



STUDY NOTE - 5

FINANCIAL STRATEGY

SECTION - 1

INTRODUCTION TO FINANCIAL STRATEGY

This Section includes

- **Concept of Financial Strategy**

1.1. WHAT IS FINANCIAL STRATEGY?

- 1.1.1 Financial strategy is a topic of importance to middle and senior line managers, who face regularly a multiplicity of financial issues in their organisation. A sound financial strategy seeks to answer:
- a. How does a Chief Financial Officer (CFO) determine the long-term target capital structure?
 - b. When to form holding and subsidiary structure or branch offices or subsidiaries overseas?
 - c. When and how should a company go public?
 - d. Is it better to take a company private in a leveraged buyout or to borrow money and repurchase stock?
 - e. Can a CFO use derivatives in structuring acquisitions and share buybacks?
 - f. How does a CFO benefit out of doing business in other countries?
 - g. Above all, how can a CFO make sure that everyone in the company contributes to the common objective of maximising shareholder value?
 - h. How much should one pay for a company? ?
 - i. What is the best way to fight a hostile bid?
- 1.1.2 Strategic financial decisions are based on rigorous cash-flow forecasts, together with accurate estimation and management of risk. It focuses on shareholder value creation, explore ways of increasing that value – both real and perceived – through:
- a. astute choice of financing methods
 - b. financial restructuring, such as recapitalisations, share buybacks and leveraged buyouts



- c. asset restructuring, such as takeovers, mergers and acquisitions, spin-offs and equity carve-outs
- d. credible and compelling communication with shareholders
- e. developing a strong culture where all decision makers are motivated to create value
- f. understanding how to increase the value of the company by appropriate investment
- g. developing knowledge about the financial markets – particularly how the markets perceive the CFO's decisions and how CFO can change their perceptions
- h. appreciating the financial strategy issues that affect the organisation.
- i. undertaking financial analysis of the organisation and interpreting the results in the context of lending and investing decisions.
- j. assessing the financial risks that the organization faces, in particular credit, interest and foreign exchange risk and adopting risk-hedging strategies that suit the risk profile of the organisation.
- k. understanding how the organization should measure financial performance internally and how the financial performance is assessed by stakeholders in a global context.
- l. Benchmarking strategies with competitors in Industry globally without restricting Comparisons to only local players.

BEST PRACTICES IN CREATING A STRATEGIC FINANCE FUNCTION

An SAP/APQC Collaboration

In the wake of recent accounting scandals and in the increasingly competitive business environment, many CFOs and the finance organizations they lead have started to take on new strategic roles within the enterprise. They are aiming at enforcing stricter control processes to ensure legal and regulatory compliance, offering strategic insights into the internal and external business environment, and connecting the business strategy with daily operations through performance tracking.

The trend toward a more strategic role is echoed by the responses of participants in recent research conducted by APQC, an internationally recognized nonprofit organization that provides best-practice research, metrics, and measures. The participants indicated that, three years down the road, they anticipate spending 30% more time on decision support and management. According to the same research, however, in spite of their aspirations, participants have not made much progress toward a greater strategic role. Finance organizations, no matter what their size, report to APQC that they still spend almost two-thirds of their time on transaction processing and controls and only one-third on decision support and management.



The difficulty in evolving the finance role lies in bridging the current gap between the finance function that emphasizes greater efficiency and the finance function that becomes a partner in managing the business. The best companies have found that reaching the goal of a more strategic finance function warrants a two-step approach, as follows:

1. These companies improve the efficiency of the various functions that come under the finance umbrella and, in the process, free up corporate resources for other activities. As one global treasury manager put it, “We must develop a finance function that is as efficient as it can be, replicate it globally, and then use it effectively to help us quickly establish brands and enter new markets.” Companies like this one choose a variety of approaches to streamline and automate finance functions while ensuring that they keep customers happy (in the case of shared-services arrangements).
2. With the efficiency of the transaction and control functions assured, these companies can turn to devising a more strategic approach for finance – giving finance not only more of a decision-making responsibility in risk management and compliance but also a proactive role in managing the daily cash position and thus increase resources for quick strategic moves.

One global consumer products company took a two-step approach to a more strategic path for finance. In the first step, the company developed a more efficient cash management, accounts payable, and accounts receivable group of functions in its worldwide operations, based on greater transparency of information. In the second step, the company developed

“straight-through processing” along every level of the finance function, leveraging its global reach to maximize cash management efficiency, foreign exchange exposure, and the global supply chain to help fund growth, participate in new marketing and distribution arrangements, and comply with worldwide regulations.

CONCLUSION: A CHECKLIST FOR A STRATEGIC FINANCE FUNCTION

The best companies, and their CFOs, recognize the importance of ready access to the right information to drive the right choices between different variables. To help determine whether your finance function is moving toward a strategic approach, take a moment and decide whether your system does the following:

- Accelerates closing processes through automation, workflow, and collaboration
- Improves business analysis and decision support by providing historical and forward-looking views, including benchmarks
- Deploys performance management tools that analyze the company and its resources
- Maximizes cash flow through improved billing, receivables, collections, payments, and treasury management



- Increases effectiveness of compliance efforts through comprehensive auditing, deeper reporting, and management of internal controls (Sarbanes-Oxley)

In addition, a truly integrated systemic foundation should help you achieve the following:

- Develop a closed-loop management process of strategy formulation, communication of goals, and measurement
- Monitor the performance of strategic key success factors using external and internal benchmarks
- Use tools that support a financial planning process that integrates global strategic planning and specific operational planning problems in a closed-loop process

In a similar way, you can also determine whether you are on the right track if your financial software provides the following:

- A single source for financial information (a prerequisite for managing business processes beyond financials more effectively)
- More timely access to accurate data, improving communication between finance and operations
- Increased alignment between front- and backoffice applications, enabling management to better administer and track business strategy and decisions
- Reduced cost of compliance with industry regulations (U.S. Financial Accounting Standards Board and Sarbanes-Oxley)
- Improved security and controls and reduced risk of contractual and regulatory non-compliance
- Improved predictability, particularly with budget

One CFO admitted, “Until we began to appreciate the importance of simplicity in thinking through our finance function and making it more strategic, we did not realize the way that technology can help you deal with complexity, and allow you to achieve the strategic goals finance should achieve.”

Are You a Strategic CFO?

As far as they’ve come, many senior finance executives still have the nagging feeling that they could be doing more.

Lisa Yoon, CFO.com January 11, 2006

Bean counter. Numbers cop. Chief financial officers have long outgrown those stereotypes;



today a more appropriate description might be business partner, strategist, first deputy to the CEO.

Yet as far as they've come, many senior finance executives still have the nagging feeling that they could be doing more. Dan Chenoweth, a Denver-based business consultant and former finance executive, believes there are several reasons why finance chiefs don't always play a big enough role at the strategy table:

- First is the lingering self-perception of being the “reporter”; some CFOs don't view themselves as a partner with the rest of the senior team.
- Another reason is the famous finance-chief personality — reserved, reactive, even passive in the strategic-planning process.
- Finally, says Chenoweth, CFOs still tend to view their ultimate responsibility as fiduciary — saving company funds and reining in spending — rather than taking on the broader role of value creator.

That CFOs have these characteristics and self-perceptions is “an increasingly invalid generalization,” maintains Steve Wasko, chief financial officer of Northbrook, Illinois-based Nanosphere Inc. He points to a shift in management philosophy from a model centered around the chief executive, in which senior managers carried out the CEO's vision, to today's increasingly team-oriented approach, in which the CFO and other senior managers help shape the company's direction and run the show.

Melissa Cruz, CFO of Waltham, Massachusetts-based BladeLogic, takes a more abstract view: “The role of the CFO is about imagining the future with the management team,” she explains, “and then translating that into financial action.”

Chenoweth does agree that there has been a “profound change” in the role of CFOs in recent years, but adds that they could “do more to blow their own horn at the strategy table.”

“Do you still see CFOs with green eyeshades?” says Wasko. “Absolutely. But companies that have such CFOs are at a disadvantage.”