CFO Insights

Are you a strategic CFO? Seven essential questions

As the CFO role continues to evolve, it is imperative that finance executives up their game strategically. That doesn't mean simply knowing the latest strategy theory or fad. It means being able to advance your organization's growth or improve its competitive position by identifying the key constraints holding it back, and then using finance to free it from those constraints. In other words, today's environment requires a CFO to be not just a strategist, but a *pragmatic* strategist.

To get there means cultivating a mind-set where you ask the right questions about where your company is currently positioned, what is holding it back from achieving its potential or what could hold it back, and then framing what you might do to move the company forward. In this issue of *CFO Insights*, Ajit Kambil, Ph.D., global research director for Deloitte's CFO Program and a director with Deloitte LLP, draws from his experience leading the Deloitte CFO Transition Lab™ program worldwide to explain how CFOs may become more pragmatic strategists and in the process identify opportunities for finance to create value.

The critical questions

Some CFOs may have a strategic mind-set naturally. But based on the outcomes of more than 100 Labs, it is clear that such a mind-set may also be cultivated by asking the following seven questions:

1. **How does your company plan to grow: through M&A, organically (i.e. by driving new or existing products to new or existing markets), or both?** The first and most straightforward question involves knowing the current strategy: What combination of these growth choices is your company currently committed to? The CFO's role then is to make sure that capital is available at the right cost for these choices to be profitable, and that the company has processes and decision-making rules for capital allocation to support that growth.

2. **What are the dominant constraints that hold back your company's growth, and how might you overcome them?** The dominant constraints are the issues that prevent a company from reaching its potential. Consider a company with a heavy debt burden that was paying an interest rate more than twice the rates available to its competitors. Here the cost of debt capital was a critical constraint, given that competitors could finance growth through M&A and other strategies much more cheaply. In response, the CFO enabled a sale of a large stake in the company to a strategic investor, raising capital and relaxing the "finance constraint." Other types of constraints include the lack of a needed or key product in the pipeline or simply the mind-set and culture of the company (see "Navigating change: How CFOs can effectively drive transformation"). Of course, some constraints are virtually impossible to overcome. For example, regulations in financial services impose new constraints on banks. Other than finding efficient ways to comply, CFOs can do virtually nothing to change the regulatory constraints. Still, determining the dominant constraints is the first step for a CFO to take in order to relax or overcome them.[1]

3. **What is the greatest uncertainty facing your company, and what can you do to resolve or navigate it?** Say the company has potential asbestos liability because the chemical was formerly used in some products, and the uncertainty around that liability is constraining the company's share price and keeping it from making aggressive growth plays. That doesn't sound like something a CFO can fix. But what if you were to go to the legal counsel and say, "Let's figure out what it would cost to settle this potential litigation, and see, given our current cash flows and the low-rate environment, whether it's worth that price to get rid of that uncertainty." Alternatively, CFOs can ask their finance, planning, and analysis (FP&A) organizations to model the consequences of different outcomes, and then decide if they want to insure against risks arising from the uncertainty. Uncertainty can "freeze" decision-making; CFOs can "unfreeze" those decisions by gathering information to resolve the uncertainty, instituting a structure to navigate the uncertainty while managing risk through insurance, or developing a step-by-step approach to real-option investment as uncertainty is resolved.

4. **What is your greatest area of spend where there is a lot of uncertainty about return?** For example, a CFO of a consumer packaged goods company with a big chunk of spend going to advertising and promotion should ask, "How can I get greater bang for my buck in my advertising and promotion spend, and how do I make headway on measuring returns from promotions to guide future spending?" Creating clarity and better disciplines on spend are often a source of quick strategic wins.

5. **Are your company's financial and growth goals ambitious enough?** What would we do differently if the company were an order of magnitude bigger? Say your company's goal is to double its revenues, from $2 billion to $4 billion, and you're looking at a variety of projects to achieve that growth, but some entail a lot of risk because of the dollars involved. The CFO might look at this challenge and say, "A $400 million project blowing up is going to do some serious damage to a $2 billion company, but not so much to a $20 billion company. So maybe our ability to invest in future growth is enhanced by increasing our scale not by two times but by 10 times through a series of rollups or acquisitions." If you bring that option to your CEO and board, you've started a conversation that could be truly game-changing for the company. It is easy to get trapped in the present. But thinking substantively beyond existing constraints and limits can sometimes help identify plays that create dramatically new strategic options.

6. **What could disrupt your company, and what can finance do about it?** This is about envisioning a competitor's move such as a merger or a new industry entrant that changes the nature of competition or a new technology that dramatically changes product offerings. Again, CFOs can ask if they themselves could use the likely playbook of a competitor to disrupt the industry and also leverage FP&A capabilities to model out disruptive scenarios and help frame responses.

7. **What would you like your company to stop doing?** Finally, are there underperforming business units or a part of the company that does not generate required returns, or customers who are not profitable? If there isn't a way to scale the business to increase returns, it may be best to dispose of it and free capital and management resources to grow more high-potential businesses. Similarly, choosing not to serve unprofitable customers or to increase prices to them may increase long-run returns.

A matter of pragmatism

All of these critical questions help CFOs identify strategic opportunities and cultivate a strategic mind-set. But even the most strategically oriented CFOs cannot succeed as an island. They cannot bring a new product into the fold unless they partner with product development, and they cannot change the promotional spend model unless they are able to work closely with marketing and sales leaders. The above questions empower CFOs as strategic thinkers because the answers can generate pragmatic starting points for a conversation with the CEO and other leaders on ways to improve company performance through finance-driven and other solutions.

By asking the above questions and formulating solutions around them, the CFO can be the pragmatic strategist by addressing critical constraints, uncertainties, and performance issues through tangible and realistic actions to move the company forward. Others on the team can push forward new product, product differentiation, or market strategies, but the CFO can keep them honest about the economic returns and viability of different positioning strategies, while creating value in the immediate context. While there are many theories, models, and fads in strategy, addressing the above questions can focus the leadership team on pragmatic and tangible ways to grow forward.

Endnote

[1] Eliyahu Goldratt's book, *The Goal: A Process of Ongoing Improvement,* (North River Press, 1992) first introduced me to the theory constraints, which I have found practical and useful in engaging a broad class of problems.

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