.

At companies that offered CDHPs—which typically consist of a high-deductible health plan combined with either a health savings account or a flexible spending account—the percentage of employees enrolled continued a slow but steady increase last year, reaching 29%. The figure had risen from 13% in 2011 to 25% in 2015.

Propelling that trend, the average monthly paycheck deduction for employee-only coverage in an HSA-eligible plan was $84, compared to $132 for a PPO plan. | D.M.

CDHPs: The Jury Is Still Out

Does your company expect to offer a consumer-directed health plan as the only medical-plan option by 2019?*



*Asked of 1,692 companies with more than 500 employees

Source: Mercer, National Survey of Employer-Sponsored Health Plans, 2016

CREDIT

Banks See Slower Loan Growth

FDIC-insured banks reported that the pace of loan growth slowed in the first quarter and that charge-offs on loans to individuals increased. But banks still recorded robust earnings for the period.

Total loans and leases fell by $8.1 billion, or 0.1% year-over-year, in the three months ended March 31, led by credit card loans, which posted a seasonal decline of $43.7 billion, or 5.5%. The FDIC attributed the decline to cardholders paying down outstanding balances, but residential mortgages also fell, by 0.5%. Credit to businesses offset some of the decline, with commercial and industrial loans up 1.3% and commercial real estate loans rising 1.7%.

Failed consumer loans also dinged banks' balance sheets. Banks charged off $11.5 billion of loans in the first quarter, an increase of 13.4%. Net credit card charge-offs rose 22.1%, while auto loan charge-offs increased nearly 28%. Charge-offs of "other loans to individuals" increased a whopping 66.4%.

But trends in noncurrent loan balances—loans and leases 90 days or more past due—do not suggest the bulk of consumers or businesses are having a hard time paying back credit. Noncurrent loans at banks fell by $7 billion, or 5.3%, in the first quarter, led by declines in noncurrent mortgages (8.2%) and commercial and industrial loans (4.6%).

More than 57% of all FDIC-insured banks reported year-over-year increases in quarterly earnings. | V.R.

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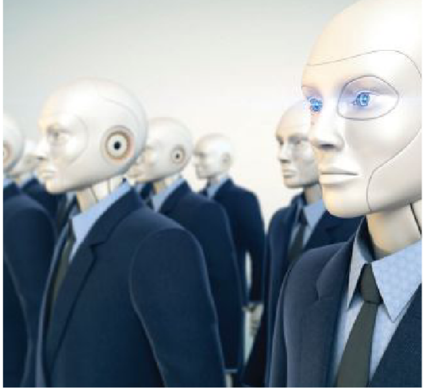
TAX

Tax Managers Forced to Up Their Game



Advancements in robotic process automation, machine learning, and artificial intelligence are expected to displace tens of millions of people worldwide from their jobs over the next decade. Among the groups of workers that may worry about that are corporate tax professionals.

After all, tax is a highly technical discipline, seemingly a juicy target for increasingly smart machines that may usurp a large portion of the work tax managers currently perform. However, the tax folks don't necessarily need to worry—that is, if they adapt to change by developing skills they may not currently possess, according to a new report, "The Tax Professional of the Future," from PricewaterhouseCoopers.

Historically, those who master the tax function well understand the tax code, regulations, and case law. They're able to research source material and perform complex income-tax-provision and tax-return calculations.

But, PwC notes, as data analytics tools and other technologies progressively rid tax of technical tasks, the function will be freed to add value in other ways, and will be expected to do so. For one, tax professionals will need to gain a more nuanced understanding of the company's business, and leverage that knowledge to take on leading roles in cross-functional technology-implementation and process-improvement projects.

"Since technologies rapidly evolve, it is the mindset that must first change," PwC writes.

Additionally, project-management, collaboration, and change-management skills will become important for tax managers, the report says. These capabilities will ensure that the tax function identifies expected outcomes and benefits while teaming with other functions and service providers.

Tax professionals will also be expected to interact effectively with the C-suite, deliver business cases for changes within tax, and impact business processes and functions beyond tax.

The report criticizes university accounting programs for not exposing students to tax courses until late in their academic lives. | D.M.

What Makes for A Public-Company CFO?

Top finance chiefs tell how they got where they are and what their potential successors need to do. By David McCann

How do finance professionals come to be on the CFO track and, ultimately, land a finance-chief job at a big public company? Certainly, all of them become deeply skilled in the technical aspects of the profession, and virtually all gain advanced abilities in leadership, strategic orientation, and communications. Still, their stories are remarkably divergent.

Some never aim to be a public-company CFO, instead envisioning they might one day run finance at a small business, but they get a public-company opportunity anyway. For others, it's the convergence of right time, right place. Some leverage a harmonious relationship with the CEO. And still others set their sights on a top finance seat early on, but their path to that goal takes some unexpected twists.

You Can't Have It All

Like a surprising number of CFOs, Scott Schenkel, who in July will complete his second year running finance at eBay, grew up at General Electric. He worked there for 17 years before joining eBay in 2007, and looking at the positions he has held since his career began, it seems clear he was on a CFO track from day one.

Scott Schenkel, CFO, eBay

But being ready for the job may not be the same as believing you're ready. "I don't think there's ever a point in time where it crystallizes, where you think, 'yeah, I'm ready, I've checked all the boxes,'" Schenkel says.

His move to eBay was intentionally designed to prepare him to one day take the finance reins at the online marketplace. The CFO at the time was Bob Swan, a respected former GE colleague. Schenkel says he was "very invested" in ascending to the post whenever the incumbent left, which happened in 2015 when Swan moved to Intel.

Along the way, Schenkel did a lot of things to prepare. He attended every board meeting for seven years. Unlike many CFOs-to-be, he had a big role in working with investors and sell-side analysts. And he got well immersed in eBay's businesses by regularly conducting operating reviews.

And yet he says it's "practically impossible" for someone to have strong experience in every area that's important to being a CFO. "I don't think it's realistic," he says. "You'll never get to all of them, at any depth."

You'd Better Have It All!

But Schenkel's view is actually a matter of debate within the CFO ranks.

Carol Tomé, CFO, The Home Depot

"I don't subscribe to that," says Carol Tomé, the longtime finance chief at The Home Depot. "It's incumbent upon the sitting CFO to invest in his or her team and make sure that if they don't possess all the skills required, they get them. In fact, I believe that my legacy will be defined by the quality of my team."

At the same time, even qualified candidates may doubt whether they have all the requirements. "Does anyone ever feel like they're fully qualified before taking a job?" she says. "I think the answer is no."

According to Tomé, the ability to clearly communicate is the skill most often missing from people who are a step or two away from earning a promotion to CFO. The role demands a lot of communicating—to boards, the management team, staff, investors, analysts, banks, rating agencies, and in the case of Home Depot, hundreds of thousands of store associates. A big key is "understanding that your message is all about your audience, and not about you," says Tomé.

While Tomé has always worked in finance and has been in her current post since 2001, she didn't set out to become a CFO. Most of her early experience was in treasury, and her only career goal was to continually build her toolkit. But after joining Home Depot in 1995, she began to get more opportunities in finance. "I found I liked being at the table, liked operational finance and internal controls, and loved the investor relations piece," she says.

Outside In

Dominic Caruso, the CFO of Johnson & Johnson since 2007, knew early in his career that he wanted to lead a finance organization, but he didn't see beyond doing that at a small company. He attained his goal in 1992 at Centacor, a pharmaceuticals firm. For the next seven years he helped the company grow, to the point that J&J paid $4.9 billion to acquire it.

Dominic Caruso, CFO, Johnson & Johnson

Seeing first-hand what would be required of the CFO at a very large, complex global company influenced Caruso to pursue varied assignments and development plans. Those experiences not only helped propel him to his current post, they also helped shape his belief that those with the desire to be a finance chief at a public company must be willing to spend 40% to 50% of their time assessing aspects of the world outside of the company, such as the industry it plays in, the national and global economies, and regulations.

That orientation provides value for the company, of course, but the ability to think outside the company's boundaries also aligns with the world views of CEOs and boards. "Candidates for a potential CFO position are assessed against a number of external criteria," Caruso says. "They are judged against candidates outside the company, and judged by board members who have seen multiple CFOs in multiple settings."

In fact, a need for outside perspective has led J&J to modify its process for filling key finance positions. Historically, the company brought in high-potential people from universities and trained them internally, such that ultimately they often became ready for executive positions without having worked for any other company. That process still applies, but only for about 75% of executive appointments. For the past three or four years, J&J has been hiring some experienced people from outside, for both divisional finance leadership positions and Caruso's next-level staff.

"We wanted to get some perspectives from companies that have had tougher times," Caruso says. "I mean, this isn't like Oz, where everything is always just great. The world around you has a lot of pressures."

Going For It

For some CFO hopefuls, timing may be everything. One person could be ready for several years before getting the opportunity, while another could be thrust into the role before being truly ready, according to Marc Stapley, chief administrative officer at genetics and biology research and testing firm Illumina.

Marc Stapley, chief administrative officer, Illumina

Stapley, the company's CFO until being promoted to his new post in January, was in the former camp. "You have to have 90% of your leadership skills honed before you get the job," he says. "It's too much of a risk for a company to hire [a CFO] with limitations or somebody they have to make allowances for."

His view is that everyone who works for him is better in their fields than he is. A natural consequence of gaining that level of expertise, and combining it with a certain degree of leadership ability and business acumen, is the desire to look elsewhere if the path to the CFO seat is blocked by the incumbent.

Before Stapley joined Illumina he served for three years as vice president of finance at Pfizer. Frank D'Amelio, the drug firm's CFO then and now, has seen several other top lieutenants depart for opportunities to run finance at other companies, as well.

"Am I sad when they leave? Yeah," says D'Amelio, who came to Pfizer as CFO in 2007. "But I'm happy they're getting that job, because that means we're developing our people. Plus, it's a magnet to attract talent."

When D'Amelio first became a CFO, at Lucent Technologies in 2001, he'd had little experience working on the corporate side, having spent much of his career in operations. His final pre-CFO post was president of Lucent's switching business. "I learned on the fly—earnings calls, capital structure, everything," he says.

Frank D'Amelio, CFO, Pfizer

But for aspiring CFOs, D'Amelio puts leadership and communications skills first. "Certain people have those skills inherently, others can develop them, and others can't," he says. CFO

Courtesy the companies

A Boon for Derivatives Users

The Financial Accounting Standards Board's ruling on hedge accounting has something for everyone. By David M. Katz

It may be hard to think of the serious-minded standard setters of the Financial Accounting Standards Board as Santa Clauses. But Rob Royall, Ernst & Young's derivatives and financial instruments leader, suggests that might be an apt metaphor after FASB voted last month to go ahead with its plan to make the first major change in hedge accounting in nearly 20 years.

"Anybody that uses derivatives will find something that they like in this," he says. "A few will find things they don't like. But mostly, it's Christmas."

Royall thinks the board's new accounting standard, aimed at improving and simplifying hedge accounting, will lower the barriers for companies to qualify for hedge accounting. It will also make it easier and cheaper for companies that have already qualified to maintain their financial and nonfinancial derivatives programs.

The final accounting standards update, expected to be published in August with some changes from the approved public exposure draft, will take effect for public companies with fiscal years, and interim periods within them, starting after December 15, 2018. For private companies, the clock will start a year later. Companies can adopt the rules early, starting in any interim period or fiscal year before their effective date.

Calling the standard "a significant, meaningful attempt to make it easier for companies to qualify for hedge accounting," Royall notes that most companies that use derivatives want to qualify. The reason is that hedge accounting enables the derivatives user to avoid accounting on the income statement for hedging's effect on earnings. That's a tough accounting challenge, since hedge results change so frequently and rapidly.

"A derivative always has to be on the balance sheet at fair value, and fair value is a number that moves unpredictably. The normal accounting for that is to take that unpredictable movement and put it right in [the] P&L now, which is really not what a corporate CFO wants," says Royall.

But if a derivative qualifies for the hedge accounting model, the company can "store" the effects of the unpredictable movements of the derivative on its balance sheet, rather than having to report them on the income statement, according to the accountant.

The part of the balance sheet where the volatility can be recorded is the "other comprehensive income" portion of the equity section. In hedge accounting, "equity goes up and down, but profit and loss doesn't go up and down until the transaction that the derivative is hedging eventually happens—which might be the following quarter [or] years later even," explains Royall.

"Most companies don't want something so unpredictable and potentially so powerful to be affecting their reporting of earnings," he adds.

Lower Costs For Some

Qualifying for such benefits represents a big lift, especially for smaller companies and those outside the financial services industries. The elimination of many requirements could lower the compliance costs for such companies and encourage them to attempt to qualify for hedge accounting, Royall suggests.

For instance, current generally accepted accounting principles (GAAP) provide special hedge accounting only for the part of the hedge that's "highly effective," meaning that the changes in the value of the hedged item and the hedging derivative significantly offset each other. The catch, however, is that companies must separately reflect the amount by which the hedging instrument doesn't offset the hedged item,

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which is referred to as the "ineffective" amount.

The reporting of hedge ineffectiveness has "been difficult for financial statement users to understand and, at times, for preparers to explain," according to the current draft of the standard. As a result, the standards board eliminated the requirement that companies must measure the amount of hedge ineffectiveness and report it separately.

That represents a big change. "The measuring of imperfection was, in many cases, quite an exercise," says Royall. For example, a company might have a hedge deemed ineffective if the risk moved $100 and the derivative moved in the opposite direction by $99. It's no exaggeration to say that "the company would have to have systems in place to measure the $1 difference," he adds.

"The measuring of imperfection was, in many cases, quite an exercise." — Rob Royall, Ernst & Young

To be sure, "FASB still believes that hedge accounting is a privilege you need to qualify for," Royall notes. But the standards board, after enabling companies to earn that privilege only by passing "robust quantitative tests," will now let them "enjoy that privilege without undue or unnecessary maintenance cost," he says.

Now that personnel and technology compliance costs might be lowered, Royall wonders if companies that are interested in using derivatives but have remained on the sidelines because of the expense will begin to use them.

Another provision of the new standard that potentially benefits many companies will enable them to account for components of nonfinancial risks (such as commodity risks) and interest risks rather than having to account for hedging the entire risk—even if the company is hedging only a part of it. Before the new standard, U.S. GAAP contained curbs on how a company could designate the hedged risk in certain cash-flow and fair-value hedging relationships. CFO

M&A Drives Big Audit-Fee Hikes

A big outlier in 2016 was Centene, whose fees soared by more than 200%.

The fees that companies pay to have their financials audited have stayed fairly flat for the past decade. But each year produces some significant outliers at individual companies.

For fiscal 2016, Centene, the big provider of Medicaid and Medicare health plans, saw its audit fees triple (see table, right). The whopping increase was accompanied by a 78% surge in revenue, from $22.8 billion to $40.1 billion, as the company completed its acquisition of Health Net and, as in recent years, experienced strong organic growth. There were no major accounting events that could further explain the massive spike in Centene's fees, according to a report on 2016 audit fees by Audit Analytics.

Mergers and acquisitions also contributed to the steep increases that several other companies experienced:

- Charter Communications acquired Time Warner Cable.
- Information firms IHS and Markit joined forces.
- Hotel companies Marriott and Starwood combined.
- Risk adviser Willis Holdings merged with consulting firm Towers Watson.
- Alaska Air acquired Virgin America.

For 2 companies among the 10 with the greatest increases in audit fees, Cognizant and Stericycle, "it appears as though accounting-related issues could have been the primary drivers," Audit Analytics said.

Cognizant's auditors found a material weakness in the company's internal controls over financial reporting, citing weak "tone at the top" and the possibility of improper payments related to overseas projects. Stericycle, meanwhile, had a number of issues, including late filings and a restatement, as well as its own weaknesses in internal controls.

Top 10 Audit Fee Increases

Company*	Audit Fees (in $M) 2015†	2016†	% increase
Centene	$4.0	$12.1	201%
Charter Communications	5.1	12.0	135
IHS Markit	3.3	7.4	121
Newell Brands	6.8	15.0	121
Marriott	5.1	10.3	100
Willis Towers Watson	8.6	17.2	99
Broadcom	5.3	10.1	90
Cognizant Technology	4.1	7.7	86
Alaska Air	1.3	2.3	84
Stericycle	$5.4	$9.2	70%

* S&P 50 companies † fiscal years
Source: Audit Analytics

At the other end of the spectrum, HP, which spun off Hewlett Packard Enterprise, enjoyed the biggest decline in fees, dipping by 15%. Others experiencing significant decreases included Ebay, PPL, Kraft Heinz, and Walgreens Boots Alliance. | DAVID McCANN

The Case for Finance Committees

Every public company should have one to focus on risks in acquisitions, debt levels, and capital allocation. By Robert Pozen

Almost all boards of U.S. public companies have three committees that report to the full board: audit, compensation, and nominating/governance. Such committees have become the workhorses of governance. With their small size and expert support, they can do more in-depth analysis of complex topics than the full board can. But since the passage of the 2002 Sarbanes-Oxley Act, the duties of the audit committee, especially, have become so large and complex that it cannot seriously assess broader financial issues.

Audit committees continue to perform the traditional functions of appointing the company's independent auditor and reviewing its financials. But they now have a long list of other obligations, including oversight of whistleblower complaints and ethics-code violations, approval of auditors' nonaudit functions, and review of the management report and auditor attestations of internal controls. Audit committees also hold private sessions with external and internal auditors, CFOs, and heads of compliance and risk.

In other words, they're overburdened. Thus, the committees no longer have enough time to seriously consider broader financial topics. If directors are going to have meaningful input into the broad financial issues faced by their companies, they need to form finance committees with the time and expertise to address those issues.

What are the main subjects that should be addressed by an effective finance committee? It should review the company's pension plans, insurance coverage, cash management, debt issuance, tax strategies, and, most importantly, capital allocation. For capital allocation, finance committees should concentrate on following up on significant acquisitions, monitoring debt levels, and scrutinizing share-repurchase programs.

Of course, boards do a detailed review of significant acquisitions before they occur. Most will carefully examine the strategic fit, projected cost savings, potential revenue synergies, and price justification. By contrast, boards don't often systematically study, several years later, whether significant acquisitions have achieved their objectives.

The finance committee could provide a good forum to look systematically at how significant acquisitions fare. The committee may find, for example, that the company typically achieves projected reductions in operating costs but not the revenue synergies possible through cross-selling. So, in the future, the board may decide to evaluate acquisitions without assuming they will earn additional revenue due to synergies.

A second focus should be company debt. With interest rates so low, companies have easily taken on more debt. But since rates are likely to rise, boards should be more cautious about their companies incurring high debt levels. Given the risk of rising rates, the finance committee should push for fixed-rate debt with longer maturities, rather than floating-rate debt of short duration.

On the other side of the balance sheet, finance committees should monitor the company's investment guidelines for surplus cash holdings. Corporate treasurers understandably want to maximize the yield on company cash, subject to risk constraints. During this period of low interest rates, some treasurers have reached for yield

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by investing a portion of the company's cash in junk or emerging-market bonds. In my view, the extra yield isn't worth the risk for cash holdings, which should be held in short-term, high-quality debt as a safety cushion.

Third, directors on the finance committee should pay more attention when authorizing share-repurchase programs. Share repurchases are sometimes justified as a way to increase a company's share price. But the 100 companies with the highest buybacks in the S&P 1500 underperformed their indexes from 2005 to 2016. Sophisticated investors see big buybacks as financial engineering.

Robert Pozen

After approving needed capital expenditures and buybacks to fund employee stock plans, finance committee members should ask tough questions before agreeing to much larger share buybacks—especially if they're financed by debt. Does the company have internal products or research projects that are likely to deliver returns above its cost of capital? Can the company make a significant acquisition that will generate additional revenues and earnings at a reasonable cost?

In short, finance committees with economically savvy directors can help ease the burden of audit committees' many new responsibilities.

Robert Pozen is a senior lecturer at the MIT Sloan School of Management and chair of the finance committee of the Medtronic board of directors.

Do You Even Know What Cyber Defense Is?

Many companies target malware and insider attacks rather than cyber attacks.

The days when you could simply install software to block cyber attacks are over. Today's adversaries are cunning, sophisticated, determined, and as happy to take down a small target as a large one.

Although the enemies have changed, many companies are just realizing that their defense postures haven't. The technology they've deployed is a patchwork, consisting of solutions from multiple vendors that don't work together.

We're seeing more complex attacks that employ sophisticated tactics, even against smaller targets. Here's a great example: Our intelligence team learned that a midsize company had been compromised. The attacker had control of all the company's systems and was trying to sell the company's confidential data on Silk Road, an online black market that transacts business on the dark web.

The attackers threatened that, if the company didn't pay a ransom within 24 hours, they would encrypt the company's data and demand payment to decrypt it. Not wanting to give in to the attackers, the company didn't pay them. No one on the black market purchased the data within those 24 hours either, so the attacker simply walked away. The ransomware campaign was launched, and the ransomware encrypted the customer's entire data hoard.

Bob Shaker

The problem was that, although the company was equipped with good security products, it had no cyber defense program. No one had even considered it. Ultimately, the company suffered greatly and spent months trying to recover.

WannaCry is another example. In that case, hackers took advantage of a security vulnerability that was still exposed for a lot of companies. The problem was something that a standard information security program might have allowed to slip by for a time or go completely unaddressed. For companies with strong cyber defense programs, including defenses against attacks like WannaCry, the attack had no effect.

Although many organizations strive to keep up with such threats, there are still too many where key executives don't understand that cyber defense is not the same as a security program. The problem extends to C-level executives who are responsible for security as much as it does to executives who aren't.

Leaders need to truly accept that their organizations are under attack, and that means understanding that there are many reasons they might be targets. Acting as if their companies are too small or lack the visibility to interest hackers is naïve.

A lot of the problem is that most non-IT, C-level executives don't have the time to properly educate themselves on cyber defense. Financial trade organizations should focus more on informing CFOs and their peers about cybersecurity. For their part, CFOs should make time for top-tier vendors to present to them just as they present to their CTOs.

Bob Shaker is a senior manager for cybersecurity services product management at Symantec.

Courtesy the companies

New CFO 'Starts from Scratch' in Major Growth Bid

Jewelry company Betteridge had a dysfunctional finance operation and declining business results, but its owner had his sights on an ambitious goal. By David McCann

Say you're the owner of a 120-year-old family business composed of four stand-alone retail stores in different cities. It provides a nice living, but you want more. In fact, you want your business to become a $500 million company within 10 years. There's a little wrinkle to smooth out, though: You've had three straight years of declining sales and contracting margins.

That's the true story of Terry Betteridge and his company, Betteridge Jewelers. He met with consultants last year to talk about his ambitions and they told him: The first thing you need to do is hire a real CFO to come in and fix your problems.

As it happened, making a profit wasn't one of the problems, even with the declining sales volume. The company was still bringing in almost $100 million of revenue per year, most of it from its high-end stores in Greenwich, Conn.; Palm Beach, Fla.; and Aspen and Vail in Colorado. The profits were such that Betteridge never needed any financing other than the free cash flow the business generated. But the status quo was not compatible with the goal to grow the company five-fold.

So, the owner took the consultants' advice and last October hired a new CFO, Nick Fischer, who had been director of financial planning and analysis at Nordstrom and prior to that a financial analyst at Capital One. It's his first CFO job.

Almost immediately upon starting, Fischer realized that the challenges he faced were greater than he expected. "I found out that very little data was being measured or analyzed," he says. "There was an interim CFO who was doing cash-flow forecasts from memory and making multimillion-dollar decisions in his head. I had never seen anything quite like it before."

Betteridge wasn't even close to being positioned to pass a formal audit so it could qualify for loans or equity financing. "What I saw shocked me," Fischer says. "When you're coming in and interviewing with a $100 million business that seems pretty well run, you assume there's an end-of-month closing process, and there wasn't one. Financial statements were being produced only twice per year. I was basically starting from scratch."

Betteridge's flagship store (above) in Greenwich, Conn., along with the company's three other locations, account for about 80% of current revenue.

So, before he could begin work on a growth plan, Fischer had to build out a new finance and accounting infrastructure and leadership team. "Consultants like Deloitte talk about finance as a catalyst of strategy and the steward of the business," he says. "But how can you possibly be a strategist or steward if you can't even report out your numbers?"

Ten years may seem like a long runway for growing a company, but Fischer judged that the situation called for fast action. To save time and gain efficiencies, he hired Consero Global, a provider of outsourced finance and accounting services, to handle all transactional work and drive the month-end close process. "Those guys are world class," he says, adding that he learned of the firm from a 2014 *CFO* article.

Fischer also hired a vice president

As part of its growth strategy, Betteridge plans to expand its company-branded jewelry line, focusing on "high-quality basics" like engagement rings, cluster earrings, and pendants.

of FP&A to oversee business and strategic planning, conduct weekly and monthly business reviews, and create forecasts—something else that wasn't being done before his arrival. Meanwhile, Fischer is working to optimize cash-flow management and looking at ways to build a capital structure to support growth.

Starting Point

To envision where Fischer and Terry Betteridge are starting from in their quest to grow the company, here is some context.

About 80% of current revenue comes from the four stores, which largely curate high-end jewelry and watch brands. The company also employs jewelry makers who produce custom pieces for clients as well as a line of Betteridge-branded items. But the branded products currently account for only $2.5 million of revenue.

There is also a smattering of e-commerce revenue, and the company attends about 15 jewelry shows per year in places like Las Vegas and Hong Kong, where wholesalers come to buy in bulk. "It's primarily a liquidation channel for us, so the margins aren't great, but it's a great way to manage inventory," says Fischer.

One nagging issue is procuring diamonds for the Betteridge-branded jewelry. Typically when retailers buy products and materials from vendors they have 60 to 90 days to pay, and often end-products can be manufactured and sold before the bill is due. But diamonds must be paid for up front, which requires a steady flow of capital.

To deal with that, Betteridge last year struck a deal with a New York hedge fund, which is providing leveraged capital for diamond purchases. It costs the company some points of gross profit margin but improves supply-chain efficiency.

Growth Plan

The vision for getting to $500 million in revenue is multifold. The biggest piece calls for expanding to 10 to 15 more locations in the United States, starting about two years from now. The company has completed a build-vs.-buy analysis that concluded it would be far better to buy existing jewelry stores and transform them over time to Betteridge's style and branding.

"There is about $80 billion of jewelry sales every year in the United States. We're only $100 million, yet we're a top-five retailer across most of our big brands, like Rolex and Cartier," Fischer says. "So there are a lot of moms and pops out there, and as those folks retire we can select markets and pick up a portfolio of stores that meet our criteria."

The existing Betteridge stores are "extraordinarily productive," he adds. "So if we can find the 10 best markets in the U.S. and acquire the best assets within them, we could add half a billion dollars of business right there." Financing for the acquisitions would come from a combination of the company's own free cash flow and seller financing, Fischer says.

From a sales standpoint, the rest of the national and global footprint would be covered by an improved and expanded online business. The first step is a complete revamping of Betteridge's website, the current version of which "is frankly terrible," Fischer acknowledges. The new site is scheduled to go live within a few months.

The other main element of the growth plan rests on expanding the Betteridge Products Group, which makes the branded jewelry. Fischer says the unit produces "Tiffany-quality" pieces but doesn't need to make Tiffany-level margins on them, providing a pricing advantage.

The plan is to vastly ramp up the manufacture of "high-quality basics" like engagement rings, cluster earrings, and pendants, and market them to "aspiring millionaires," as opposed to the high-net-worth crowd that comprises Betteridge's core demographic. The items will be sold in the company's stores, but Fischer also is working on a wholesale strategy to move the products in large volumes.

"How can you possibly be a strategist or steward if you can't even report out your numbers?"

—Nick Fischer, CFO, Betteridge

A potential hurdle is the ability to hire enough top jewelry makers. "It's a huge factor," Fischer notes. But a goal for the high-quality basics line is achieving a heightened production volume, which will require a manufacturing facility in an area that's "a lot less expensive than Greenwich, Conn."

There's a lot for Fischer to do, but the goal of reaching $500 million is highly motivational. "We are on an exciting journey," he says. CFO

Courtesy Betteridge

CAPITAL MARKETS

Good Investor Relations Drives the Share Price

Half of public-company CEOs and CFOs are significantly less well-off financially than they should be. By Brad Samson

Pick any industry group of stocks. If you compare valuations and trading metrics, you consistently find a couple of stocks trading at premium multiples at the top of the group. Many others trade at discounts to both the average performers and the leaders—yet most of them haven't missed earnings or had another kind of stumble. So they appear to be undervalued.

With a disproportionate percentage of their wealth tied to their company's share value, the executives of the issuers of these discounted stocks are worth materially less than they should be, often 15% to 40%. This problem compounds over time, as I've never seen a stock have a sudden "catch-up" moment when the market realizes it has been mispriced. That means that if you're undervalued now, you're unlikely to recoup all of that value in the future.

If your personal economic interest isn't enough to make you question what to do about this, remember that every one of your employees who holds company stock is in the same boat.

"Valuation Disconnect" (page 23) uses real data to prove my point (although the company names have been changed to protect the guilty). None of the companies has had an earnings miss or other material structural issue that affected their valuations.

Stocks A and B have long been considered the bellwethers of this industry group. Despite ranking 8th in the industry for expected 2018 earnings-per-share growth (over 2017 EPS), Company A was trading at a 50 multiple

and its volume-to-float ratio showed strong trading liquidity at the time of this data. Company B, with half the expected growth of A, had less than half the price-to-earnings (P/E) multiple, which seems more reasonable.

However, Company C, with half the expected growth rate of B and ranking near the bottom of the 20-company industry group, traded at a higher multiple and had tremendous liquidity. Clearly, it's doing something different.

One could say that the first three companies' executives are not only in the "good half," being worth what they should be financially, but they may even be worth more than they should be. Good for them!

But, for companies D, E, and F at the other end of the valuation continuum, stock values, trading multiples, and trading volumes do not reflect their group-leading revenue and earnings growth rates. (Note that D, E, and F do not have P/Es, as all are operating at losses, but the EPS change data reflects expected reduction in losses.) How is it that three of the top-growing companies in this industry group can trade so lightly and at such modest valuations? These companies' executives and employees are all in the "wrong half."

The common denominator for all of this is how these companies work with Wall Street—in other words, their investor relations programs. If you want proof that investor relations has significant economic benefits for companies, there is no stronger data than these kinds of comparisons within industry groups.

So, what should companies do to make sure they're in the right half of valuation?

• **Get on the road and talk to investors.** IR is a sales game, which means the more people you call on, the more sales you will make. Don't just go to a

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few conferences; go to every one you possibly can. Even go to the conferences featuring the analysts you don't like. Do lots of road trips with your analysts to call directly on investors. If you take only one thing from this article, this point should be it.

• **Hire a strong internal IR person or a good IR agency or consultant.** Recognize that 90% of the questions investors ask are not about absolute facts, such as financials. They are 90% speculative, such as "If competitor A does X, how does that affect you and how can you respond?" All the CFOs I know hate those kinds of speculative questions. Staff this role to handle them.

• **Become a better friend to sell-side analysts.** The top complaint I've heard from sell-siders over the years is that most of the companies they cover seem not to appreciate or adequately support the job they're trying to do. Specifically, companies show their lack of support by putting an inexperienced and uninformed junior person in the IR role and either responding slowly to queries or providing responses that lack thoughtfulness.

The best way I know to turn a negative analyst back toward the good side of the force is to treat that person the same way you treat the analysts you love. For example, if you go to a negative analyst's conference, you can take his or her negative points head-on. Investors will love that you are not afraid to confront those points.


Brad Samson

• **Look for ways to expand your addressable market of investors.** First, many of the investor-targeting systems you can buy focus on investors who have bought peer stocks in your industry group. But there are better systems that help you target investors based on how well the characteristics of your stock match a portfolio, regardless of industry.

Second, think about other industry investor groups that could be interested in your stock. I once worked for a printing company, but based on an expansion of our strategy, was able to gain the interest of investors who liked outsourcing plays. At another company, I moved the focus from consumer electronics to health-care investors.

Third, consider markets beyond the United States. Talk to your sell-side analysts. There will be a fistfight among them over who gets to take you to markets in Europe, the Middle East, and Asia-Pacific.

• **Revitalize your investor story.** Every year during the December slowdown, I sit back and make a fresh assessment of the investor deck. Sometimes I start with a stack of blank sheets and scribble out how we're best telling the story at that point, and compare that to the actual deck we've been using.

Look at your deck with a critical eye. Does it inspire? Does it do a good job of painting the opportunities your company is pursuing? Does it adequately explain your strategy? Are the proof points strong? Do you have a strong opening "hook"? If this were your IPO deck, would it sell?

The only one of those questions that may not be obvious is the "hook," so let me elaborate. When you're giving a speech, it's best to (verbally) slap the audience across the face to get them to put down their phones and start paying attention. Sometimes I like to ask a show-of-hands question. When I was at Fitbit, I asked how many people in the room had an Apple watch.

Sometimes I have a killer statistic that wakes people from their lethargy. For example, at one company, I did some research and learned that the problem the company solved, hospital communications errors, was the number-three killer in the United States after cancer and heart disease. Leading with that got people's attention.

Note that none of these suggestions is that difficult or expensive. If your stock is undervalued and you're not worth what you should be, it may not have to be so. CFO

Brad Samson is a 20-year IR executive. He currently provides strategic counsel to early-stage companies.

Valuation Disconnect

Three of these real but unnamed companies are overvalued, and three are undervalued.

Company	Revenue Change '17 to '18*	EPS Change '17 to '18*	EPS Change Industry Rank	FY18 P/E ratio	FY18 P/RG† ratio	Volume/ float ratio
A	19%	35%	8	50	0.91	1.5
B	9%	11%	13	20	0.99	1.2
C	5%	5%	18	26	0.93	2.8
D	18%	88%	6	NM††	0.89	0.8
E	45%	325%	1	NM††	0.85	0.5
F	93%	30%	9	NM††	0.95	0.7

*Expected † RG = revenue growth †† NM = not meaningful
Guidance provided by the companies

Courtesy the author

Balance Due

Boards seek the optimal compensation formula to satisfy all sides in the conflict over executive pay packages.

By Keith Button

Structuring executive compensation is a delicate balancing act that isn't getting easier. Pay plans have multiple goals—attracting and retaining top talent, motivating performance, and keeping activist shareholders at bay—that are often at odds with each other.

Ostensibly, both shareholders and the boards of directors that set executive pay want management leaders, particularly CEOs and CFOs, to carry out the business strategy that is judged to be the best path to long-term company growth and share-price appreciation. Most agree the best bet for accomplishing those outcomes is a strong alignment of pay and performance.

Yet, when it comes to how and how much executives are paid, there are numerous areas of concern for the various stakeholders, which, in addition to the investors and directors, include analysts, employees, and of course the executives themselves. The growing income inequality in the United States has many groups criticizing executive pay, especially CEO compensation, as excessive and unwarranted. Investors

Paul Taylor/The Image Bank/Getty Images

want stronger links between pay and performance, but tempered with policies that give executives real "skin in the game." Executives themselves want to be compensated appropriately for their abilities and results.

Compensation committees today are busily tweaking their pay policies to address all of those concerns. But many are struggling to find a balance between demonstrating good governance and justly rewarding and retaining top executives.

Treading Carefully

Results of the nonbinding shareholder advisory votes on executive pay packages, required for public companies by the Dodd-Frank Wall Street Reform and Consumer Protection Act, have indicated that investors are generally OK with executive compensation programs. They've given a majority thumbs-up about 96% of the time, and in more than 90% of cases the approval rate has been at least 80%, notes Rick Smith, a managing director in the global employer services practice at BDO.

That suggests companies are spending sufficient time connecting executive pay to the business plan and doing a good job explaining the structure in proxy statements, Smith says.

But boards shouldn't take too much solace in those results. In structuring pay plans, boards' compensation committees must keep in mind that they understand the company's particular needs in a way that few outsiders—even some large institutional investors—can, says Marc Hodak, a partner at compensation consulting firm Farient Advisors. In the current climate, however, they run a real risk of alienating shareholders if their actions don't appear to have a justifiable motive.

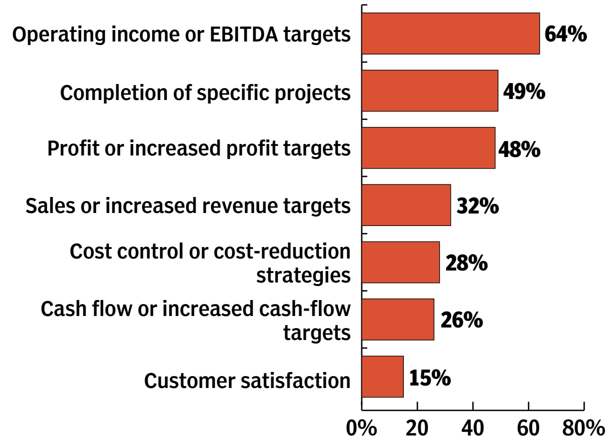
For example, a board may grant a significant equity award that it sincerely believes is in the company's best strategic interests but, for competitive reasons, may shy away from explaining the strategy to the full satisfaction of outsiders. Or, while many executive pay plans employ a mix of metrics to determine incentive payouts, some boards may believe so steadfastly that earnings are what drive value that they base incentives solely on that. Either of those behaviors may give shareholders pause.

"My advice [to boards] is to always do what they think is right, and we'll explain it as best we can," Hodak says. Such explanations can, though, be strained in cases where company performance is suffering, creating pressure to appease investors.

Still, the surest way for a company—a big one, at least—to get itself in trouble with shareholders on the pay front is to grant a large, one-time equity award to a particular executive without disclosing a very well-thought-out rationale in the proxy, says Matthew Goforth, a research manager at Equilar, an executive compensation research firm. Such an award may be extended to a new hire, to an executive who may be seen as a retention risk, or in connection with an acquisition. A board may see this as a well-established practice; investors and the public may view it as a form of largesse.

Figuring Bonuses

What measures do U.S. companies use to determine finance executive performance bonuses?



Source: Association for Financial Professionals survey of 3,100 U.S. finance executives, February 2017

"My advice [to boards] is to always do what they think is right, and we'll explain it as best we can."

—Marc Hodak, partner, Farient Advisors

The Imitation Game

Even the basic foundations of compensation plans are being questioned in the current environment. A common methodology for setting senior-executive pay packages looks at what peer companies—comparably sized ones with similar business models in the same or a related industry—are paying. Executives with less-than-average experience or skills start below the median compensation level. Compensation committees are increasingly arming themselves with data to ensure they're paying what they have to from a competitive standpoint, but no more, to procure and retain the executive talent they need.

Some experts say companies shouldn't place so much

Courtesy the companies

emphasis on their peers' pay practices, however. "The bane of the comp committee's existence is the uniformity that many companies feel compelled to pursue because they don't want to be criticized or have been criticized," says Alan Johnson, managing director of Johnson Associates, a compensation consultant.

A bolder approach may be particularly useful for optimally setting variable compensation, which, according to Hodak, typically comprises 60% to 90% of top executives' pay packages. Even the boards of two similar companies may have very different ideas about what kinds of incentives will best motivate company leaders, in which case the copycat mentality may serve neither of them well.

Other pay practices that are in vogue these days may be somewhat less debated because companies have adjusted their practices. For example, tax gross-ups, or pledges to

Fee, Fie, Foe, Pay Ratio

Many CFOs disdain the coming requirement to compare CEO pay with the workforce median.

While the Trump administration favors scrapping the CEO pay ratio rule, it's slated to take effect in 2018 and will do so, barring an unlikely event. So companies are bracing for the fallout.

Under the rule, promulgated by the Securities and Exchange Commission to satisfy a provision of the Dodd-Frank Act, companies must disclose the ratio of their chief executive's total compensation compared with that of their median-paid employee.

When a company's CEO pay ratio becomes public it will surely affect employees as they realize how their pay stacks up against the median, according to Steve Seelig, an executive compensation counsel at Willis Towers Watson.

"The ratio will be disclosed, it will get very big play in the local press wherever the company's people are, and it might even be on the evening news," Seelig says. "The natural reaction of an employee is going to be shock."

For the rule to be delayed or eliminated, Seelig notes, one of two unlikely scenarios would have to transpire. For one, Congress could repeal it within Dodd-Frank. The Financial Choice Act, which would roll back many Dodd-Frank provisions including the CEO pay ratio, passed the House in March. But it is not expected to pass the Senate. The other scenario is that all three SEC commissioners, one of them a Democrat, could agree to meet (thereby constituting a quorum) to vote on a change.

Like some in Congress, companies widely view the pay ratio disclosure as an exercise that will waste time and money while providing no useful information. But the SEC rule allows companies to use statistical sampling techniques to establish the ratio, rather than having to take every employee's compensation into account. "We were surprised when we talked to companies and read comment letters from companies and advisers who don't think [the sampling techniques] reduce the burden," Seelig says. "That's simply not so. They reduce the burden significantly."

Companies can use statistical sampling to find the employee group most likely to contain the median-paid employee, then gather pay data just for the employees in that group to zero in on the assumed median.

The SEC says companies need only briefly describe their methodology for calculating the ratio. In fact, it could be summarized in a single paragraph, Seelig says.

"The [pay] ratio will be disclosed, it will get very big play in the press wherever the company's people are, and it might even be on the evening news."

—Steve Seelig, executive compensation counsel, Willis Towers Watson

The fact that the pay ratio will be a filed disclosure is causing some consternation among CFOs, he adds, because they bear personal responsibility for its accuracy. But the allowance of statistical sampling means the number will by definition be an estimate, so companies should simply state as much in their disclosure.

"I think it's important for CFOs to understand that an error rate can be built into the calculation," Seelig says. "It will take the pressure off." | K.B.

BALANCE DUE

reimburse executives for their incremental taxes owed following compensation spikes, have largely fallen out of favor, according to Richard Bannister, North America practice leader, executive compensation, for Willis Towers Watson.

For equity-based incentives, more companies are instituting holding periods after vesting, Hodak notes. Typically, they may require the executive to hold 25% of vested shares for one or two years. The goals are to discourage behavior that drives up stock price in the short term at the expense of long-term performance, and to make sure the executive has ongoing, meaningful "skin in the game."

More companies are also requiring executives to retain a certain number of company shares at all times to ensure that top managers' interests remain aligned with those of shareholders, Goforth says. Large-cap companies typically require the CEO to hold at least six times the value of his or her annual salary in company stock. (For CFOs, the ratio is usually lower.)

But, Hodak cautions, while investors like to see senior executives holding lots of company stock, companies should be careful not to push the tactic too far. If an excessive portion of an executive's net worth is tied up in the stock, at a certain point it becomes an incentive for the executive to leave, whereupon he or she can cash out the stock and diversify their assets.

Another trend driven by the quest to establish stronger links between pay and performance relates specifically to grants of restricted stock, which historically vested after a certain time period passed. Now, more such awards are vesting only when the company hits certain earnings goals or outperforms peers on a certain metric, Hodak observes.

Too Much of a Good Thing?

If there's one thing companies need to work on it's addressing the flaws in pay for performance. The 2010 passage of Dodd-Frank heightened the profiles of the top proxy advisory services, Institutional Shareholder Services and Glass Lewis, which successfully advocated for linking equity-based performance incentives to total shareholder return. But while the practice that those firms promoted has been adopted almost ubiquitously in the name of good governance, the overall amount of pay based on performance is reaching the advisable limit, according to Hodak.

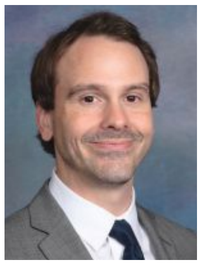
One issue, he says, is that paying a high volume of performance-based equity greatly complicates incentive plans, resulting in reduced transparency for shareholders. In many cases investors aren't sure exactly what management is being rewarded for.

Also, the bigger the portion of compensation that is at risk for senior executives, the greater overall compensation companies must offer them. "Investors would never accept additional risk without the prospect of additional reward, so they can't expect [CFOs and CEOs] to behave any differently," Hodak says.

Furthermore, a portion of incentive compensation simply must remain subject to directors' discretion. "It would be great to live in a theoretical world where comp plans could be very algorithmic and [still] affect human behavior," Goforth says. But executives are naturally skeptical of over-engineered programs, he adds.

One way companies are tweaking pay-for-performance is by focusing on year-over-year measures of company performance and making sure they align with long-term strategies, says Goforth, whose firm spots such trends by combing through thousands of Compensation Discussion & Analysis (CD&A) statements each year.

For example, a company may focus on measuring short-term performance in a certain area of its business, believing that incremental growth there will eventually lead to long-term shareholder growth. For purposes of calculating the annual payouts, a company may come up with tweaks for common metrics, like revenue, earnings per share, cash flow, and operating income, to more precisely fit its vision of success.



"It would be great to live in a theoretical world where comp plans could be very algorithmic and [still] affect human behavior."

—Matthew Goforth, research manager, Equilar

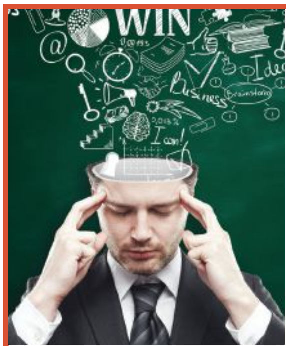
More companies are capping awards that grow over time at a certain pre-determined value, based on facts and circumstances, Goforth says. For example, an award based on a company's performance relative to a peer group could be capped if the company's absolute stock price dropped during that period. The purpose is keeping the value of the incentive in line with actual shareholder value creation.

The Long Arm of the Claw

CFOs and CEOs might not welcome a relatively new development in compensation, the clawback. Among all the aspects of executive pay that compensation committees grapple with, clawbacks are of late a high priority. There are few kinds of publicity more damaging to a company than news of executives benefiting from failure or, worse, fraud.

Public companies are required under the Sarbanes-Oxley Act to reclaim money executives made as a result of fraud

Courtesy Equilar



What Executives Want

In the study, "Making Executive Pay Work: the Psychology of Incentives," PwC asked if the current compensation model for executives works for the individuals it is meant to motivate. The study found:

- **50% more executives choose a clearer pay package than a more ambiguous one of the same or potentially higher value.**
- **Executives value deferred pay significantly below its economic or accounting value—a deferred bonus is typically discounted by around 50% over three years.**
- **Most executives would choose to be paid less in absolute terms but more than their peers—only a quarter choose a higher absolute amount, but which is less than their peers'.**
- **For their ideal jobs, executives would take a 28% pay cut.**
- **Fewer than half of executives think that their long-term incentive plan is an effective incentive.**
- **Executives discount performance pay compared with fixed pay by about 10% for cash bonuses and 50% or more for deferred bonuses and long-term incentives.**

Source: PwC and the London School of Economics and Political Science, study of 1,106 executives from 43 countries

or accounting errors, but it's becoming common to include more expansive clawback provisions in executives' employment contracts.

Still, disclosures of clawback policies are usually not very detailed. If the SEC's proposed rules for implementing Dodd-Frank requirements were implemented, companies would have a very objective, bright-line test for when to implement a clawback, according to Goforth. But for now, companies generally prefer to make decisions on a case-by-case basis, with boards using their best judgment except when egregious misconduct or financial restatements mandate a clawback.

When a company's financials are restated, incentive payouts should be recalculated, and any already-awarded compensation based on the incorrect figures should be clawed back, regardless of whether the executive had any personal role in the misstatement, Goforth says.

Executives should also suffer financial consequences for purposeful bad actions, even if the financial fallout for the company is nil. "It's a weapon that's extraordinarily blunt," Johnson says. "It should be used when appropriate, and it should be very obvious when it's appropriate. A view that the company is just going to take back money that someone lost could create a very odd set of behaviors."

An executive could even wreck a business to avoid reporting a clawback-triggering loss. "If the company says it's going to fire an executive and take back the money he's made, the executive might double down," says Johnson. "And then a big problem becomes a gigantic problem."

Out with Opaqueness

Trying to solve the flaws in pay for performance, though, can lead to compensation plan complexity. Institutional investors are complaining about the length of CD&As, which now run up to 40 pages. "They've gotten larger every year on average, and investors have gotten weary of it," Hodak says. "It's an enemy of good governance."

Descriptions of bonus plans are among the most complicated parts of CD&As, with explanations of the different payout levels, why they were set where they were, and how multiple performance measures play against one another. A metric could be based on three or four factors, two of which could be "gates," such as "nothing gets paid out if the executive doesn't hit a certain earnings number," Hodak says. If that number is hit, then bonuses are distributed based on, say, cash flow, revenue, and depending on the company, even safety metrics, he adds.

But the biggest driver of complexity in many executive comp programs is the inclusion of long-term incentives based on relative measures like relative total shareholder return covering multiple rolling periods simultaneously, according to Hodak.

"Once upon a time, management compensation was really simple," he says. "You had salary and a bonus that was typically based on hitting earnings, and got a little bit more or less depending on how much you performed above or below your earnings targets. And you got stock to keep you focused on the long term. Plans could be discussed in two or three pages."

The big challenge is to simultaneously satisfy two conflicting wishes of institutional investors: the desire to place constraints on how executives are paid and the need to have comp plans be transparent and written in plain English. The complexity that investors abhor may be driven by their own demands. Until that contradiction is resolved, executive compensation plans will remain in the spotlight. CFO

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

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The 2017 *CFO*/Hackett Group Working Capital Scorecard

LATE SHIFT

Delaying payments is boosting the working capital performance of America's largest companies, but also masking a lack of efficiency.

BY VINCENT RYAN

Cash is the lifeblood of a company, so managing short-term assets and liabilities to a strong working capital position is one of the things a company has to be great at. After all, efficiently managing cash leads to higher liquidity and a reduction in the debt and equity needed to sustain operations.

Therefore, it's good news when a company's cash conversion cycle (CCC)—the amount of time it has cash tied up in working capital—shrinks. That's exactly what happened overall for America's largest companies in 2016, according to this year's *CFO*/Hackett Group Working Capital Scorecard.

The CCC for the 1,000 largest nonfinancial U.S. companies surveyed by The Hackett Group fell by 1.4 days in 2016, to 35.7. Excluding the still ailing oil and gas sector, which represents about 10% of the Hackett 1,000's revenue, the improvement was even better—a decline of 2.7 days.

But when examined closely, large companies' working capital performance is not as stellar as the CCC number suggests. First, with sales in the global economy relatively healthy and the cash to pay receivables plentiful, an

Garry Gay/Photographer's Choice/Getty Images improvement over a very mediocre performance in 2015 was almost expected. And despite the downtick in days, the CCC in 2016 was still relatively high. It was at nearly the same level in the depths of the Great Recession, when banks pulled company credit lines and businesses put off payments to suppliers in order to stay liquid.

The second reason the overall CCC improvement invites skepticism is that the trends in the components of working capital—days sales outstanding (DSO), days payables outstanding (DPO), and days inventory outstanding (DIO)—reveal a disconcerting trend: a degradation in DSO performance, a slight deterioration in DIO, and an improvement in DPO. In short, companies were less efficient at managing their inventory and receivables in 2016, but they took longer to pay their suppliers.

The takeaway? For many finance chiefs of large companies, freeing up the billions of dollars of cash they have tied up in working capital is not a priority in this economy. And why would it be? The Hackett 1,000 had $921 billion in cash on hand at the end of 2016, a collective 71% increase since 2008. A 7.3% increase in outstanding debt last year, to $5.1 trillion, helped fuel the buildup.

"Increasingly, companies say working capital is not a focus, because cash is so cheap," says Veronica Wills, associate principal and North American working capital practice lead at Hackett. "For some companies, cash debt financing is almost free compared with inflation, so for them [working capital] is not a burning platform." In other words, as of the end of 2016, large companies' working capital wasn't working nearly as hard as it could have been.

Pushing Out Payables

One element of working capital has received some scrutiny from companies, according to the survey: days payables outstanding. In 2016, for all industries DPO increased 7.6%, from 49.5 days to 53.2 days. A longer DPO means a shorter cash conversion cycle. (See "How Working Capital Works," page 34.) DPO has been on an almost steady climb since 2009, as many market-leading large companies have extended payment terms to at least 60 days and sometimes up to 90 to 120 days.

Stretching payables so long can destabilize suppliers' finances, and it's also the easiest way for a large company to improve its working capital numbers. Delaying payments requires no optimization of processes or operations management buy-in. But since the trend has been occurring for a few years, some companies may not be doing it to improve their working capital position as much as to "stabilize [working capital] and counter any impacts of payment term extensions being pushed onto them," says Craig Bailey, a senior director at Hackett.

Companies that don't make their suppliers finance their purchases with longer payables periods may be at a competitive disadvantage, says Scott Pezza, director of financial supply chain research at SAP Ariba. "Buyers using net 30 keep suppliers healthy, which benefits other buyers who have extended those same suppliers to net 90," Pezza explains. "The 'extenders' gain the dual benefits of a healthy supply chain and their own bolstered working capital."

Buyers also triple payment terms as a gambit: when a supplier is moved to net 90, based on Pezza's observations, they're more likely to agree to an early payment discount than those suppliers that are already at net 90. "Extending terms ... is a means to make accepting discounts more palatable," Pezza says.

"Fix your internal processes first, then consider a supply chain finance program."
— Shawn Townsend, REL

But large companies aren't deserting their suppliers, either. In parallel with lengthening payment terms, they are injecting liquidity through supply chain finance (SCF) programs, says Shawn Townsend, a Hackett Group director. In such programs, the supplier sells its receivables prior to maturity to a designated financial institution. The supplier has to take a discount to get paid more quickly, but the discount is based on the buyer's credit strength, not the supplier's. In addition, the discount is lower than that paid to sell a receivable on an open market, says Townsend.

But here some companies may have been making a mistake in the last couple of years, says Hackett's Wills, by jumping to supply chain financing prematurely, in part because banks are pushing the programs heavily.

"SCF programs should be part of an overall integrated strategy, but they should come toward the back end," Wills says, after a company has done other things to improve DPO. These other steps include eliminating early payments to suppliers; changing the payment due date to the date an invoice is received instead of the date printed on the invoice; renegotiating payment terms; and optimizing payment run frequency.

By moving to supply chain finance before optimizing payment strategies, a company "is getting a similar result [in DPO] at great expense," she explains, "because it is sharing the benefit with the bank. It's almost an artificial way of

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improving working capital."

Echoes Townsend: "Fix your internal processes first, then consider a supply chain finance program."

Receivables Degrade

The flip side of DPO, of course, is days sales outstanding, and here, the trend is unhealthy. Overall, DSO increased in 2016 by 1.9 days, or 5.3%, to 38.2 days. That's the apex for DSO in the Hackett Group survey in the past 10 years. While the increase in DPO plays a part in companies getting paid later, presumably most of the largest 1,000 companies have the leverage to force customers to adhere to net 30 terms. But at this point in the economic cycle, they may also be extending credit to less creditworthy customers or negotiating looser terms to increase sales.

Internally, there is plenty companies can do to improve DSO performance, including more stringent credit analysis, faster invoicing, and tighter collection policies.

The upper quartile of U.S. companies in the Hackett universe had a DSO of 28 days in 2016, compared with the overall median of 45.6 days. The total accounts receivable improvement opportunity—defined as the amount of cash that could be freed up if all the companies in Hackett's survey performed at the level of the top quartile in their industries—stood at $323 billion.

Wills cautions CFOs against "taking their eyes off the element of financial control" that DSO represents. "If you negotiate terms to make a sale, when times do get tough again, or maybe you want to invest in an acquisition and suddenly need bigger cash reserves, you can't take those terms away from your customer," she says. And if a company decides it is going to be lax on payment terms because of an abundance of liquidity, "to reverse a change in customer behavior can take years of optimized collections strategy to bring the [customer's] behavior back to 'good.'"

Finally, if a company is publicly traded, market analysts are constantly monitoring its DSO numbers. "Companies can't artificially make their accounts receivables look good," Wills says. "If I want to see how well a company is managing its cash, I'm going to look at DSO, and that's going to tell me how much control they have."

Inventory Burn-Off?

Of the three pieces of working capital opportunity, the largest is inventory, at $412 billion. Including the oil and gas industries, DIO lengthened 0.3 days in 2016, to 50.6; without oil and gas, DIO fell 0.8 days, to 53.0. That performance compares with a DIO deterioration of 2.6 days in 2015. Inventory is the most complex area of working capital to manage, and "the benefits can take longer to run down," says The Hackett Group's Bailey. Improvements don't show up on the bottom line for two to three years. In addition, DIO improvement "can never be led just by finance, in the way DSO and DPO can," Bailey says. "It really requires a cross-functional approach and buy-in."

Many factors have raised DIO the last few years, including the troubles U.S. companies had forecasting when consumer demand would rebound following the Great Recession. "Generally most organizations were expecting demand to pick up earlier than it did," Bailey says.

The 2015 port strike in Long Beach, Calif., has also had a long-lasting effect, as many companies had stocks stranded and as a result decided to institute a practice to keep inventory buffers higher. "The obvious reaction was, "We're going to hold more inventory, we're going to stock more

"Once interest rates rise, companies are going to be less willing to obtain third-party financing or issue debt to pay for their endeavors—it will limit the things they want to do that require cash." — Veronica Wills, The Hackett Group

inventory into the pipeline to rebuild customer confidence but also in case this happens again,'" Bailey says.

The sourcing of goods to western China, Bangladesh, and Vietnam over the past few years has also extended lead times for companies. The question now is whether large U.S. companies are starting to burn off some of the excess inventory that has accumulated during that time, says Bailey. The truth is it's hard to tell, he says, although some industries have had isolated success.

For example, the Internet catalog and retail sector, which includes Wayfair, Amazon.com, and Overstock.com, saw DIO fall about 5 days in 2016. These retailers are "pushing for suppliers to deliver directly to customers," Bailey says, which could explain the drop in DIO. Ironically, it's just such a trend that could lead to an increased global focus on DIO. "If companies find they are coming under pressure to hold inventories longer for their customers, that's when they'll proactively look at how to manage their own inventory levels," he explains.

In reality, better management of inventory, like the other elements of working capital, is often something companies are forced to do, not something they proactively tackle. And they rarely focus on working capital for a sustained period: In the Hackett survey, for example, only 102 of the 1,000 companies improved their CCC every year in the last three years.

The only thing that might change that in the near future is higher U.S. interest rates, says Wills.

"Once interest rates rise, companies are going to be less willing to obtain third-party financing or issue debt to pay for their endeavors—it will limit the things they want to do that require cash," says Wills. "The cost of financing is a direct hit to overall profitability. But by tying up less cash in working capital, companies will be able to rely less on financing." CFO

Vincent Ryan is editor-in-chief of CFO.

Keeping Score

Drawing from The Hackett Group's latest working capital survey of the 1,000 largest U.S.–based companies (excluding the financial sector), the 2017 *CFO/* Hackett Group Working Capital Scorecard shows the best and worst companies in working capital management in 27 industries. Companies are ranked by their cash conversion cycles.

The survey calculates working capital performance based on the latest publicly available data, as sourced from FactSet. In order to provide comparable analysis, The Hackett Group has made adjustments to the data to reflect the impact of off-balance-sheet arrangements and financing revenue and receivables.

How Working Capital Works

Days sales outstanding (DSO): AR/(total revenue/365)

Year-end trade receivables net of allowance for doubtful accounts, divided by one day of revenue.

A decrease in DSO represents an improvement, an increase a deterioration.

Days inventory outstanding (DIO): Inventory/(total COGS/365)

Year-end inventory, divided by one day of cost of goods sold (COGS).

A decrease is an improvement, an increase a deterioration.

Days payables outstanding (DPO): AP/(total COGS/365)

Year-end trade payables divided by one day of COGS.

An increase in DPO is an improvement, a decrease a deterioration. For purposes of the survey, payables exclude accrued expenses.

Cash conversion cycle (CCC): DSO + DIO - DPO

Number of days for each indicator added up for the assets part of the balance sheet and subtracted for the liabilities.

The lower the number of days, the better.

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

Companies are classified according to the FactSet industry classification system, using data sourced from FactSet. For purposes of the survey and presenting the results, certain industries have been grouped together.

The 2017 *CFO*/Hackett Group Working Capital Scorecard

Best in Industry
Worst in Industry

	CCC			DSO			DIO			DPO		
	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015
Aerospace & Defense												
Northrop Grumman	34	1%	34	49	11%	44	16	-4%	17	31	16%	27
ManTech Intl.	44	5%	42	73	2%	72	0	NM	NM	30	-1%	30
Aerojet Rocketdyne	49	-1%	50	28	-23%	37	44	12%	39	23	-13%	26
TransDigm Group	215	10%	195	66	11%	60	190	7%	178	41	-5%	43
B/E Aerospace	244	4%	235	44	-7%	47	268	4%	258	67	-5%	71
Rockwell Collins	282	7%	263	76	5%	72	283	9%	260	77	11%	69
Median	**102**	**-5%**	**108**	**66**	**-1%**	**67**	**79**	**-7%**	**85**	**36**	**2%**	**35**
Airlines												
Sky West	-14	3%	-14	5	-25%	7	19	-14%	22	38	-12%	44
Hawaiian Holdings	-8	-23%	-6	14	10%	13	5	4%	5	27	13%	24
JetBlue Airways	-6	-7%	-5	9	22%	8	4	2%	4	19	13%	17
Allegiant Travel	11	26%	9	11	149%	4	8	-3%	8	7	111%	4
Southwest Airlines	12	95%	6	10	12%	9	10	9%	9	8	-34%	12
Alaska Air Group	14	10%	12	19	34%	14	5	-11%	6	10	41%	7
Median	**(0)**	**33%**	**(1)**	**11**	**16%**	**10**	**9**	**3%**	**9**	**21**	**6%**	**20**
Automotive Parts & Aftermarket												
Tower Intl.	-8	-153%	-3	34	-25%	45	16	1%	16	59	-10%	65
Cooper-Standard	4	-75%	15	48	-3%	50	20	-4%	21	64	17%	55
Visteon	11	-23%	15	60	3%	59	24	-15%	28	73	1%	72
Cooper Tire & Rubber	86	6%	81	52	11%	47	85	19%	72	51	36%	37
Gentex	89	-3%	92	46	-1%	46	75	1%	74	32	12%	28
LKQ	128	2%	126	37	22%	30	136	4%	131	45	28%	35
Median	**24**	**-13%**	**28**	**47**	**-1%**	**47**	**36**	**-7%**	**39**	**61**	**10%**	**56**

NM = not meaningful, because the results moved from positive to negative, or vice versa. Results shown are for fiscal years. Medians shown are for the full industry. Based on financial statements of the 1,000 largest U.S. public companies (excluding the financial sector), as reported by FactSet. Source: The Hackett Group

Best in Industry
Worst in Industry

	CCC			DSO			DIO			DPO		
	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015
Beverages												
Molson Coors Brewing	-47	-73%	-27	50	15%	43	83	116%	38	179	65%	109
PepsiCo	-15	-97%	-8	33	4%	32	38	1%	38	87	12%	78
Coca-Cola Bottling	17	25%	14	39	15%	34	29	16%	25	50	13%	45
Dr Pepper Snapple Group	19	-19%	23	33	1%	33	30	-7%	32	44	6%	42
The Coca-Cola Co.	34	-5%	35	34	3%	33	66	-4%	69	66	0%	66
Monster Beverage	58	-16%	69	69	6%	65	55	3%	54	66	33%	50
Median	**18**	**-2%**	**18**	**36**	**9%**	**33**	**47**	**23%**	**38**	**66**	**14%**	**58**
Building Products												
A. O. Smith	3	-86%	22	70	-2%	72	61	10%	55	128	22%	106
TopBuild	19	35%	14	53	-1%	53	32	-8%	35	66	-11%	74
Armstrong World Industries	32	48%	22	32	-6%	34	51	6%	48	51	-16%	60
Armstrong Flooring	85	9%	78	26	-2%	26	108	12%	97	49	9%	45
Griffon	98	9%	89	67	15%	58	79	-1%	80	49	-1%	49
Watsco	98	-4%	102	41	3%	40	78	-1%	79	21	25%	17
Median	**54**	**-9%**	**59**	**40**	**-4%**	**42**	**55**	**-6%**	**59**	**48**	**3%**	**46**
Chemicals												
Advansix	2	-90%	22	36	0%	36	46	-6%	49	79	27%	62
Pacific Ethanol	27	-10%	30	19	3%	19	17	-21%	21	9	-8%	10
PolyOne	33	15%	28	40	6%	37	45	11%	41	52	5%	50
Sensient Technologies	184	-5%	194	51	-17%	62	172	0%	172	39	-2%	40
Monsanto	198	-3%	204	52	31%	40	211	-2%	215	65	27%	51
FMC	271	-3%	278	203	-1%	206	136	-6%	145	69	-6%	73
Median	**76**	**3%**	**74**	**54**	**4%**	**52**	**71**	**0%**	**71**	**48**	**1%**	**48**
Computer Hardware & Peripherals												
HP	-31	-37%	-23	31	-11%	35	42	1%	42	104	5%	99
Brocade Communications Systems	14	144%	6	44	16%	38	35	55%	23	65	19%	55
Hewlett Packard Enterprise	25	-41%	42	72	-11%	81	20	-15%	24	67	7%	62
Super Micro Computer	87	-9%	95	48	-20%	59	88	-13%	102	49	-25%	66
Netgear	142	8%	131	86	6%	82	102	18%	87	46	26%	37
Fortinet	152	21%	126	90	-5%	94	132	10%	120	70	-20%	88
Median	**49**	**-5%**	**52**	**60**	**-6%**	**63**	**49**	**4%**	**47**	**63**	**8%**	**59**
Consumer Durables												
Select Comfort	-20	-208%	-6	5	-37%	9	63	-17%	76	88	-3%	91
HRG Group	6	-97%	189	34	-80%	176	86	17%	73	115	90%	60
Whirlpool	8	67%	5	48	8%	44	58	0%	58	97	0%	97
Mohawk Industries	112	-2%	115	53	0%	53	107	-5%	112	47	-5%	49
Matthews Intl.	117	0%	118	73	0%	73	69	-8%	75	25	-18%	30
Fossil Group	146	-4%	152	45	7%	42	145	-12%	164	44	-20%	55
Median	**66**	**-23%**	**86**	**48**	**8%**	**44**	**74**	**-2%**	**76**	**65**	**18%**	**55**
Containers & Packaging												
Crown	-9	-635%	-1	30	-2%	31	69	11%	62	108	14%	95
Ball	16	12,342%	0	47	35%	34	71	38%	51	102	19%	85
Owens-Illinois	21	20%	17	32	-5%	33	72	-10%	80	83	-14%	96
Bemis	63	0%	63	42	4%	40	67	7%	63	46	15%	40
Packaging Corp. of America	79	7%	74	44	8%	40	64	8%	59	29	11%	26
AptarGroup	112	6%	105	68	10%	62	72	1%	72	28	1%	28
Median	**43**	**0%**	**43**	**44**	**8%**	**40**	**61**	**7%**	**57**	**54**	**-2%**	**55**
Electronic Equip., Instruments & Components												
Jabil Circuit	1	-59%	3	27	-10%	30	55	-4%	58	81	-4%	84
Tech Data	17	-24%	22	42	2%	41	31	1%	31	56	13%	50
Fortive	41	-2%	42	55	-4%	58	66	4%	64	81	1%	80
Diebold Nixdorf	119	46%	81	92	47%	62	111	39%	79	84	39%	61
Keysight Technologies	145	5%	138	55	7%	51	151	-1%	153	60	-8%	65
Bruker	216	6%	205	55	5%	53	200	9%	183	39	25%	31
Median	**78**	**-1%**	**79**	**58**	**1%**	**57**	**68**	**-3%**	**70**	**60**	**0%**	**60**
Energy Services & Equipment												
Rowan	12	-54%	27	57	-16%	68	NM	NM	NM	44	10%	40
Diamond Offshore Drilling	52	1%	51	54	-9%	59	11	-9%	12	13	-34%	20
McDermott Int.	71	53%	46	46	87%	25	53	-11%	60	29	-25%	39
Oceaneering Intl.	121	13%	108	79	8%	73	59	8%	54	16	-17%	19
Schlumberger	127	30%	98	123	36%	90	78	37%	57	74	50%	49
National Oilwell Varco	304	26%	242	138	34%	103	189	18%	160	24	10%	21
Median	**100**	**31%**	**76**	**81**	**15%**	**70**	**56**	**12%**	**50**	**35**	**12%**	**31**

NM = not meaningful, because the results moved from positive to negative, or vice versa. Results shown are for fiscal years. Medians shown are for the full industry. Based on financial statements of the 1,000 largest U.S. public companies (excluding the financial sector), as reported by FactSet. Source: The Hackett Group

The 2017 *CFO*/Hackett Group Working Capital Scorecard

Best in Industry
Worst in Industry

	CCC			DSO			DIO			DPO		
	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015
Engineering & Construction												
Fluor	30	22%	24	62	19%	52	NM	NM	NM	32	17%	28
Matrix Service	39	-5%	41	82	6%	78	1	50%	1	44	19%	37
KBR	39	39%	28	86	41%	61	1	-51%	1	48	41%	34
Aegion	85	5%	81	84	-6%	90	25	47%	17	25	-5%	26
Dycom Industries	89	-12%	101	96	-10%	106	13	16%	11	20	23%	16
Tutor Perini	107	7%	101	189	7%	176	NM	NM	NM	82	8%	76
Median	**52**	**-3%**	**54**	**82**	**2%**	**80**	**2**	**-9%**	**2**	**32**	**3%**	**31**
Food												
Leucadia Natl.	-131	-10%	-118	139	13%	123	12	16%	10	282	12%	252
Mondelez Intl.	-32	-109%	-15	37	13%	32	59	9%	55	128	25%	102
The Kraft Heinz Co.	-20	-191%	22	12	-57%	29	66	-21%	84	98	8%	91
McCormick	84	1%	83	38	0%	39	112	6%	106	66	9%	61
Seaboard	84	34%	63	43	57%	27	58	10%	53	17	-4%	17
B&G Foods	134	-22%	172	31	19%	26	141	-18%	173	39	42%	27
Median	**49**	**0%**	**49**	**27**	**2%**	**27**	**56**	**9%**	**51**	**32**	**18%**	**27**
Food & Staples Retail												
Village Super Market	-11	5%	-10	NM	NM	NM	13	-11%	15	23	-4%	25
PriceSmart	3	-37%	5	1	-25%	1	43	2%	42	40	6%	38
Wal-Mart Stores	6	-42%	10	4	3%	4	45	-3%	46	43	8%	40
Sears	68	-6%	73	8	26%	6	84	-14%	98	23	-25%	31
Vitamin Shoppe	81	-1%	82	5	137%	2	104	7%	98	28	59%	18
GNC	109	-2%	112	19	-6%	20	131	3%	127	41	17%	35
Median	**18**	**-19%**	**23**	**6**	**-2%**	**6**	**37**	**-10%**	**41**	**27**	**-1%**	**28**
General & Specialty Retail												
AutoZone	-26	1%	-26	10	11%	9	280	3%	272	316	3%	307
O'Reilly Automotive	-6	-159%	10	8	14%	7	248	-7%	267	263	-1%	265
CST Brands	-1	-14%	-1	4	53%	3	9	16%	8	15	24%	12
Rent-A-Center	188	-6%	200	8	6%	8	202	-4%	210	22	22%	18
Conn's	190	-14%	220	160	-5%	168	76	-17%	91	47	19%	39
Tiffany	599	8%	556	21	13%	18	609	7%	570	31	-6%	33
Median	**70**	**-2%**	**71**	**7**	**7%**	**7**	**93**	**-1%**	**95**	**42**	**5%**	**40**
Household & Personal Care												
Procter & Gamble	-33	-203%	-11	24	4%	24	59	8%	54	116	31%	89
Coty	-21	-260%	13	57	1%	57	125	-2%	127	203	19%	171
Kimberly-Clark	9	-42%	15	40	5%	38	57	-9%	62	88	3%	85
Intl. Flavors & Fragrances	135	4%	131	64	-1%	65	132	-2%	135	61	-11%	69
Estee Lauder	155	-6%	164	41	3%	40	264	1%	261	150	10%	136
Nu Skin Enterprises	197	-7%	212	5	-11%	6	230	-1%	232	38	51%	25
Median	**55**	**49%**	**37**	**40**	**10%**	**37**	**113**	**5%**	**108**	**80**	**8%**	**75**
Industrial Conglomerates												
Honeywell Intl.	55	1%	54	76	5%	72	68	0%	68	89	3%	86
SPX	65	-12%	74	62	-17%	75	50	8%	46	47	-2%	48
Steel Partners	66	-2%	67	51	21%	43	58	-3%	60	44	24%	35
3M	96	-2%	97	53	6%	50	90	-1%	91	48	10%	44
General Electric	113	-14%	130	73	-14%	85	111	-4%	116	72	2%	70
Textron	143	-1%	144	28	-1%	28	160	3%	155	46	15%	40
Median	**81**	**5%**	**77**	**62**	**0%**	**62**	**80**	**18%**	**68**	**48**	**8%**	**44**
Internet & Catalog Retail												
Wayfair	-50	5%	-53	2	28%	2	3	-38%	4	55	-7%	59
Amazon.com	-47	-14%	-41	16	6%	15	52	-9%	57	114	1%	113
Overstock.com	-15	35%	-24	6	61%	4	5	-9%	6	26	-20%	33
HSN	49	-13%	57	34	13%	30	61	-8%	66	46	17%	39
Liberty Interactive	53	-18%	65	45	-15%	53	46	-10%	51	38	-3%	39
Lands' End	89	-7%	95	11	30%	8	156	0%	157	78	12%	70
Median	**20**	**-44%**	**37**	**16**	**6%**	**15**	**46**	**-10%**	**51**	**53**	**2%**	**52**
Machinery												
Navistar Intl.	3	-64%	8	12	-20%	15	53	7%	49	62	10%	57
Paccar	10	-9%	11	16	12%	14	20	4%	19	26	15%	22
Stanley Black & Decker	30	-29%	42	38	-9%	42	80	-3%	83	89	7%	83
Astec Industries	163	-20%	203	34	-8%	37	154	-19%	190	24	2%	24
Carpenter Technology	175	16%	152	51	2%	50	166	21%	137	42	19%	35
Joy Global	230	7%	214	105	13%	93	176	6%	166	51	13%	45
Median	**90**	**4%**	**86**	**57**	**5%**	**54**	**77**	**-1%**	**78**	**45**	**6%**	**43**

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Best in Industry
Worst in Industry

	CCC			DSO			DIO			DPO		
	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015	2016	1-yr. % change	2015
Metals & Mining												
Consol Energy	-9	45%	-16	40	38%	29	18	-28%	25	67	-5%	71
Alcoa	13	213%	4	26	112%	12	54	13%	47	67	21%	56
SunCoke Energy	16	-30%	22	18	21%	15	37	-8%	41	40	20%	33
Newmont Mining	104	-8%	113	7	-44%	12	127	-5%	133	29	-11%	33
Reliance Steel & Aluminum	112	13%	100	37	5%	36	93	21%	77	18	38%	13
Allegheny Technologies	150	13%	133	53	34%	39	136	2%	133	39	-3%	40
Median	**63**	**9%**	**58**	**32**	**26%**	**26**	**68**	**4%**	**65**	**33**	**9%**	**30**
Office Equipment, Services & Supplies												
Deluxe	-12	-350%	-3	30	12%	27	26	-7%	27	68	19%	57
Pitney Bowes	-6	36%	-10	49	5%	47	25	8%	23	80	1%	80
Republic Services	6	102%	3	39	0%	39	3	10%	3	35	-7%	38
Clean Harbors	56	28%	44	66	13%	58	34	46%	23	43	16%	37
Tetra Tech	75	-26%	102	101	-29%	142	NM	NM	NM	26	-35%	40
ACCO Brands	119	9%	109	92	3%	89	76	4%	74	49	-8%	53
Median	**31**	**11%**	**28**	**48**	**0%**	**48**	**25**	**4%**	**25**	**46**	**1%**	**45**
Oil & Gas												
Murphy Oil	-329	29%	-463	70	-3%	72	77	18%	65	475	-21%	600
Anadarko Petroleum	-179	27%	-245	43	73%	25	35	60%	22	258	-12%	292
Continental Resources	-156	24%	-204	137	59%	86	90	51%	59	383	10%	349
Buckeye Partners	67	72%	39	27	15%	23	58	109%	28	18	47%	12
Enterprise Products Partners	78	113%	37	52	49%	35	36	107%	17	10	-35%	16
Cheniere Energy	108	1591%	-7	59	662%	8	70	20%	58	21	-71%	73
Median	**8**	**236%**	**2**	**42**	**34%**	**31**	**24**	**32%**	**18**	**52**	**27%**	**41**
Pharmaceuticals												
Bristol-Myers Squibb	52	15%	45	88	2%	86	105	-28%	145	141	-24%	186
AbbVie	71	-19%	87	68	-10%	76	114	-30%	162	111	-26%	151
Johnson & Johnson	84	0%	84	59	6%	56	166	1%	165	141	3%	136
Merck	160	1%	158	65	6%	61	224	7%	210	129	14%	113
Eli Lilly	264	-5%	277	69	8%	64	313	-10%	348	118	-12%	135
Zoetis	371	8%	344	68	-5%	72	367	8%	340	65	-5%	68
Median	**125**	**-2%**	**127**	**68**	**0%**	**68**	**195**	**4%**	**188**	**115**	**-8%**	**124**
Semiconductors & Semiconductor Equipment												
Amkor Technology	22	-23%	29	53	-21%	67	37	-19%	45	67	-19%	83
Advanced Micro Devices	33	-52%	69	27	-45%	49	87	-3%	90	81	16%	70
Synopsys	52	0%	52	66	5%	63	NM	NM	NM	14	27%	11
Lam Research	158	-5%	167	78	3%	76	125	-7%	134	45	5%	43
MKS Instruments	178	16%	153	70	53%	46	144	14%	127	36	88%	19
KLA-Tencor	280	15%	243	75	-2%	76	243	21%	200	37	10%	34
Median	**122**	**0%**	**122**	**52**	**6%**	**49**	**120**	**-5%**	**126**	**50**	**-6%**	**53**
Telecommunications Equipment												
Apple	-79	-20%	-66	27	1%	27	6	-2%	7	112	14%	99
Qualcomm	20	-44%	36	34	22%	28	72	18%	61	86	61%	53
EchoStar	32	59%	20	58	7%	54	16	17%	14	43	-12%	48
Ciena	74	1%	74	81	-2%	82	57	7%	54	64	3%	62
CommScope	78	-23%	101	71	-12%	80	62	-8%	68	55	18%	46
Trimble	95	-20%	119	55	-5%	58	80	-20%	99	40	6%	38
Median	**55**	**-1%**	**55**	**57**	**1%**	**56**	**60**	**4%**	**57**	**59**	**7%**	**55**
Textiles, Apparel & Footwear												
Steven Madden	31	55%	20	15	32%	11	51	23%	41	34	6%	32
Kate Spade	74	-23%	97	20	-28%	28	121	-24%	159	67	-26%	91
Guess?	77	1%	76	36	-9%	40	95	13%	84	54	14%	48
Under Armour	123	-17%	148	47	18%	40	137	-6%	145	61	64%	37
Columbia Sportswear	130	-2%	132	51	-12%	58	141	3%	136	62	-1%	63
Hanesbrands	158	-4%	164	49	14%	43	186	-3%	193	77	8%	71
Median	**101**	**3%**	**98**	**36**	**-9%**	**40**	**123**	**-6%**	**131**	**54**	**14%**	**48**
Utilities												
NextEra Energy	-68	-329%	-16	43	5%	40	66	18%	56	176	57%	112
Avangrid	-29	-253%	19	69	-21%	88	40	-27%	54	138	12%	123
Edison Intl.	-22	-102%	-11	33	-21%	42	12	-12%	14	67	1%	67
Westar Energy	68	5%	65	41	7%	38	103	3%	101	76	3%	74
One Gas	93	8%	86	74	46%	51	108	19%	91	90	61%	56
Dominion Resources	123	15%	107	49	28%	38	216	45%	148	142	77%	80
Median	**28**	**-7%**	**30**	**47**	**14%**	**41**	**41**	**6%**	**39**	**61**	**15%**	**53**

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Delayed Departures

Older employees who cannot afford to retire present a costly challenge for the entire company. **By David McCann**

In early 2014, Hugh O'Toole of retirement plan provider MassMutual felt discouraged—"haunted," he says—by finance chiefs' lack of engagement in their companies' 401(k) plans. ¶ When he met with the rare companies that still offered defined-benefit (DB) pension plans, the CFO was typically the most engaged person in the room, he says, because the employer was responsible for 100% of the funding and investment liability.

But when it came to defined-contribution (DC) plans like the 401(k), the attitude was typically, "It's a nice HR story, but why should I care about employees' retirement readiness?" O'Toole says. After all, workers themselves provided a majority of the plan's funding and assumed all of the investment risk. Not even a trove of academic research pointing to a negative association between employees delaying retirement and a company's financial results got CFOs' hearts pumping.

O'Toole actually quit his job as senior vice president of sales to take a hard look at the problem. "They [CFOs] wanted to see it in their own data," he says of what he found during a lengthy series of discussions with finance chiefs over the few months following his departure from MassMutual. "They wouldn't make decisions based on academic studies."

What O'Toole did next landed him at the forefront of a surge in the use of data models to help companies understand more about retirement readiness: he founded a firm, Viability Advisory Group, dedicated to quantifying the relationship between the level of workers' retirement readiness and company financial performance. The promise inherent in such information is that the more companies know about the problem, the more proactively they can take measures to mitigate it.

Looking at Outcomes

Retirement readiness is often a problem despite many CFOs' ambivalence about retirement outcomes. Only 26% of Americans think they are saving enough for retirement, according to research by the Transamerica Center for Retirement Studies. In addition, only about 4% of U.S. private sector workers are enrolled in a traditional pension plan.

> **"Mid-level people who are ready for promotions or leadership positions get very frustrated if the levels above them are clogged up."**
>
> —Dean Aloise, global consulting leader, Conduent HR Services

Methodologies to measure a workforce's retirement readiness, using data such as an employee's age, gender, 401(k) account balance, and contribution level, have been around for years. They've grown progressively more sophisticated, and companies that are interested in knowing how many of their older employees are likely to stick around past, say, age 65 can get good directional data on that.

But Viability's econometric model looks at the problem from the company's perspective: it calculates the cost to companies of workers who retire late. The model primarily uses wages, health-care costs, and workers' compensation.

For employers that have used Viability's solution, the average annual cost for those items totals about $98,000 for a 60-year-old employee and $102,000 for a 70-year-old employee—a difference of 3.7%. Opinions may differ on whether that gap is meaningful or negligible, but it doesn't come close to portraying the true cost of an employee delaying retirement. A retiring worker is, on average, replaced by a much younger, less expensive one. Salary and benefits costs for 40-year-olds, for example, average just $68,000, according to the Viability model. (See table, page 40.)

That means even a brief retirement delay by an employee can prove costly.

Thinkstock

Someone who retires at 66 instead of 65, for example, costs his or her company an average of $34,000, according to Viability. If retirement is postponed to age 70, the cumulative tab rises to $172,000. And if 100 people at a company fit that profile, it creates a hit of more than $17 million.

Perhaps even more important, though, "there are softer costs [to workers delaying retirement] that are much more significant to employers, even though they are harder to measure," says Dean Aloise, global consulting leader at Conduent HR Services.

That's a reference largely to the downstream impact on the next generation of employees. "Midlevel people who are ready for promotions or leadership positions get very frustrated if the levels above them are clogged up," Aloise says. "They tend to be disgruntled, which affects their engagement and causes retention issues."

While such impacts are difficult to measure precisely, there are ways to dig into available data to estimate them. Look at turnover data for people who have been trained and are eligible to move up, Aloise suggests. If that can be correlated to pockets in the company where people are hanging on past the expected retirement date, the company knows it has a problem, he says.

And the effects cascade right down through the organization, even impeding the hiring of entry-level people. "You can't just keep adding head count, because your margins will deteriorate," Aloise adds. If a company usually hires 100 people from universities in the summer but now is hiring only 50, that too is an indication there's a problem.

Somewhat more controversially, Aloise also suggests that studying business metrics may reveal, depending on the industry, suboptimal productivity or a stagnation of innovation and ideas correlated with retirement unreadiness.

On the other hand, companies may not want every worker who is in their 60s to retire. It's important to distinguish between healthy delays in retirement and unhealthy ones, notes Shane Bartling, a senior retirement adviser for Willis Towers Watson. Older employees who are highly experienced in value creation and remain engaged and motivated likely will offer more value than the hard-dollar savings their retirement would generate.

Moving the Needle

To the degree a company does want to proactively mitigate the ill effects of unhealthy retirement delays, though, what courses of action are available?

When the future cost of older workers delaying retirement is forecast to be significant enough, a company might want to incur the present expense of increasing its 401(k) matching contributions, resulting in a net savings. Greater awareness of the savings opportunities for companies also may encourage more employers to implement automatic enrollment in a 401(k) for new employees and automatic escalation of employee contributions tied to salary increases.

"CFOs have often stopped the auto features from being implemented, not wanting to disrupt the employee population for what they saw as something not very beneficial to the company," O'Toole notes.

Placing significant restrictions on participants taking out loans from their DC plan is another tactic. Phil Webb, a senior adviser at Retirement Plan Advisors, goes as far as suggesting that employers should consider disallowing loans altogether.

The biggest improvement in retirement readiness, of course, comes from workers electing to save a larger chunk of their paycheck. Convincing employees to raise their contribution rate by a couple of percentage points "is where the real magic happens,"

The Costs of Aging

As workers get older, employers' average annual salary and benefits costs per employee increase.

AGE	WORKERS' COMP	HEALTH CARE	SALARY
30	$2,250	$4,073	$47,601
40	$2,613	$4,478	$60,813
50	$3,384	$6,155	$74,235
60	$5,298	$9,709	$83,197
70	$6,121	$11,219	$84,480

Source: MassMutual Viability

401(k) Fees by the Numbers

$155,000
Amount a worker with an average annual income of $30,000 and a 401(k) savings rate of 5% will lose to fees over his or her lifetime

$278,000
Amount a worker with an average annual income of $90,000 and a 401(k) savings rate of 5% will lose to fees over his or her lifetime

1.27%
Average expense ratio fee paid by participants, in addition to an average 1.2% per year in trading fees

Source: "The Retirement Savings Drain: Hidden and Excessive Costs of 401(k)s" from Demos

Webb notes. But HR officials have been trying to convince participants to do that through educational and promotional campaigns since the dawn of 401(k) programs, with fairly modest success.

Still, there are some untapped opportunities. According to Bartling of Willis Towers Watson, not enough companies offer health savings accounts, which allow participants to sock away cash they can use, tax-free, to pay medical bills in retirement.

For many plan sponsors, especially midsize and smaller ones, an even bigger missed opportunity is offering DC plan participants the ability to invest in low-fee investment vehicles.

Webb says he finds most CFOs are quite aware of retirement funds' investment fees. But they're much less aware of the other costs of running a 401(k) plan. Those include brokerage fees, as well as fees for recordkeeping and preparing the required annual Form 5500 report on plan returns and management. There are also fees for performing required discrimination testing to ensure that highly compensated employees don't receive an unlawfully high share of plan benefits.

Often those services are performed by the same financial institution that provides the plan's menu of investment options. "Unfortunately, in a lot of plans those costs are baked into the funds' expenses, and [CFOs] don't know enough about stripping them out or who's getting paid, and how much, from the funds," says Webb.

Service providers to 401(k) plans are actually required under federal law to disclose their fees to plan sponsors, which in turn are obligated to report them to participants. But in many cases plan sponsors don't pay much attention to the fee disclosures, let alone benchmark them against other plans' fees, according to Tom Zgainer, CEO of America's Best 401k.

"Smaller companies and even midsize ones generally believe that the 401(k) plan must be working fine if nothing seems to be [overtly] breaking," Zgainer says. Participants, working for companies of any size, typically don't look at the fee disclosures either,

Lay the Groundwork for Savings

Financial wellness programs help workers overcome common but serious challenges to building wealth.

Employees aren't likely to save for their golden years when they're under immediate financial stress. They may first need to get themselves out of debt or get their spending under control.

"Financial wellness" is a hot benefits concept, but it's not just the participants who benefit from programs to help put them on sounder financial footing. Not only do the programs ultimately impact retirement readiness, but studies have drawn a link between financial stress and lost productivity.

Such wellness programs are part of a trend toward a more holistic approach to retirement readiness that takes an employee's full life situation into account, notes Greg Marsh, managing director of retirement plans for Bridgehaven Fiduciary Partners.

Most large employers offer some type of financial wellness education. Midsize companies may look to firms like Bridgehaven, which provides programs of its own and also partners with outsourced providers. Here are some of the firms companies hire:

• **Financial Finesse** provides clients with financial wellness assessment tools and an aggregated report on all assessment results in its database, broken down by age, income, gender, and location. The firm also offers a financial helpline and one-on-one consultations with employees.

• **Smart Dollar** teaches a step-by-step approach to handling money. Lessons for getting out of debt and on a budget are delivered through video presentations and interactive tools. The approach is designed to be easy to understand and implement.

• **HelloWallet** offers programs for controlling spending and creating emergency savings. It also provides a web portal that offers participants convenient access to their investment account balances.

• **Student Loan Genius** provides technology that allows employees to evaluate their loan-repayment options and to pay off loans via payroll deductions. It also offers companies a mechanism to make matching contributions when employees make student-loan repayments. | D.M.

Savings Crisis

Many Americans struggle to be ready for retirement.

52%
Have less than $10,000 saved for retirement

68%
Don't have a monthly budget

49%
Have more credit-card debt than savings

Sources: Smart Dollar, Financial Finesse he notes. “People don’t read anymore … they don’t get past the second page.”

That behavior can be devastating to a participant’s retirement readiness and future financial health. “If Joe and Bill both put in the same amount of money over 30 years, but Joe pays 1% in fees and Bill pays 2%, with negative compounding Bill may run out of money in retirement 10 or 12 years earlier,” says Zgainer.

Large companies typically have investment committees that perform due diligence to ensure they have good-quality 401(k) plans. But at companies with about 300 or fewer employees, it’s rare to find a full-blown, engaged investment committee, according to Zgainer. “It’s just a laissez-faire approach to plan governance,” he says.

A majority of companies still don’t offer passive-investment options carrying low fees like index-based funds, even though such options have grown increasingly popular with investors over the past decade. That’s problematic, as actively managed funds, Zgainer observes, tend to have periods of brilliant performance interspersed with lengthier periods of poor performance. Passively managed index funds, by comparison, are a “steady-as-you-go strategy for the long term,” he says.

Blast from the Past

If a company is looking for a truly out-of-the-box solution for getting workers ready to retire, here’s one recommended by Conduent’s Aloise: start a defined-benefit pension plan. Never mind that a majority of companies that once offered DB plans have terminated or frozen them, and that the employer landscape is devoid of new ones. (See graph, below.)

Traditionally, Aloise notes, pension plans were far more effective at managing retirement readiness than 401(k) plans are today. Not only did they offer guaranteed retirement income, they could be designed to offer incentives to retire early. According to the National Institute on Retirement Security, administering the average DB plan costs 46% less than a typical 401(k) plan to provide the same benefit level. That’s due to higher 401(k) fees, lower investment returns, and the ability of DB plans to pool risk.

“This, I think, is what CFOs should be thinking about for the future,” Aloise says. “We’ve learned so much by now about how to manage volatility and manage assets and liabilities. Actuaries, investment consultants, and other providers are sophisticated enough to avoid the pitfalls of the past.”

Pension plans went into stagnation because they got into financial trouble. For one, many were designed in an era of high interest rates. As rates dropped, plan sponsors found the promises they made to employees were more expensive than expected.

Also, in the 1980s plan sponsors were required to use yields on high-quality corporate bonds to discount pension liabilities as part of a move to mark-to-market accounting. They also were forced to recognize the cost of future pension liabilities on their balance sheets.

Another factor was that people were living longer than they did when most DB plans were designed.

But employers today are newly open to some strategies that, if used in connection with a DB plan, could significantly lessen the financial risks, according to Aloise. Those strategies include increasing interest-rate hedging ratios to limit volatility; offering windows during which plan participants can opt for a lump-sum distribution of their pension accounts; and purchasing annuities on behalf of plan participants, thereby transferring the risk associated with those populations.

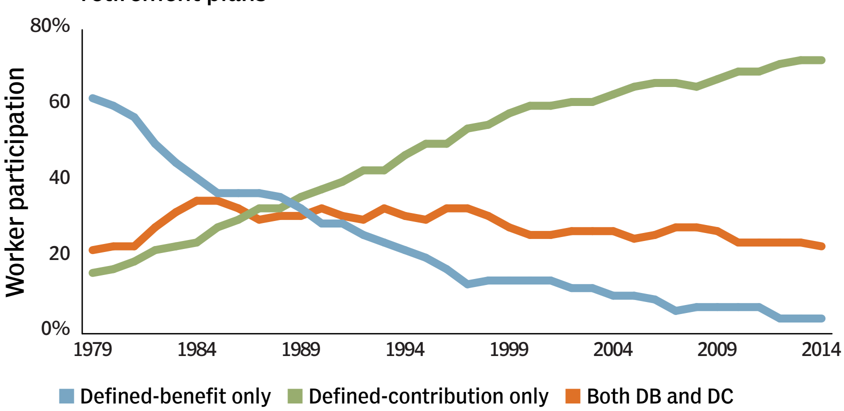
“The pendulum swung to having only defined contribution plans,” says Aloise. “It’s time for it to swing back a little bit.” CFO

David McCann is a deputy editor of CFO.

Undefined Benefits

Over the past 35 years, the percentage of employees enrolled in defined-benefit plans sank to single digits while the percentage of defined-contribution plan participants more than tripled. The proportion of workers with both a DB and a DC plan stayed steady.

Private-sector workers participating in employment-based retirement plans



Sources: U.S. Department of Labor, Pension Benefit Guaranty Corp., Employee Benefits Research Institute

Growth, Interrupted

The second-quarter Duke/*CFO* Business Outlook Survey shows U.S. CFOs are wary of placing big bets on growth initiatives. By Chris Schmidt

Uncertainty about U.S. regulatory and trade policies is prompting some companies to put business expansion plans on hold, according to the second-quarter Duke University/CFO Magazine Global Business Outlook survey.

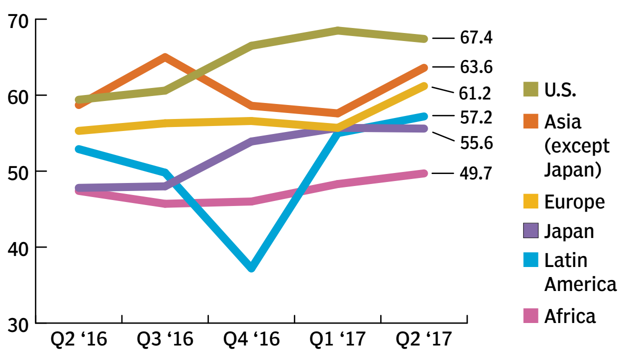
More than one-third of U.S. finance executives (36%) report that the level of uncertainty their companies face is currently higher than what they perceive as normal. Among the respondents who say their companies face increased uncertainty, nearly 6 in 10 (58%) say that the uncertainty will cause their firms to proceed at a slower pace with or even delay business expansion efforts.

What particular areas of uncertainty are keeping U.S. CFOs from pulling the trigger on growth initiatives? Healthcare policy and regulatory policy are both cited by 33% of respondents, followed by uncertainty over economic growth (30%) and U.S. tax policy (28%).

U.S. finance chiefs were also asked which aspects of trade and tax policies are holding back their company's plans for expansion and new projects. International trade deals (28%) are most frequently cited, followed by the income tax rate for C-corporations and the income tax rate for pass-through businesses (both 27%). The proposed border tax comes in fourth (25%).

Economic Optimism Rises in Multiple Regions

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



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

U.S. CFOs describe several ways in which uncertainty about the direction of federal government policies is putting a crimp in their growth plans. Several finance chiefs indicate that their plans for business expansion into Mexico have been cut back or put on hold. Others say that the delay in U.S. federal tax-cut legislation has led them to trim capital expenditures or adopt a more conservative stance toward spending in general.

Several respondents put forward a theme of pursuing core strategies built on their companies' strengths and focusing on things that are under their control.

But a company's choosing to pursue only core strategies can act to slow or stop new projects. And there are other factors holding back growth initiatives, the survey finds. When asked if their companies pursue all projects that are expected to earn a return higher than the hurdle rate they use to evaluate investment projects, for example, only 21% of respondents say "yes." About two thirds (67%) say "no."

What's preventing companies from pursuing these value-creating projects? Shortage of management time and expertise is the most popular answer, given by 51% of finance executives. That's followed by the project in question not being consistent with the company's core strategy (41%), the risk of the project being too high (39%), a shortage of funding (38%), uncertainty about specific project types (34%), a shortage of employees (32%), and overly optimistic projections of the return on investment (28%).

Optimism Still High

Although many growth initiatives may not see the light of day, so far the stagnation in Washington is not souring CFOs on the overall economic outlook. In addition, at the time of this writing, the global markets continue to reflect a similar mind-set.

The Duke/*CFO* optimism index for the United States fell slightly in the second quarter, to 67.4 on a 100-point scale. That's down from 68.5 in the first quarter but still above the long-run average of 60. Hiring plans are stronger than one year ago, and U.S. companies expect to pay higher wages, with median wage growth of about 3%, over the next 12 months (finance chiefs in the construction and tech industries expect wage growth to be even higher).

The most pressing concerns of the top management of U.S. companies are difficulty attracting and retaining qualified employees (cited by 41% of respondents), government policies (36%), the cost of employee benefits (36%), economic uncertainty (32%), data security (31%), and regulatory requirements (30%). Interestingly, the least pressing concerns of top managers are inflation (cited by 2%) and deflation (1%).

CFOs in other parts of the world also remain optimistic, with some regions seeing a significant pickup in business confidence.

41%

U.S. finance executives who say that attracting and retaining qualified employees is among the most pressing concerns of top management.

CFO optimism climbed to 61.2 in Europe, from 55.7 one quarter ago, lifted at least in part by political leaders' promises to introduce European-level reforms to spur growth. In the next 12 months, European finance chiefs expect capital spending to strengthen and employment to grow moderately (1.7%). The top concerns of Europe's CFOs include economic uncertainty, attracting and retaining qualified employees, and governmental regulations and policies, in that order.

Still, about one in five finance chiefs of European companies say they are delaying expansion until they get concrete evidence of regulatory reform and of an upswing in the European economy. Shortage of funding and of qualified employees is limiting the ability of European companies to pursue certain value-creating projects, European CFOs indicate.

In Asia, CFO optimism increased to nearly the same level as in the United States in the first quarter. CFOs of Asian companies project capital spending will rise 5% in the next 12 months and employment will grow 2.7%. The top concerns of finance chiefs in Asia are difficulty attracting employees, currency risks, and falling employee productivity.

About one-third of finance chiefs in the region say uncertainty about economic growth and tax policy is greater than normal, but few Asian firms are slowing expansion plans in response. Too much uncertainty and overly optimistic projections are primary reasons that some value-creating projects are not always pursued, Asia's finance chiefs say.

Latin American CFOs are signaling moderate optimism, up from very low levels one year ago, as the region's economic optimism index climbed to 57.2. In Mexico, the optimism of CFOs has almost fully recovered from a significant drop in the fourth quarter of 2016, when the United States elected a president who promised to get tough on immigration from Mexico and vowed to renegotiate trade deals with the country.

Still, there are significant concerns about economic uncertainty and weak demand in Latin America. Business spending will be flat and full-time employment will fall in the next 12 months, according to the region's finance chiefs.

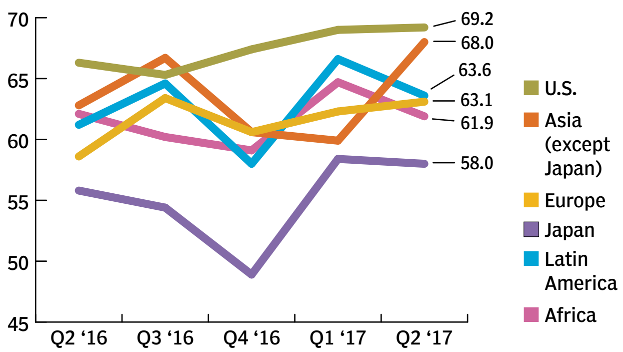
In addition, more so than in other parts of the world, CFOs in Latin American say they will delay or cancel expansion plans due to economic and political uncertainty. Shortage of funding is the top reason for not pursuing all value-creating projects.

At 49.7, business optimism in Africa is the lowest in the world. CFOs' outlook for employment is weak. The biggest concerns of the finance chiefs of African companies are economic uncertainty, volatility of the political situation, and governmental policies. Fifty-five percent say that uncertainty is worse than normal, and among those firms more than half are holding off on business expansion in response.

Shortage of funding limits the ability of companies in Africa to pursue value-creating projects, CFOs of African companies say, in addition to projects not being core to the firm and scarcity of management's time. CFO

Company Confidence Strengthens In the U.S., Europe, and Asia

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



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

Source for all charts: Duke University/*CFO* Magazine Global Business Outlook Survey of finance and corporate executives. Responses for the current quarter include 377 from the U.S., 49 from Asia (outside of Japan), 26 from Japan, 130 from Europe, 120 from Latin America (including Mexico), and 41 from Africa.

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FIELD NOTES

Perspectives from CFO Research

The Road to Finance Transformation

For CFOs, the lure of the destination—genuine data-driven decision-making that drives enterprise-wide innovation—is worth the difficulty of the journey. By Chris Schmidt

A CFO who can accurately report on the financial position of his or her organization with great detail and insight—and on a timely basis—is empowered both immediately and in the future. For today, that accurate financial snapshot clarifies competitive positioning; for tomorrow, it enables planning that is actionable, constant, and fluid.

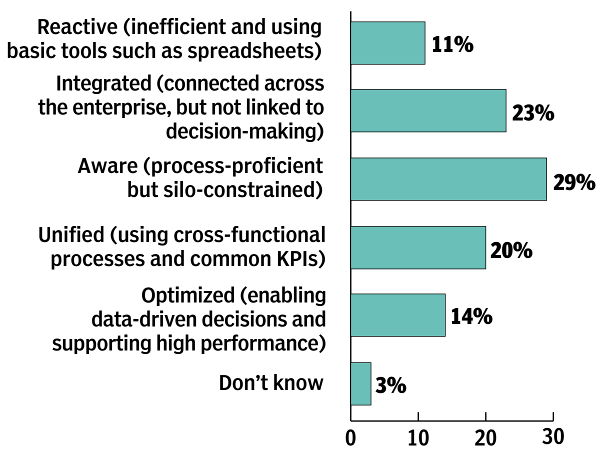
For most CFOs, unfortunately, assembling a financial snapshot that contains "great detail and insight" can be a slog. They don't have the technology or processes to paint an accurate portrait of the business or, if they do, they can't generate it quickly enough for it to be of great use. What is needed at these companies? Nothing less than a transformation of the way finance handles and uses the data the organization generates.

Such a transformation is heavily dependent on better use of technology. The value of a technology-led transformation within finance was explored in a recent survey of 157 senior finance executives, conducted by CFO Research in collaboration with software provider Longview.

When asked about the state of their finance function's technology, most of the survey respondents—a combined 63%—describe it as "inefficient," "silo-constrained," or "not linked to decision-making." Only 14% report that their finance functions are in an "optimized" technological state; that is, their systems enable data-driven decisions and support high performance. For many, it appears, the finance transformation journey has paused short of its destination. (See Figure 1, below.)

FIGURE 1

Which of the following adjectives best describes where your finance function is on its technology "transformational journey"?



CFOs who are not supported by sophisticated financial reporting technology can be hamstrung, along with their companies, in planning and strategy development. According to the CFO Research survey, only 12% of the respondents "strongly agree" that their current technology is flexible and agile enough to support business-strategy and business-model changes over the next two years. And only 11% strongly agree that their finance function uses technology to support new business-innovation initiatives.

For CFOs dealing with the issues of today, that lack of technological support can cause bad or knee-jerk decisions, as the finance chief struggles to detect the root cause of an issue. For CFOs dealing with tomorrow's issues, a lack of support prevents the ability to re-forecast, course-correct, and make strategic decisions about customers and product lines. In both instances, the CFO's core role in supporting growth and innovation is effectively stymied.

The Way Forward

While their companies' tools and technologies may be outdated and inefficient, a strong majority (82%) of survey respondents believes that leading-edge technology is essential to finance function transformation. Nearly as many respondents (80%) think there is measurable value in partnering with a technology solutions provider rather than just purchasing technology for the transformation.

One respondent writes that CFOs must now be "more technologically oriented and technology-driven and more passionate about technology. They have to regularly stay up-to-date with [the] latest information on technology." Another advises CFOs to "have a clear vision, and a Plan B, and a Plan C."

Still another finance executive says that CFOs should take advantage of a transformational technology project by seeking to improve the entire organization, not just finance: "Make the project a company project, for all functions, not just finance. You have the opportunity to reengineer your company through this implementation."

And, in fact, a majority of CFOs have mapped out just such a future for their finance functions. According to the survey, strong majorities of finance functions have clearly articulated short-term (75%) and long-term (63%) visions, as well as long-term and short-term technology roadmaps to achieve those visions (65%). The best-laid plans have been made with the best of intent. The destination has been entered into the GPS.

14%

Finance executives who say their companies' finance technology is in an "optimized" state

Two Key Pieces

Most finance executives surveyed believe the gain is worth the pain when it comes to implementing cloud and big data solutions, two key tools to better reporting and planning.

The survey shows that 71% of finance executive respondents think that shifting finance solutions to the cloud is fundamentally challenging; however, 66% believe the value realized from a cloud strategy exceeds the cost of meeting its challenges.

Similarly, more than three-quarters (76%) of the finance executives surveyed believe that implementing a strategy to leverage big data is fundamentally challenging, but 62% say the value realized from big-data strategies exceeds the cost of that challenge.

These last two data points show that CFOs know that important trends and patterns exist in the siloed data that surrounds them. But many finance chiefs find themselves data-rich and information-poor, with relevant information residing in disparate systems. Getting that data organized and analyzed is daunting, even though for the organization the payoff can be enormous.

The CFO's Role

Finance chiefs seem to be highly aware that the fates of their position are intertwined with the organization's successful adoption of technology.

About half of the finance chiefs surveyed (49%) believe that advances in technology will fundamentally change the role of the CFO. But the barriers to success are many. Some finance executives in the survey say that having to understand the financial impact of technology options—quickly weighing their short- and long-term benefits and costs—will be one of the biggest changes for CFOs over the next two years. One respondent notes that finance needs to be "heavily collaborative" with the information technology department over the near term.

Close ties with IT don't just make sense when weighing technology investments; they will also be key to making data secure in an era of heightened corporate vulnerability to cyber attacks. One surveyed executive notes that the transition of accounting and finance to digital from paper will require a new security and controls focus: "New internal controls will have to be established that are technology-based, and they will need to rely on system security more than physical security." That's because effective risk management for today's CFO is tied to advanced technology tools. Nearly three-quarters (73%) of survey respondents say they think leading-edge technology can reduce the number of CFO pain points—and for senior finance executives, risk equals pain.

But as important as risk management is, the ultimate target for many finance chiefs is a metamorphosis for finance. One executive reports that it is important for the CFO to "improve the tools and thus the ability of the finance staff to do value-added analysis for our business partners (instead of) spending time on gathering data and reporting on results." Another executive states that, in addition to supporting ROI calculations for potential innovation changes, finance should "be a better partner with other functions in developing a longer-term vision of how innovation could transform various business processes." A third finance executive reports that it is important for the CFO to "improve the tools and thus the ability of the finance staff to do value-added analysis."

For a CFO willing to make the investment, transformational finance technology is clearly a trip worth taking. CFO

The Leading Edge

Many CFOs believe that technology is driving profound changes in the finance function.

82%
Say leading-edge technology is essential to business transformation

73%
Note that leading-edge technology can reduce the number of CFO pain points

49%
Believe advances in technology will fundamentally change the role of the CFO

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The Heat Is On

Summer in North America brings to mind the power of the Sun and the fact that the many fans and air conditioners that bring relief from the "yellow dwarf" still rely on electricity from fossil fuels. But the solar industry is slowly increasing its share of electric capacity. How much do you know about this burgeoning industry? Take our quiz to find out.

1 In the first quarter of 2017, the United States installed 2,044 megawatts of solar photovoltaic cells to reach 44.7 gigawatts of installed capacity. How many U.S. homes could be powered by that amount of installed capacity?
A. 15.2 million
B. 8.7 million
C. 2.3 million
D. 5.6 million

2 Which solar industry company did not declare bankruptcy in the past two years?
A. Suniva
B. SunEdison
C. Sungevity
D. Sunrun

3 Which U.S. state is not one of the top 10 states with the most cumulative solar capacity?
A. New York
B. Utah
C. Texas
D. Florida

4 Which company is the biggest adopter of solar energy, measured by megawatts installed at its U.S. facilities?
A. Target
B. Walmart
C. FedEx
D. Apple

5 Approximately how many Americans work in the U.S. solar industry?
A. 560,000
B. 1 million
C. 260,000
D. 7.5 million

6 Which company is the top solar residential contractor?
A. SolarCity
B. Vivint Solar
C. Solar Universe
D. Sunnova

7 By 2020, solar is expected to deliver what share of total U.S. electrical generation?
A. 5%
B. 8%
C. 10%
D. 3%

8 How large a tax credit does the U.S. federal government offer for solar systems installed on residential and commercial properties?
A. 15%
B. 35%
C. 30%
D. 8%

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

Source: Solar Energy Industries Association. Photo from Thinkstock.