7 Habits of Effective CFOs

CPE Edition

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7 Habits of Effective CFOs

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Course Information

Course Title: 7 Habits of Effective CFOs

Learning Objectives:

- Recognize the difference between being effective and efficient.
- Describe how a CFO should communicate financially viable alternatives to others.
- Recognize the risks associated with pruning current operations.
- Specify the proper role of the CFO in the acquisition process.
- Describe the essential components and requirements of an adequate cash forecasting system.

Subject Area: Personal Development

Prerequisites: None

Program Level: Overview

Program Content: The *7 Habits of Effective CFOs* course discusses the top seven tasks that a chief financial officer should address in order to be as effective as possible. The suggestions cover a broad range of topics, including financial analysis, cutting back failing or substandard operations, bottleneck management, and how to deal with risk. The course also notes how these recommendations vary from the contents of a typical CFO job description. *7 Habits* is specifically designed for the CFO who wants to improve his or her job performance.

Advance Preparation: None

Recommended CPE Credit: 1 hour

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About the Author

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7 Habits of Effective CEOs
7 Habits of Effective CFOs
7 Habits of Effective Controllers
Accountant Ethics [for multiple states]
Accountants' Guidebook
Accounting Changes and Error Corrections
Accounting Controls Guidebook
Accounting for Breweries
Accounting for Casinos and Gaming
Accounting for Derivatives and Hedges
Accounting for Earnings per Share
Accounting for Income Taxes
Accounting for Intangible Assets
Accounting for Inventory
Accounting for Investments
Accounting for Leases
Accounting for Managers
Accounting for Mining
Accounting for Retirement Benefits
Accounting for Stock-Based Compensation
Accounting for Vineyards and Wineries
Accounting Information Systems
Accounting Procedures Guidebook
Activity-Based Costing
Activity-Based Management
Agricultural Accounting
Auditor Independence
Behavioral Ethics
Bookkeeping Guidebook
Budgeting
Business Combinations and Consolidations
Business Insurance Fundamentals
Business Ratios
Business Valuation
Capital Budgeting
CFO Guidebook
Change Management
Closing the Books
Coaching and Mentoring
Conflict Management
Constraint Management
Construction Accounting
Corporate Bankruptcy
Corporate Cash Management
Corporate Finance
Cost Accounting (college textbook)
Cost Accounting Fundamentals
Cost Management Guidebook
CPA Firm Mergers and Acquisitions
Credit & Collection Guidebook
Crowdfunding
Developing and Managing Teams
Effective Collections
Effective Employee Training
Employee Onboarding
Enterprise Risk Management
Entertainment Industry Accounting
Ethical Frameworks in Accounting
Ethical Responsibilities
Excel Charts and Visualizations
Excel Data Analysis Tools
Excel Data Management
Excel Formulas and Functions
Fair Value Accounting
Financial Analysis
Financial Forecasting and Modeling
Fixed Asset Accounting
Foreign Currency Accounting
Franchise Accounting
Fraud Examination

(continued)

Fraud Schemes
GAAP Guidebook
Governmental Accounting
Guide to Analytical Procedures
Health Care Accounting
Hospitality Accounting
How to Audit Cash
How to Audit Equity
How to Audit Fixed Assets
How to Audit for Fraud
How to Audit Inventory
How to Audit Liabilities
How to Audit Payroll
How to Audit Receivables
How to Audit Revenue
How to Conduct a Compilation
How to Conduct a Review
How to Run a Meeting
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IFRS Guidebook
Interpretation of Financial Statements
Introduction to Excel
Inventory Management
Investor Relations Guidebook
Law Firm Accounting
Lean Accounting Guidebook
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Optimal Accounting for Payroll
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Payables Management
Payroll Management
Performance Appraisals
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Project Management
Property Management Accounting
Public Company Accounting
Purchasing Guidebook
Real Estate Accounting
Records Management
Recruiting and Hiring
Revenue Management
Revenue Recognition
Sales and Use Tax Accounting
Succession Planning
The Balance Sheet
The Income Statement
The MBA Guidebook
The Soft Close
The Statement of Cash Flows
The Year-End Close
Treasurer's Guidebook
Unethical Behavior
Working Capital Management

On-Line Resources by Steven Bragg

Steven maintains the accountingtools.com web site, which contains continuing professional education courses, the Accounting Best Practices podcast, and thousands of articles on accounting subjects.

7 Habits of Effective CFOs

Introduction

When hired, a chief financial officer (CFO) can diligently attend to each item listed on her job description, and yet fail in the job. The reason is that some elements of the CFO job description are relatively minor, while others are essential to the survival of the business. The new CFO needs to be able to distinguish between these elements and focus on the few that are really necessary. In addition, the CFO may find that some critical aspects of the job are not even listed in the job description, making it even more difficult to decide how to proceed. In this course, we point out the seven most essential aspects of the CFO position, even if they are not listed anywhere in the job description.

How do we decide which aspects of the job are important? They must result in the CFO being as effective as possible. A highly effective CFO is one who always does the right thing. In essence, this means that the actions of the CFO result in a business achieving its intended goals. Very few CFOs are truly effective, since many of them are waylaid by insignificant issues, or incorrectly place a premium on being excessively efficient. Being *effective* means that a person has a strategic mindset, always ensuring that the organization is deploying its resources correctly. Being *efficient* is more of a tactical issue, where the organization is maximizing its productivity. The trouble with an excessive focus on efficiency is that the organization may be highly efficient in activities where the business should not be engaged. Consequently, a strong focus on effectiveness results in a more financially viable business over the long term.

A key part of the following recommendations is that each one is described as a *habit*. This means the CFO engages in the activity on a regular basis, to the extent that it is hard to give up. Ideally, the CFO gives these habits an extremely high priority, so they are always addressed before less critical activities. By maintaining a tight focus on the following seven recommendations, the CFO is maintaining a high level of effectiveness on a continuing basis.

In the following sections, we will describe a situation that needs to be addressed, the negative impact of not giving it a proper level of attention, and then note why the CFO is the best person to deal with it.

Habit #1 – Search for Financially Viable Solutions

In far too many organizations, the CFO plays the role of Ebenezer Scrooge, constantly turning down the proposals of other people as being too risky, too expensive, or requiring too much money. This negative predisposition causes a number of problems. First, the CFO earns a reputation for not being willing to work with the rest of the company, which results in her exclusion from any number of ongoing conversations about how the business should be run. Second, by eliminating the discussion about new and riskier alternatives, the CFO is essentially forcing the organization to continue on its current path. Over the long term, following the current path will eventually result in reduced profits for the business, as the market shifts in other directions and competition increases. In short, the traditional CFO role of viewing proposals from a conservative perspective paints the CFO in a negative light within the company, and may harm the business over the long term.

Our first habit for an effective CFO is to take an entirely different approach to the handling of issues posed by others, which is to always look for a financially viable solution. When someone proposes an action, the CFO responds with the financial circumstances under which the solution can be made financially viable. This gives others a clear understanding of the consequences of different strategic or tactical directions, thereby improving their knowledge of the financial parameters within which the company operates. Here are several examples of how a CFO might respond to a suggestion:

Proposed action: We should construct a warehouse near customer Alpha, so that we can provide them with same-day delivery.

CFO response: We can make that work if we build a mini-warehouse that costs less than $3 million, stock it with just the key inventory that customer Alpha uses, and also offer its services to at least five other customers in the area, so that we can service $20 million of annual sales from that location.

Discussion: The CFO has outlined the exact parameters that must be met in order to make the proposed warehouse deal work. The message being given is that the person making the suggestion (probably the sales manager) needs to come up with additional customers, as well as the incremental amount of sales that will be needed.

Proposed action: We should create a new product line to sell a smaller version of our Mongo Bike to pre-schoolers.

CFO response: We can make that work if we run a third shift for the smaller version, and shift some of the advertising dollars from the adult line to this new line, probably on a permanent basis. We may need to sell the bike through a few "big box" retailers, which means that we will give up 30% of the price to the retailers. However, as long as we keep the direct cost per bike at $100 or less, that will still give us a sufficient margin.

Discussion: The CFO has provided the proposer with the cost target that must be met, noted the need to build relationships with certain retailers, and pointed out that some marketing funding must be shifted. The proposer must now decide if he wants to put in the effort to turn the original suggestion into reality.

Proposed action: I think we should cut the price of the green widget product by $3. That should bring in way more sales!

CFO response: We can make that work as long as the sales volume increases by 2,000 units per month. We will need the extra sales volume to make up for the lost margin on each unit sold. If we can sell more units above that level, each additional unit will create $2 of profit.

Discussion: The CFO has given the proposer the key number to work with – is it possible to generate an extra 2,000 units of sales per month? If so, the price cut could be worth pursuing.

In all three cases, the CFO is engaging in two positive actions. The first is to point out that the proposal can yield a positive outcome by stating "We can make that work if…" This is a complete reverse of the negative response that a more traditional CFO might give. The second positive action is the delivery of a simplified financial message. The CFO states those criteria that must be met so that the proposal can succeed. There is no attempt to burden the recipient with a massive set of scenario plans (though such material may back up the CFO's presentation). Instead, the focus is on a clear and accurate presentation that is thoroughly understandable by someone who is not versed in finance and accounting verbiage.

The CFO can take the concept a step further by not waiting for someone else to propose an action. It is entirely acceptable for the CFO to conduct her own research and suggest activities that may make financial sense for the organization. Again, these suggestions should be couched in a simple and streamlined format, so that the recipient can immediately grasp the essentials of the proposal and what conditions must occur in order for it to be successful.

The CFO may encounter possible scenarios to investigate every day. A proper analysis of each one could take up all of her time, so it will probably be necessary to hand off the actual analysis work to one or more financial analysts. The CFO then reviews their analyses and presents the results to others. The extra financial analyst cost is quite worthwhile, if the expense results in key new initiatives being found and acted upon.

The search for financially viable solutions is one of the most essential habits of the effective CFO, for it puts the entire management team in search mode, constantly reviewing the competitive landscape for opportunities that can be acted upon.

Habit #2 – Prune the Business

A concern with the first habit is that it places the CFO in the position of only looking at new initiatives. There is no concern with the existing business, so there is a risk that existing products, product lines, stores, sales regions, and subsidiaries are underperforming or even absorbing more cash than they spin off. The eventual result is a less-than-optimal sales mix that, in total, yields an unusually low profitability level or return on assets.

The solution is our second habit for an effective CFO – to routinely monitor the performance of the organization, and prune it when necessary. Any suggestion to prune assets involves the same brief, focused presentation that was just noted for the first habit. For example:

> Example 1: The contribution margin on the candy cane line last year was -0.05 percent, so we lost $38,000 on it. The problem is that overseas labor costs are so low that we cannot compete without outsourcing the work. Should we outsource or close down the line?
>
> Example 2: The paint booth is costing us $100,000 per year in environmental compliance costs. We've received an offer from ABC Painting to take on the work, and they guarantee one-day turnaround times for the work. At our current sales level, outsourcing will cost us $20,000 more per year, but we eliminate the compliance costs, so the net savings is $80,000. Should we keep the work in-house or outsource it?
>
> Example 3: Big Retailer wants us to ship them the Big Easy Chair product on a daily basis and with no forecast information, so we'll need to maintain an on-hand inventory of $1,000,000 of the product at all times. In exchange, we earn a 5% profit on this product, which was $15,000 last year. So, we are getting a 1.5% return on our working capital investment. Should we close down this relationship or try to re-negotiate the deal?

In each example, the CFO is noting which parts of the business are falling below expectations, and clarifies the situation, making it easier for the management team to arrive at a decision. This does not mean that the CFO's recommendations will always be followed – there may be good reasons for continuing with an investment. Nonetheless, an effective CFO should bring these situations to the attention of management. If no action is taken, the CFO should continue monitoring these items and bring them up again, if the circumstances change.

It can be quite difficult to push through a pruning recommendation, especially when it involves a sacred cow that no one wants to interfere with – for example, it may be the core product that the company founder used to start the business. Further, by pushing for an elimination, the CFO is at risk of gaining back the reputation for a negative attitude that we discussed as part of the first habit. Consequently, pruning calls for delicate handling of the issue, taking into consideration the feelings of everyone involved, and making as clear a case as possible for the recommended action.

In short, pruning the organization is just as necessary as the ongoing search for new business, to preserve the positioning and cash flows of the rest of the firm to the greatest extent possible. By maintaining an active pruning campaign, the CFO creates a war chest of cash that can be directed at new initiatives.

Habit #3 – Manage the Bottleneck

Every business has a bottleneck that prevents it from growing. The bottleneck may be a machine in the production area, or a salesperson who has no additional time for sales work, or a supplier that cannot deliver a key raw material – and there are many more examples. A bottleneck represents an absolute block on growth – it is impossible for the organization to increase in size without managing the bottleneck in some

way. For example, a company could be in an industry where the sales staff must be highly trained in order to generate sales, and the supply of salespeople is tightly limited. If so, the company must focus on either training new salespeople or making the existing salespeople more efficient. The trouble is that many organizations have no idea where their bottleneck is even located, so there is no way to manage it.

The solution is our third habit for an effective CFO – to locate and closely monitor the bottleneck, putting out a stream of suggestions for improving its performance. For example, if a production machine is the bottleneck, the CFO may propose to add a third shift, or bring in replacements whenever the main work crew is taking a break, or enhance the machine's preventive maintenance to reduce the risk of machine breakdowns. Bottleneck management is so important that the CFO needs to keep this issue in front of the management team at all times, including metrics on bottleneck performance and how it is impacting the company's growth plans. For example:

> We planned for an increase in speaker sales of 100,000 units last year. We did not achieve any of those sales, because we were unable to obtain any additional rare earth deliveries from our main supplier, thereby cutting into our ability to produce more magnets for the speakers. Suggestions for eliminating this bottleneck in the future are:
>
> - Line up a second supplier and pay it a premium to reserve capacity for the company
> - Ask the engineering staff to work on a new speaker design that requires a smaller amount of rare earth minerals
> - Send an engineering team to our suppliers to assist them with extraction technologies
> - Invest in our main supplier, so that we can lock in a larger proportion of its production capacity

Note that the example states the problem, notes how it impacted the company, and (see Habit #1) also provided a number of possible solutions.

The CFO can also monitor suggestions coming from other parts of the business for various actions, and provide commentary to the management team regarding how those suggestions would impact the bottleneck. Doing so may alter how those suggestions are treated. For example:

> The sales manager has suggested that we accept Big Box Retailer's purchase order for 1,000,000 purple widgets at a price of $14.50 each. That order will take up 10% of the time of our production bottleneck, and displace an order for the same product that is priced at $16.00 each. So, accepting the order means that we will lose $1,500,000 of margin. As an alternative, I suggest accepting the order but outsourcing that phase of the production work to a supplier; the cost is higher, but we will still earn $0.25 per unit, which is $250,000 of profit that we would not otherwise have.

In a business that suffers from severe bottleneck restrictions, focusing on the bottleneck could be considered the number one priority of an effective CFO, since it has such a massive impact on profits.

Habit #4 – Advise on Acquisitions

Companies tend to spend far too much on acquisitions, and routinely buy organizations that are not a good strategic fit. These problems occur when the president gets caught up in the excitement of a bidding war, or merely wants to buy a company in order to increase the amount of total sales reported to shareholders. Overpaying for an acquisition is the cardinal sin of investing, since there is already a high probability that the transaction will fail or underperform, usually due to cultural differences between the organizations.

The solution is our fourth habit for an effective CFO – this is one of the rare cases in which she absolutely must be the negative influence in making a purchase transaction. The CFO should set criteria that prospective acquisitions must pass, such as having unique capabilities that will enhance the company's strategic position. If the president appears willing to pay an excessive price in order to make a trophy acquisition, the CFO must be willing to talk the president down from his or her emotional high by discussing the realities of what the acquisition will actually do for the company.

We make note of this habit, despite its negative orientation, because an incorrect acquisition decision can bankrupt a business, soaking up its available cash and placing it hopelessly in debt. In addition, acquisition integration can soak up an immense amount of management time. In short, because acquisitions are inherently risky, the CFO must set aside an inordinate amount of time to examine each proposed deal, and be willing to stake out a position that may be unpopular with the rest of the management team.

EXAMPLE

As a CFO, the author reviewed in excess of 400 proposed acquisitions and rejected all but three. The president elected to proceed with a fourth acquisition that the author had not recommended. The result was an exceedingly difficult relationship with the management team of the new subsidiary, diverting the attention of the president from other activities for several years.

A further activity in this area is to continue reporting to the management team on the results of past acquisitions. When there have been failures, the CFO can use this information as a learning tool, so that the management team will be less inclined to make the same mistake again when deciding whether to engage in other acquisitions in the future.

A final thought is that the proper analysis of proposed acquisitions can require an enormous amount of time and a broad range of skills, so the CFO will likely have to delegate this task to a review team. The CFO then formulates a go/no go recommendation based on the findings of the review team.

Habit #5 – Act on Risk

Any business is subject to a wide range of risks. For example, having facilities in a flood plain presents the risk that flooding will shut down operations and cause massive damage. Or, a supplier could be in the same situation, so that flooding of the supplier's facility will result in an interruption of the company's supply chain. Yet another example of risk is that a key employee with sole knowledge of an in-house computer system will be incapacitated or leave the company. With some thought, one might come up with dozens or even several hundred risks for which there is a reasonable possibility of occurrence. When a risk actually occurs, an organization may be put out of business for some time, or even be forced to declare bankruptcy.

The solution is our fifth habit for an effective CFO – to identify risk and take action when needed to mitigate or even eliminate the risk. In some cases, risk can even be used as a tool to *increase* sales. By properly managing risk, a business can smooth out its earnings (when deflecting certain risks) or increase its earnings (when using risk as a competitive advantage).

Risk management can be used to mitigate the occurrence of unusual expenses, so that the actual expenses incurred are much closer to budgeted expectations. This is particularly important for a publicly held company, which can then give the investment community reliable guidance about its future results. When a business consistently reports earnings that do not vary much from predictions, investors will probably keep the stock price within a relatively narrow range, and there will be no reason for any investors to engage in short selling. Another benefit is that reliable earnings attract lenders, so that a business is more likely to be offered reasonable interest rates and longer-term lending arrangements. Lower interest rates reduce the cost of a firm's capital, so that it can invest in more projects that have lower projected returns. Having longer-term debt arrangements means that a business can more easily weather market crises, since it does not have to constantly roll over its debt into new loans.

The CFO can enhance earnings by actively identifying opportunities that are risky, but which also generate high returns. For example, an organization might choose to start doing business in a country where profits could be substantial, but where there is also a risk of currency devaluation. Taking this approach can result in higher profits, but those profits are also likely to be more variable – very high in some periods, but with notable losses in others. This use of risk management works well when the management team is willing to aggressively pursue profits.

The most likely scenario in a well-managed business is that management takes advantage of both types of risk management. They are well aware of the risks to which the business is subjected, and take steps to mitigate risks in certain areas while accepting the risk associated with selected business opportunities. The CFO can assist the team by showing them a range of outcomes depending on the occurrence of various events, such as a supply chain disruption.

The amount of risk taken on by a business depends on the comfort level of the management team. Some may prefer a highly stable environment from which the probability of risk has largely been reduced, while others are more comfortable taking large chances throughout the organization in order to pursue the possibility of maximizing profits. The CFO will need to gauge the team's comfort level with risk, and tailor her recommendations accordingly.

The analysis of potential risk to which a business is subjected should not be a casual affair, but rather a studied one. This means keeping a running list of problems that other companies have encountered within the industry and in adjacent industries, and reviewing the list at regular intervals to see if events have made any risks more or less likely. As was the case with several previous habits, this analysis can require a substantial amount of time, so the CFO may need to delegate the work to a subordinate.

The identification of risks may present opportunities; a company could launch initiatives in new areas that competitors might consider excessively risky. This is particularly likely when a higher level of risk is accompanied by a greater chance of reward.

EXAMPLE

There is a general dearth of storefronts near a certain section of coastline, since it has been hit by three hurricanes in the past ten years. A real estate company is fully aware of the hurricane risk, and develops a new building design that mitigates the risk of storm damage by elevating the first floor of the building, leaving room for storm waters to flow under the building. The company successfully builds and operates these structures, which survive several additional hurricanes with minimal damage. In this case, the company is fully aware of the risks, and chooses to proceed in a manner that mitigates those risks.

EXAMPLE

A CPA firm has just been devastated by a major tornado that wiped out a large part of the city in which it is located. It could take the prudent path of following the other CPA firms out of town, to relocate to a safer city. Instead, the partners decide to construct a robust safe room for the employees that will also contain client files, and markets this upgrade as a document storage facility for clients. The result is a major boost in business, especially since most of the other CPA firms have fled the city.

A reverse way of looking at risk-related opportunities is to evaluate when to exit an excessively staid business. A low-risk environment tends to also generate low returns, so it can make sense to see if any product lines or customers that have a combination of low risk and low reward should be eliminated. This point is related to our earlier Habit #2, Prune the Business.

EXAMPLE

Gulf Coast Insurance is evaluating its hurricane insurance to see if there are any opportunities to improve its overall rate of return. An examination by geographic region discovers that the Tallahassee area has not borne the brunt of a hurricane for some time, which has resulted in a gradual decline in the insurance rates that can be competitively set in this area. Management concludes that the margins are too low in this region, so it elects not to renew policies in this area, and instead focuses its sales force on other areas where the claim risk is higher, but where prices are also higher.

Habit #6 – Monitor Cash Flows

A business flourishes when it is watered with a sufficient amount of cash, and withers when there is not enough cash to support it. Thus, cash flow is absolutely critical to the viability of an organization. The trouble is that many parties contribute to cash inflows and outflows, with no central coordination. For example, the credit manager may grant a request to a customer for an inordinately long payment period, not realizing that doing so results in a negative cash flow situation for the business as a whole. Or, a buyer in the purchasing department decides to accept a good deal on a bulk purchase of a key commodity, resulting in a massive cash outflow for raw materials that may not be used for months. In both cases, someone relatively low in the corporate hierarchy is making decisions that could trigger a last-minute scramble to find new financing to make the next payroll.

The solution is our sixth habit for an effective CFO – to monitor cash flows and take action to ensure that cash is available when needed. This is especially critical when an organization has few financial resources available in the form of debt or equity, and so must rely upon its operating cash flows to fund the business. Or, an entity may suffer from occasional sharp declines in cash flows, which require immediate funding to offset. In either case, the CFO must have an adequate forecasting system in place to give adequate warning of a problem.

The existing cash forecasting system may not be adequate. It contains information from many parts of a business, and some of this information may be incorrect – or missing. The CFO will need to continually review the accuracy of the forecast, comparing its projections to actual results, and adjust both the model and the information feeds to increase its accuracy. This is an ongoing effort, since the business is likely changing over time, which will alter the sources and quality of cash flow information.

This habit does not just involve tweaking the cash flow model and observing the results. In addition, the CFO must foster a network of funding providers that can provide cash within the forecasting time frame. This means having relations with lenders and investors that are close enough to ensure that additional funds can be obtained with a few phone calls.

Further, the CFO needs to educate everyone within the organization who has an impact on cash flows. To use the preceding examples, this means having a discussion with the credit manager about the impact of his decisions on cash flows, as well as a talk with the buyer about the negative effects of bulk purchases. This may include sharing the cash forecast with people well outside of the management team, which builds a broad awareness of the need to manage cash flows.

An indirect benefit of this educational effort is that the CFO will build up a broad network of contacts within the organization. This network can then be used in other ways, such as to give the CFO early warning of problems within the organization that are not being reported through the company's normal monitoring systems.

In short, the maintenance of a functional cash flow system not only keeps a business healthy – it is also one of the key drivers of a CFO's network of contacts, both within and outside of an organization.

Habit #7 – Manage Strategy

The company president is supposed to be in charge of strategy, setting the overall vision for the organization. However, someone with leadership characteristics does not necessarily have the managerial skills needed to develop a comprehensive written strategy that is well thought out. The result can be a business where the management team has a clear understanding of the general corporate direction, and yet there is no documented plan. When this is the case, there is a good chance that no one has ever investigated the financial implications of the strategy, or explored worst-case or best-case scenarios, capital requirements, and so forth. In this situation, there is a heightened risk that the company will encounter an unexpected failure point, and not be able to achieve the president's vision for the firm.

The solution is our seventh and last habit for an effective CFO – to manage the corporate strategy. The key word in this final habit is *manage*. The president is still in charge of the overall vision, while the CFO

translates it into a document in which all possible aspects of the vision have been considered and tested. For example, the vision created by the president might be:

> The company will be the pre-eminent provider of food carts in North America.

The CFO needs to examine every aspect of this simple vision statement and see if it will actually work. To continue with the example, this means that the following questions must be answered:

- *Market*. How large is the North American market for food carts? What are the barriers to entry? Who are the other players in the market? What are their strengths and weaknesses? How will they react when the company tries to take away their market share? How does one establish a niche in this industry?
- *Sales and marketing*. How are food carts sold to customers? Is a sales force needed, or can sales be shifted to an in-house sales group? What about the cost of a commission plan? Do customers expect a discount for bulk purchases? How are prospective customers made aware of the company?
- *Competitive factors*. Which product features are most important to customers in their buying decisions? Graphics? Food cooling equipment? Burners? Cash security? Ease of cart movement?
- *Regulatory*. Are food carts regulated? If so, what requirements are imposed, and what is the associated cost? Is this cost passed through to the customer? Is regulation a barrier to entry?
- *Capital requirements*. What investment in plant and equipment will be needed to attain the sales level needed to be the market leader? How frequently must this investment be replaced?
- *Financial*. Given the previous information, what kind of returns can the company expect? What happens to the returns in a worst-case scenario? How can the company be structured to reduce its losses if the worst-case scenario occurs?

Based on this analysis, the CFO provides feedback to the rest of the management team regarding weaknesses in the strategy and how to guard against them, as well as the steps needed to achieve the plan. Over time, the CFO also provides feedback regarding how the company is progressing against the plan. In addition, if the management team is contemplating any changes in direction, the CFO can adjust the plan to account for the changes, and show the team the financial impact of the changes.

This final habit is not a minor issue, for it is extremely common that the president's vision is not fully thought through, resulting in critical weaknesses that can destroy a business. For example, the food cart scenario just used was based on a real situation in which a food cart manufacturer actually *was* trying to become the market leader, based on a simple vision statement. The president made a large investment in capital equipment and new hires, and was surprised when new sales never materialized. The reason was that no one had ever estimated the total size of the market, which was miniscule. If the vision had been properly vetted, the investment never would have been made.

In short, managing the corporate strategy is an essential part of the CFO's job, and it is one that needs to be an ingrained, long-term habit.

Bonus Habit – Search for the Next Crisis

Many companies have extensive metric reporting systems that are designed to bring problems to the attention of management, such as excessively overdue receivables or an unusually high level of customer turnover. The universal problem with these metrics is that they were originally developed to spotlight issues that the company experienced in the past – they do a terrible job of highlighting the *next* crisis. To combat this situation, it is quite worthwhile for the CFO to develop contacts deep within the organization and among the firm's suppliers and customers, and routinely ask them about the newest issues that appear to be impacting the company. For example, the lead shipper on the shipping dock might be aware of problems with inadequate shipping containers, while customers may express dissatisfaction with the quality level of the latest product, and the lab manager is concerned about the quality of the ingredients in the latest food

product. Establishing and maintaining this broad range of contacts gives the CFO a massive amount of information that does not come from established information channels, and which can occasionally be used to detect problems before they can become full-blown crises for the business. In effect, this informal network can mitigate the risk of sudden losses by dealing with issues when their effects are still quite small.

Comparison of the 7 Habits to the CFO Job Description

We have just described seven of the most crucial activities in which a CFO should be engaged. How do these items compare to the standard job description of a CFO? The following job description represents the normal set of responsibilities for a CFO, which encompasses the administrative, financial, and risk management aspects of a business. The description is split into the following five general areas:

- *Planning*. This involves the formulation of the strategic direction of the business and the tactical plans, budgeting systems, and performance metrics required to achieve that direction.
- *Operations*. This involves the direct oversight of a number of departments, as well as coordinating the operations of those departments with other areas of the business. It can also include the selection, purchase, and subsequent integration of acquired businesses.
- *Financial information*. This involves the compilation of financial information into financial statements, and the presentation of this information to various internal and external recipients.
- *Risk management*. This involves understanding the current and potential risks to which the business is subjected and taking steps to mitigate those risks.
- *Financing*. This involves monitoring projected cash balances and arranging for either additional financing or investment options, depending on the amount of expected cash balances.

More specifically, the CFO’s job includes the following tasks:

Planning

- Develop a strategic direction for the business, along with supporting tactics
- Monitor the progress of the company in meeting its strategic goals
- Oversee the formulation of the annual budget
- Develop a system of performance metrics that support the company’s strategic direction

Operations

- Manage the accounting, treasury, tax, human resources, and investor relations departments
- Oversee the activities of any supplier to which functions have been outsourced
- Participate in the functions and decisions of the executive management team
- Implement operational best practices throughout his or her areas of responsibility
- Engage in acquisition selection, purchase negotiations, and acquiree integration into the business

Financial Information

- Oversee the compilation of financial information into financial statements, with accompanying disclosures
- If the company is publicly held, certify the financial statements filed with the Securities and Exchange Commission (SEC) as part of the Forms 10-Q and 10-K
- Report financial results to management, the board of directors, and the investment community

Risk Management

- Understand the current and potential risks to which the business is subjected
- Take steps to mitigate risks, including the use of control systems, shifting risk to other parties, and insurance coverage
- Report on risk issues to the board of directors
- Ensure that the business complies with all regulatory and other legal requirements
- Monitor known legal issues involving the company, as well as legal issues impacting the entire industry
- Review and act upon the findings and recommendations of internal and external auditors

Financing

- Monitor projected cash balances
- Arrange for financing to meet future cash requirements
- Invest excess funds based on projected cash balances
- Invest funds on behalf of the company pension plan
- Maintain relationships with banks, lenders, investors, investment bankers, and outside analysts

Our first habit, searching for financially viable solutions, does not appear in the job description at all. This is because it is more of a mindset than a specific job responsibility, to be applied whenever dealing with suggestions coming from other parts of the business. Our second suggestion, pruning the business, also does not appear in the standard job description. The reason is that the job description is oriented toward maintaining existing operations, rather than reducing them. The third habit, managing the bottleneck, also does not appear in the job description. The bottleneck is almost never located within the finance and accounting areas, so it would not occur to someone writing the job description to include it. The fourth habit, advising on acquisitions, *does* appear in the job description. However, our recommended habit is to act as a brake on prospective acquisitions, whereas the job description implies that the CFO should assist in completing them. The fifth habit, acting on risk, approximately follows the job description, though the habit is slanted more in the direction of using risk as a strategic tool. The sixth habit, monitoring cash flows, closely follows the job description. Finally, the seventh habit, managing strategy, is relatively close to what is stated in the job description. In short, roughly half of our recommended habits for an effective CFO do not even appear in a standard CFO job description.

Another concern with the standard CFO job description is the extent to which it is *unrelated* to any of the seven habits. We note the following items:

- Oversee the budget
- Develop performance metrics
- Manage various departments
- Oversee certain suppliers
- Implement best practices
- Oversee financial statement preparation
- Report financial results
- Regulatory compliance
- Act on audit recommendations
- Invest excess cash
- Invest pension funds

The preceding items from the job description are essentially busy work for the CFO. They involve daily management tasks or efficiency improvements, but do not elevate the effectiveness of the organization as

a whole. Consequently, the CFO needs to minimize the time spent on these tasks or delegate them entirely, in order to focus more attention on the seven habits.

Summary

In this course, we have shown that the actions of an effective CFO depart substantially from the actions stated on a normal CFO job description. By focusing on our seven habits, a CFO can focus on the activities that really matter in a business, allowing it to select the right vision that is financially viable, ensure that funds are not spent incorrectly, and maintain a sufficient flow of cash into the business. By following the seven habits, the CFO becomes a valuable, proactive member of the senior management team.

The seven habits we have described can be overwhelming. They require a significant time investment, spent in detailed analysis work. Consequently, the CFO will need to delegate a large part of the analysis effort, focusing instead on making recommendations based on the results of those analyses.

We close with a reiteration of the seven habits, which are as follows:

1. Search for financially viable solutions
2. Prune the business
3. Manage the bottleneck
4. Advise on acquisitions
5. Act on risk
6. Monitor cash flows
7. Manage strategy

Review Questions

1. The following is an action that can remediate the effects of a bottleneck:
    a. Bring in substitutes when machine operators are taking a break
    b. Prune back on excessive amounts of preventive maintenance
    c. Cut overtime
    d. Reduce the travel budget of the sales staff

2. A side effect of reporting earnings that do not vary much from predictions is:
    a. A stock price that moves within a narrow range
    b. An increase in short selling
    c. Lower interest rates on debt
    d. Shorter-term debt arrangements

3. The following are elements of a CFO job description that relate to the seven habits, except for:
    a. Monitor projected cash balances
    b. Understand the potential risks to which a business is subjected
    c. Regulatory compliance
    d. Develop a strategic direction for the business

Answers to Review Questions

7 Habits of Effective CFOs
Review Answers

1. The following is an action that can remediate the effects of a bottleneck:
    a. Bring in substitutes when machine operators are taking a break
    b. Prune back on excessive amounts of preventive maintenance
    c. Cut overtime
    d. Reduce the travel budget of the sales staff

    a. **Correct. When substitutes replace the regular staff of a bottleneck machine during break periods, the machine can continue operating, which reduces the amount of the backlog at the bottleneck.**
    b. Incorrect. Preventive maintenance is needed to prevent a catastrophic failure of a bottleneck machine, which would result in much more downtime than is required by the preventive maintenance.
    c. Incorrect. When overtime is reduced at a bottleneck operation, there is less labor available to service the operation, resulting in a reduction of processing time.
    d. Incorrect. When the sales staff is the bottleneck, it may need an extensive travel budget in order to visit customers and close deals. Cutting the travel budget will therefore reduce sales.

2. A side effect of reporting earnings that do not vary much from predictions is:
    a. A stock price that moves within a narrow range
    b. An increase in short selling
    c. Lower interest rates on debt
    d. Shorter-term debt arrangements

    a. **Correct. When investors continually see earnings being reported at levels near their expectations, share prices tend to stay within a narrow range, since there is little uncertainty about earnings.**
    b. Incorrect. When earnings rarely fluctuate, short sellers are not attracted to the stock, since there is a minimal likelihood that the stock price will decline.
    c. Incorrect. When a business reports consistent earnings over time, lenders are more interested in issuing debt, and so will offer lower interest rates on the debt.
    d. Incorrect. When lenders feel secure about a company's reported earnings trend, they are more likely to allow longer lending periods.

3. The following are elements of a CFO job description that relate to the seven habits, except for:
   a. Monitor projected cash balances
   b. Understand the potential risks to which a business is subjected
   c. Regulatory compliance
   d. Develop a strategic direction for the business

   a. Incorrect. The monitoring of projected cash balances is an essential part of Habit #6, which is the ongoing monitoring of cash flows.
   b. Incorrect. Understanding potential risk is a key part of Habit #5, acting on risk, since one must first understand the risk environment before taking action.
   c. **Correct. Regulatory compliance is a requirement of the job, but it does not elevate the effectiveness of the organization.**
   d. Incorrect. The development of a strategic direction is essentially a restatement of Habit #7, to manage the strategy. The president sets the vision for the business, and the CFO converts the vision into a workable strategy.

Glossary

B

Bottleneck. A point of congestion in a system that limits the system's total output.

C

Cash flow. The net amount of cash moving into and out of a business.

Chief financial officer. The senior person responsible for the financial activities of a business.

E

Effective. To do the right thing or produce the desired result.

Efficient. The maximization of productivity.

H

Habit. Engaging in an activity on a regular basis, to the extent that it is hard to give up.

R

Risk. A probability of damage or loss.

S

Strategy. A plan for bringing about a desired future outcome.

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Final Examination

The final examination for this course is provided below. Feel free to circle your choice for the best answer to each question. To enter your answers online and receive an immediate grade and completion certificate, follow these steps:

1. Go to www.accountingtools.com/cpe
2. Click on the "Access the Training Module | Complete a Test" button near the top of the page.
3. Login with your user name and password.
4. Select the **Take a Test** option and then select the **Programs** option. Click on the program that you want to take.
5. Take the test. You can stop and restart the test at any time.

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1. An example of effectiveness is:
    a. A product is designed within the minimum possible time frame
    b. A product is designed that meets the expectations of customers
    c. A company invests in computer-aided design software to assist its product developers
    d. Product design specifications are discussed by e-mail, rather than in person

2. The communication of a financially viable alternative should include:
    a. A clear understanding of the consequences of a strategic direction
    b. The reasons why a suggestion should not be pursued
    c. The chain of approvals needed to enact it
    d. The required rate of return

3. Pushing for a pruning action introduces what risk?
    a. That assets will be eliminated that actually provide outsized returns
    b. That cash flows will turn negative
    c. Upheaval in the management suite
    d. That the CFO will gain a negative reputation

4. The CFO's primary role in a prospective acquisition is to:
    a. Secure the required funding
    b. Be the negative influence in making a purchase transaction
    c. Conduct due diligence
    d. Examine the tax effects of the deal

5. An adequate cash forecasting system requires the CFO to:
    a. Switch to an automated forecasting model
    b. Close the books faster
    c. Educate everyone who has an impact on cash flows
    d. Install a better capital budgeting system