



STUDY NOTE - 1

OVERVIEW OF FINANCIAL MANAGEMENT

SECTION- 1

FINANCE AND RELATED DISCIPLINES

This Section include

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1.1. FINANCE AND RELATED DISCIPLINES

- 1.1.1 Finance refers to funds required for a business or an activity. 'Finance' requirements of an enterprise is not 'one time' but recurring. The discipline of financial management as a separate and distinct subject of study has evolved over a period of time. The subject has its origins in Economics. However, it has today grown into a specialized discipline, integrating knowledge from many diverse fields as explained further in this chapter. The head of finance, also called Chief Financial Officer (CFO) must possess adequate skills and exposure in the following areas.

1.2. ECONOMICS

- 1.2.1 The mother discipline relating to human's economic endeavors is Economics. It deals with various factors of production, the returns available on each of them, costs and revenues and so on. A fundamental knowledge of Economics is essential for the finance manager to understand the macroeconomic environment in which an organization operates and the micro economic or firm level impact of macro economic environment.



1.3. ACCOUNTING

- 1.3.1 Accounting is the recording of financial transactions of an organization and is based on several principles, conventions and legal requirement. It provides the basic data for financial analysis. It helps the Finance Manager analyse, understand and interpret the implications of finance decision on the profitability and viability of the enterprise on a time frame.

1.4. MATHEMATICS AND STATISTICS

- 1.4.1 Today's world of finance has become a lot more sophisticated and complex, relying heavily on mathematical models and therefore, in certain areas of finance such as analytics or risk modelling, knowledge of mathematics and statistics have become essential. Financial modeling has become a separate subject by itself.

1.5. COSTING

- 1.5.1 Cost efficiency is a major strategic advantage to a firm, and will greatly contribute towards its competitiveness, sustainability and profitability. A finance manager has to understand, plan and manage cost, through appropriate tools and techniques including budgeting and Activity Based Costing.

1.6. LAW

- 1.6.1 A sound knowledge of legal environment, corporate laws, business laws, Import Export guidelines, international laws, trade and patent laws, commercial contracts, etc. are again important for a finance executive in a globalized business scenario. The guidelines of Securities and Exchange Board of India [SEBI] for raising money from the capital markets are an example. Similarly, now many Indian corporates are sourcing from international capital markets and get their shares listed in the international exchanges. This calls for sound knowledge of Securities Exchange Commission guidelines, various listing requirements of international stock exchanges operating in different countries etc.,.

1.7. TAXATION

- 1.7.1 A sound knowledge in taxation, both direct and indirect, is expected of a finance manager, as all financial decisions are likely to have tax implications. Tax planning is an important function of a finance manager. Some of the major business decisions are based on the economics of taxation. A finance manager should be able to assess the tax benefits before committing funds. Present value of the tax shield is the yardstick always applied by a finance manager in investment decisions..



1.8. TREASURY MANAGEMENT

- 1.8.1 Treasury has become an important function and discipline, not only in banks, but in every organization. Every finance manager should be well grounded in treasury operations, which is considered as a profit center. It deals with optimal management of cash flows, judiciously investing surplus cash in the most appropriate investment avenues, anticipating and meeting emerging cash requirements and maximizing the overall returns. It helps in judicious asset liability management. It also includes, wherever necessary, managing the price and exchange rate risk through derivative instruments. In banks, it includes design of new financial products from existing products.

1.9. BANKING

- 1.9.1 Banking has completely undergone a change in today's context. The type of financial assistance provided to corporates has become very customized and innovative. During the early and late 80's, commercial banks mainly used to provide working capital loans based on certain norms and development financial institutions like ICICI, IDBI, and IFCI used to provide long term loans for project finance. But, in today's context, these distinctions no longer exist. Moreover, the concept of development financial institutions also does not exist any longer. The same bank provides both long term and short term finance, besides a number of innovative corporate and retail banking products, which enable corporates to choose between them and reduce their cost of borrowings. It is imperative for every finance manager to be up-to date on the changes in services & products offered by banking sector including several foreign players in the field thanks to Government's liberalized investment norms in this sector.

1.10. INSURANCE

- 1.10.1 Evaluating and determining the commercial insurance requirements, choice of products and insurers, analyzing their applicability to the needs and cost effectiveness, techniques, ensuring appropriate and optimum coverage, claims handling, etc. fall within the ambit of a finance manager's scope of work & responsibilities.

1.11. INTERNATIONAL FINANCE

- 1.11.1 Capital markets have become globally integrated. Indian companies raise equity and debt funds from international markets, in the form of Global Depository Receipts (GDRs), American Depository Receipts (ADRs) or External Commercial Borrowings (ECBs) and a number of hybrid instruments like the convertible bonds, participatory notes etc., Access to international markets, both debt and equity, has enabled Indian companies to lower the cost of capital. For example, Tata Motors raised debt at less than 1% from the international capital markets recently by issuing convertible bonds. Finance managers are expected to have a thorough knowledge on international sources of finance, merger implications with foreign companies, Leveraged Buy Outs (LBOs), acquisitions abroad



and international transfer pricing. The implications of exchange rate movements on new project viability have to be factored in the project cost and projected profitability and cash flow estimates. This is an essential aspect of finance manager's knowledge. Similarly, protecting the value of foreign exchange earned, through instruments like derivatives, is essential for a finance manager as the volatility in exchange rate movements can erode in no time all the profits earned over a period of time.

1.12. RISK MANAGEMENT

1.12.1 Modern business is fraught with various types of risks and is an integral part of the finance function. Proper identification of risks, installation of appropriate risk control measures, risk transfer mechanisms through hedging, insurance, etc. are key responsibilities of a finance executive. A finance manager has to deal with three types of risk viz., price risk, interest rate risk and exchange rate risk. Price risk is all about fluctuations in commodity prices going up or coming down, interest rate risk is all about interest rates moving up or down and exchange rate risk means volatility in exchange rates. For managing each of these types of risks, appropriate hedging tools have to be used. Knowledge of such tools is a pre-requisite for a finance manager. Besides the knowledge, the cost of using such tools should not be more than the benefits. Also, the timing of judgement is a crucial aspect in this respect.

1.13. INFORMATION TECHNOLOGY

1.13.1 Information technology is the order of the day and is now driving all businesses. It is all pervading. A finance manager needs to know how to integrate finance and costing with operations through software packages including ERP. The finance manager takes an active part in assessment of various available options, identifying the right one and in the implementation of such packages to suit the requirement.

1.14. MANAGEMENT

- 1.14.1 Of course, a finance professional when matures and moves up in the hierarchy of an organization, he or she becomes an important executive, taking a broader view and caters to a wider range of stakeholders. A sound knowledge in general management principles and strategy confers significant advantage and enhances the finance professional's overall performance.
- 1.14.2 Above all, he or she is expected to possess significant skills in people management. Modern management is all about managing talent, motivating people and ability to work as a team and influencing people, both within and outside the organization.
- 1.14.3 Refer to the articles given at the end of the chapter. The article titled, "The Essential Skills", gives a comprehensive overview of the skills of a Chief Financial Officer (CFO). The role of a CFO, in India and elsewhere, has metamorphosed into a more all round role.



1.15. SOFT SKILLS

1.15.1 Any senior executive in today's competitive business world is expected to have considerable proficiency in various soft skills. The most important of these is communication – both verbal and non-verbal.

1.15.2 The article titled “You're On” shows the importance of possessing good presentation skills a CFO is expected have and the type of audience he / she has to handle today.

1.16 CASE STUDY

The Essential Skills

To ascend to (and remain in) the CFO's office, you need much more than financial acumen. Alix Stuart, CFO Magazine, November 1, 2007

No one becomes a CFO without possessing the commensurate finance skills. No one thrives as a CFO, however, without having much more. As Scott Simmons, vice president of Crist Associates, a Chicago-based recruiter, puts it: “No company wants just a really good finance person anymore; they want someone who can go beyond that.”

But exactly what are those other essential skills? What capabilities, talents, and expertise should be in a CFO's toolbox no matter what industry or company he works for or challenges she may face?

To hear CFOs tell it, “toolbox” may be the wrong metaphor: magician's bag of tricks is more like it. There's nothing easy about mastering the soft skills they say are essential, and which seem to boil down to clairvoyance, X-ray vision, and the ability to bend time. Ultimately, however, there is a common theme. “Once you get past the technical skills, it's all about people — communicating with them, developing them, empowering them, and listening to them,” says Charles H. Noski, retired CFO of AT&T and Northrup Grumman. “If you do those things well, it will contribute to your success as an executive, whether you're a CFO or not.” Patience, experience, and a solid dose of intuition can help you round out your financial acumen with the following tricks of the trade.

Time Benders

Every executive knows all too well that a 24-hour day can feel woefully insufficient. Overload may be a way of life in finance, but there are ways to cut through the clutter.

Stephen D. Young, CFO of time-management consulting firm and accessory-maker Franklin Covey, tells his staff to stop producing any information they deem unimportant and “see if anyone notices.” That advice has led to a 40 percent reduction in the volume of data reported over the past two years. For example, “rather than having a budget-versus-actual analysis sliced five different ways, we slice it two different ways, and rather than have 15 different inventory reports we have 10,” Young says.



Young also takes a merciless approach to his E-mail inbox. He glances at it several times a day but doesn't respond to any messages until the end of the day unless they are clearly urgent. That establishes a very high bar — Young says he leaves about 60 percent of his messages unopened.

Frank Gatti, CFO of ETS, also relies on a strict E-mail hierarchy. "Not all E-mails are of equal importance," he says. Aside from those sent by his CEO, "investors and bondholders come first. Respond quickly even if you don't have all the facts, just to let them know you'll get back to them when you do."

Managing Up

Every CFO has to deal with a CEO, and figuring out how to make the boss happy is a skill no aspiring finance chief can be without. "The CEO connection is the single most important thing a CFO must understand and maintain," says David Johnson, CFO of The Hartford Financial Services Group. While a sound strategy will depend on myriad interpersonal factors, Johnson says he thinks a critical element is candor, which is key to becoming a trusted adviser to the CEO.

"You need to know what your CEO's hot buttons are: what's important to him, what is he being judged against, what's his value system?" says Tony Panos, a consultant who developed and teaches a class on managing up for one of Cornell University's extension schools. "Anything you suggest should fit into that. You should demonstrate how you are helping him meet his goals."

But what about managing up to a dictatorial CEO? The advice is the same, Panos says, but he recommends looking a bit deeper for motive. "People who are dictatorial tend to have some level of fear driving them. Start by looking at what those fears are and how you can mitigate them."

The Art of Saying No

CFOs are often labeled as the original "Dr. No," and in fact they may be more likely than other senior executives to put the kibosh on ill-advised plans or projects. But many CFOs agree that a thumbs down, or any form of unwelcome news, can be delivered professionally and with a little less sting.

One way is to "help people feel like they're coming to a decision together," says Bright Horizons Family Solutions CFO Elizabeth Boland, by giving them the facts and the potential risks rather than a final answer. Richard Fearon, CFO of Eaton Corp., says that listening can make all the difference. "You just need to hear the idea through so that no one feels short-changed," he says. In a well-managed company, he adds, the CFO won't have to play the heavy very often, because bad ideas will usually be weeded out before they get to his door.

Sometimes, of course, the CFO will have to say no. The toughest situations, in Boland's view, are those in which the lack of revenue potential "makes it really evident that a proposal is not even worth talking about." She counsels patience. "We try to talk through all possible revenue opportunities," she says, "before saying it won't work." When all else fails, says



Fearon, you simply turn the tables. “I just ask what the person would do if he or she owned 100 percent of Eaton.”

Vetting Vendors

Third-party consultants, contractors, and service providers have become essential in this era of increased regulation and outsourcing. And thanks to Sarbanes-Oxley, not only has “reliance on third-party vendors reached a new extreme,” says Jeff Burchill, CFO of FM Global, but so has the complexity of deciding which firms to hire. In the past, the decision was based largely on who was the low bidder. But now that public-company CFOs face a potential personal liability regarding the quality of financial reporting, “price may not even come up,” Burchill says. Consequently, CFOs often have to be “personally involved in the selection process,” he says.

That means digging deep on references. Ideally, have a technical person on your staff find out exactly how a consultant handled, say, a software conversion at the reference’s company and what complications ensued, says Bright Horizons’s Boland. Then ease into the relationship slowly, signing up for only a short project to start. Build in time for unexpected problems.

Setting out detailed, measurable expectations can help guide the relationship. “You don’t want to micromanage what you’ve outsourced, so you need to have the right reference points to measure them against,” says ETS’s Gatti. He recommends asking the vendor for an easy-to-read dashboard showing early warning signs for problems, along with more-detailed weekly or monthly reports.

Finally, realize that managing vendors now carries the additional burden of being responsible, at least to a degree, for the quality of their internal controls. “It’s bad enough trying to monitor your own internal controls,” Stephen Bainbridge, a law professor at the University of California, said at a recent symposium. But overseeing another company is “more difficult and more expensive.”

Develop X-ray Vision

The CFO is in a unique position to have a window into every aspect of a company, but that’s no substitute for real vision.

“We participate in or lead some of the most complex decisions an enterprise can make, so one of our jobs is to see the consequences of all those paths that others can’t see,” says The Hartford’s Johnson. And that, says Robert Mittelstaedt, dean of Arizona State University’s business school and board member at two public companies, requires being “analytic enough to constantly think about ‘what-if’ scenarios.” After all, CFOs “are better versed than anyone about the financial implications of any of those risks,” he says.

Many CFOs are analytic by nature, of course, but Johnson says that what really helps hone a CFO’s powers of perception is trouble, and the more the better. “Until things go very



wrong in ways that were completely unanticipated, you don't develop those skills," he says. And he should know. Having helped clean up fraud at Cendant and worked with companies in bankruptcy as an investment banker, Johnson has seen his fair share of crises. He actually reads forensic audit reports of disasters at other companies to help keep him on his toes.

Legal Ease

The last thing any company needs is a lawsuit. But in Corporate America, they come with the territory. Patent infringement, employee discrimination, workers' compensation, and, perhaps scariest of all, securities class-action cases are all a fact of life.

The real issue is risk avoidance, and there are some simple safeguards, says Cynthia Jamison, national director of CFO Services for Tatum LLC. For example, "Have routine legal forms that are used for 'usual' business [that is, customer contracts, NDAs, option agreements, and so on]. Then, whenever something is out of the ordinary, or someone requests a substantial change to normal policy, call a lawyer."

Bill Stephan, the former CFO of Harborside Healthcare, added another layer of protection. "We had a policy that no field personnel could enter into contracts." Instead, the company, an 80-location nursing-home operator, mandated that only the CFO and the in-house counsel were allowed to sign. But Stephan avoided bottlenecks by pledging to turn around any documents very quickly — often in the same day.

Having a good working relationship with your counsel — whether inside or outside — can be a safeguard in itself. In fact, says John Iino, a partner at Reed Smith LLP and co-chair of the firm's Corporate & Securities practice group, lawyers are most efficient "when they are kept close to the internal decision makers." Only then, he adds, can they help companies "draw the line between legal compliance and financial compliance" in such areas as executive-compensation disclosure. Stephan worked close enough with his inside counsel, in fact, that he became adept at spotting legal red flags.

Of course, there are times when outside counsel must be called in. This is especially true, says Jamison, "if you are in a defensive posture — say, a customer threatens to sue or you get subpoenaed for a court appearance." That's when the CFO's skills come in handier than ever. "It's just like managing anything else," says Stephan. "You want someone who is working in your best interest. And you want to avoid anyone with a tendency to overlawyer or who's just out to win points." If you don't, you'll regret it when the bills come in, he adds.

Street Talk

Increasingly, a wide range of stakeholders want direct access to the CFO. Knowing what communication techniques work with which audiences can help finance shine, both within and outside the company.

But honing your skills as a public face of the organization requires a bit of homework. Before his company went public in March, Steffan Tomlinson, CFO of Aruba Networks, listened in on



some 20 conference calls and kept a log of questions asked by analysts so that he would know just what to expect when Aruba held its first call. From that, he learned that “tone and tenor mean a lot, especially over the phone,” and “how you answer questions about competitors is telling.” He says that when executives on one of the calls he listened in on stumbled over certain questions, their company was soon described by an analyst as faltering.

Frequent calls, road shows, and meetings can be a grind, but Boland of Bright Horizons says it’s critical to stay focused. “You get very routine about how you do your presentations and what you think people want to know,” she says. “Try to hear what they’re really asking.”

If the audience is internal, be prepared to forgo finance jargon in favor of plain English. “I’ve worked with many CFOs who aren’t CPAs but became CFOs because they were able to synthesize financial information into something useful,” says Bruce R. Evans, a managing partner at private-equity firm Summit Partners. Offer a few select bar charts and graphs when possible, instead of tables of numbers. And don’t talk too much. “Even when the work behind something is extremely complex,” says Gatti, “your audience really just needs to know the headlines.”

Leading by Example

As the head of the finance department, the CFO must lead and inspire — and know when to get his hands dirty.

It is a delicate balance, says Joseph E. Esposito, recently retired CFO of Concord, Massachusetts-based SolidWorks Corp. “You have to demonstrate that you are a leader, but without interfering.” That means offering the guidance and counsel of a top executive, he says, but letting your employees do their day-to-day jobs. Boland echoes that idea: “As CFO, you’ve got the title and authority to be involved, but you have to make other functions feel like you’re an assistant, that you’re there to make them look good.”

There are times, however, when the pressure is such that a CFO must step into the fray. Esposito has found that a particularly effective approach is to jump in as a short-term project leader. As a CPA, he says, there have been many times when he’s been able to lead a technical project, such as dealing with stock-options accounting, and that when he has done so it has come as a big relief to his staff. “To them, something like that is just a big pain in the neck,” he says, “since many have never seen it before and may never see it again.”

At the same time, sometimes it’s the little things that count. For ETS’s Gatti, for example, leading by example means getting his expense reports in on time so that he can encourage others to do the same.

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You’re On!

Sharpening your presentation skills.

Kate O’Sullivan, CFO Magazine

July 01, 2004



The stammering, the sweating, the laptop that freezes and leaves the speaker stranded at the podium: presentations like this are the stuff of nightmares. Today, finance executives are presenting to everyone from employees to equity analysts, and they're taking steps to avoid such disastrous trips to the microphone.

According to corporate-presentation coaches, the CFO is a major client these days — not to mention a major challenge. “It started with the whole stock-market run-up, when all the investor activity put the CFO in the spotlight,” says Deirdre Peterson, a New York-based communications trainer who says she's been coaching more finance executives than ever lately. “Now they're in the spotlight because they're being scrutinized.”

For both outsider and insider audiences, today's CFO is often the one expected to deliver the hard financial news about a company, whether good or bad. Finance executives convey those messages in traditional forums such as board meetings, departmental gatherings, and industry conferences, as well as, frequently, over the telephone in news interviews and earnings calls with analysts. “There's a sense of credibility about the financial picture when you're hearing the numbers from the CFO,” says Timothy Cage, also a New York-based communications coach.

Some of the presentation challenges finance executives face are universal. “The most glaring problem I see is a lack of connection with the audience,” says Cage. “What to a busy executive may seem like a professional, brisk, coherent approach comes across as cold, aloof, uninterested, and uninteresting.” Dan MacLean, a senior faculty member at Communispond, a New York communications training company, agrees. “Most people don't come across the way they think they do,” he says. The ubiquitous technique of videotaping speakers and allowing them to watch themselves is a powerful — if often painful — tool for trainers to illustrate this point.

But there are dangers, like information overload, that are more specific to the CFO. “CFOs have a ton of information to present, and their tendency is to want to display it all and, frankly, bore the audience to tears,” says MacLean. “Investors need the information, but not all of it.” Finance executives may “think a lot about what they're going to say, but it's how they deliver the words that gives them their impact.”

Then there's the seemingly dry material. “Compared to a marketing presentation, where the material could be about ideas, image, or a new program,” says Peterson, a CFO may find that “just walking through the numbers can get really boring really quickly.” And unlike sales and marketing executives, who may receive more presentation training, CFOs often don't learn intonation and gesturing techniques for capturing audiences.

“It's Not Intuitive”

Kevin Gregory sought out communications training in 2002, after he ascended to the finance chief's job at ProQuest Co., a \$470 million electronic-content publisher based in Ann Arbor, Michigan. “For a lot of people, myself included, presenting is not intuitive,” says Gregory. “And I had not had a lot of experience with it in the controller role.”

With a schedule that lately has included a number of shareholder and analyst phone calls and “mini road shows” with investors, Gregory says he now represents the company to the



outside world once a week on average. He has learned to maintain an awareness of the listener's perspective when preparing a presentation. "It's easy to jump into a discussion and assume that there's a certain level of understanding that's just not there" when addressing unfamiliar groups, he says. "If you just start drilling down immediately, you're going to lose everybody. You need to start with the overall premise and then work through the specifics."

It is vital to set a tone that's tailored to your particular audience, says Peterson. Investors, especially, "don't want overt spin." While the CFO's approach must be "more than just reciting the numbers," she says, "it can't become too promotional, either."

David S. Johnson, CFO of Carter & Burgess Inc., an engineering and architectural firm based in Fort Worth, learned the importance of effective presentations during his 15-year tenure at General Electric Co., where he listened to such speaking legends as former CEO Jack Welch and former finance chief Dennis Dammerman. In the time between leaving GE and landing his current post in 1998, Johnson took a course from Communispond to hone his skills.

"As you move from one job to the next, the amount of presenting you have to do goes up dramatically," says Johnson. Especially after moving into "a leadership role like CFO or high-level controller, the ability to speak to large groups is critical." At Carter & Burgess, which has a workforce of around 2,300, Johnson says that training employees through presentations saves significant time and effort. Giving a targeted talk about the bottom-line benefits of facilities leasing, for example, helps him avoid answering dozens of questions on the subject later.

Between training sessions and investor meetings, Johnson says, he sometimes finds himself talking to groups as often as three times a week. "There's such an incredible jump in the impact you have when you're an effective speaker," says the CFO. "And it doesn't take a lot of effort to do it right."

Say What?

Some speaking tips from the experts.

Know the audience. Instead of "What do I want to say?" think "What does the audience need to hear?" suggests Communispond's Dan MacLean.

Focus on delivery. "Voice quality matters," says trainer Deirdre Peterson. Especially on the phone, keep listeners alert with "verbal flags like 'our top priority' or 'the key thing.'"

Don't just read figures off a page or a computer screen. "It looks like the CFO lacks confidence in the numbers," notes communications coach Timothy Cage.

Keep PowerPoints basic. Don't "get too complex with animation and flying bullet points," says MacLean. Emphasize important points and skip the extras. "Sometimes we give PowerPoint a little too much power."