CFOs IN PE-BACKED COMPANIES

STRIKING A BALANCE

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The global financial slowdown sweeping across most of Europe and North America raised several questions around how CFOs should position themselves as harbingers of value creation in their organizations. Having played the role of digital evangelist in the frenetic digital transformation exercise during the immediate post-pandemic days, CFOs saw their responsibility basket grow beyond the measuring, managing, and reporting of traditional elements of financial value. To this were added sustainability goals as natural extension. However, the one thread that ran through this gamut of functions that were either subsumed or brought into direct line-of-sight of a CFO was the enterprise's profitability goals. Because everything that they do has to help the business sell more or get better prices for their products or services.

Creating business value, then, is at the core of the CFO function and will remain so till such time as a new entity called the Chief Revenue Officer (CRO) joins the finance team. Several large corporations have in fact added this position to their leadership team because they are aware that scaling a business is no simple task, especially in big businesses. A McKinsey report notes that barely 10% of S&P 500 companies have achieved growth surpassing the GDP for a continuous period of three decades or more.

And executives that achieve these numbers do so by breaking the force of inertia to rethink growth strategies and taking decisive action to put the talent and resources on to a well-defined growth plan. And yet again, the CFO is tasked with developing analytics-based insights for this very plan.

However, when it comes to the PE-backed start-up segments, the CRO remains a distant future, which means it is once again the head of finance that needs to take ownership of developing scale. We bring this up because the first two quarters of 2023 have been especially grim for early-stage start-ups. Taking to his social media handle investor Tom Loverro recently spoke of an impending "mass extinction event for early and mid-stage companies", and warned that "late 2023 and 2024 will make the 2008 financial crisis look quaint for startups." Traditionally, 90% of these companies could potentially go belly-up, says San Francisco-based research group Startup Genome. With funds drying up and VCs cherry-picking the winners they want to further invest in, the CFO becomes mission-critical for value creation within an enterprise – the only metric that is capable of generating confidence and getting investors interested.

TAKING A LEAF OUT OF THE PE INDUSTRY PLAYBOOK

In the given scenario where growth is not guaranteed across small, medium and large enterprises, the CFOs of these enterprises could do well to take a leaf out of the playbook of their counterparts in the PE industry, one that has seen prolific growth over the past decade. During this period, their assets under management grew from $2 trillion in 2013 to $4.4 trillion in 2022. Credit is due to the CFOs and COOs of these firms for sustaining such growth. An EY Global Private Equity Survey notes that the PE CFO's role evolved in direct proportion to the size and complexity of the company.

From leaders of finance functions that include accounting, taxation and accounts payables, they shifted to strategic roles that provided insights to investment professionals and portfolio companies while managing a larger talent pool. In other words, the CFOs upped their game in the digital transformation initiatives as data, analytics, and actionable insights rolled into a "single vision of truth" for each stakeholder who grappled with strategic transactions – be it selling equity in a company or acquiring a new business.

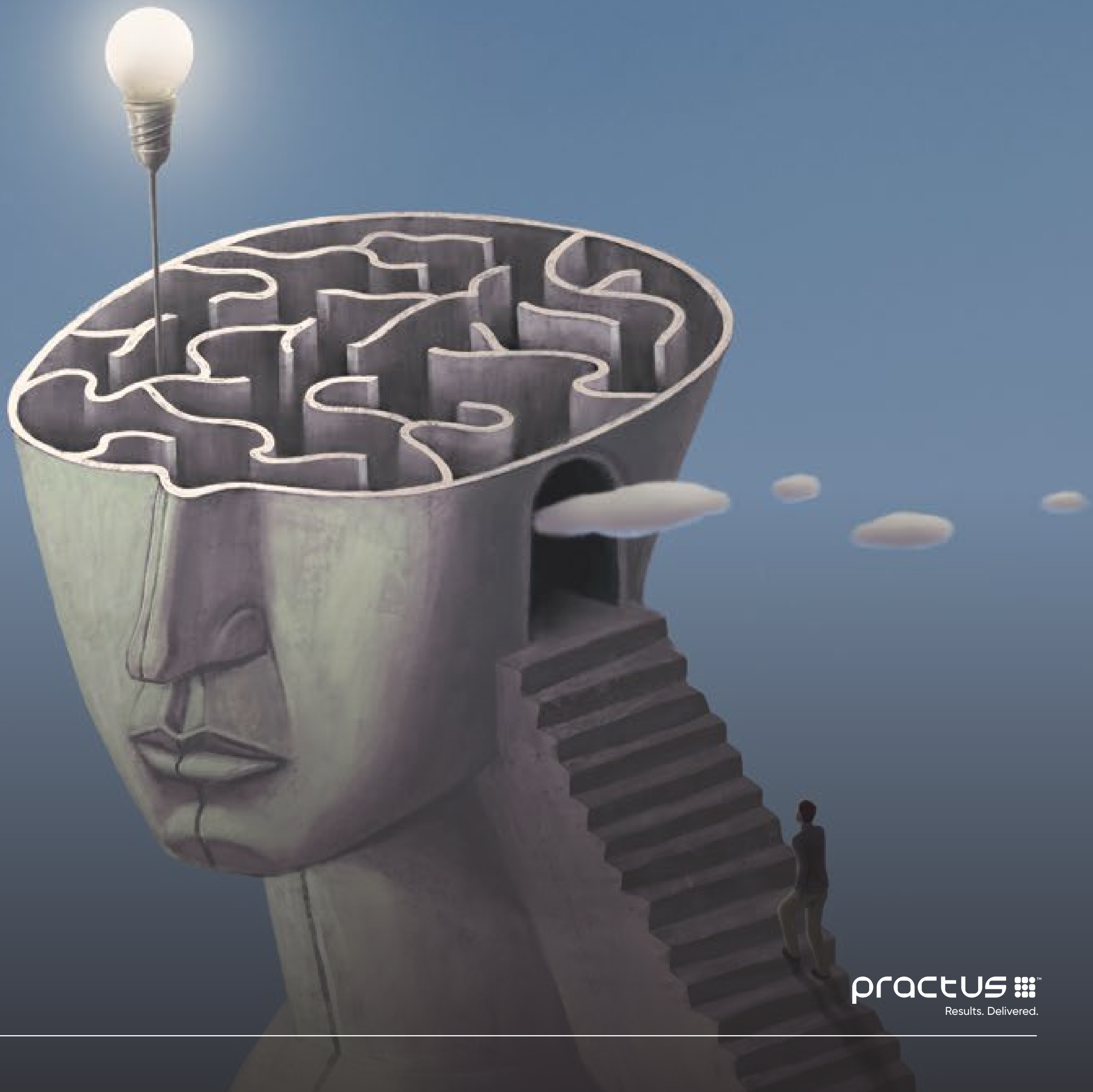
Build up the company infrastructure with a view to better supporting the decision-making with a clear focus on enhancing data management and reporting to key stakeholders.

Accept that the future would require their roles to expand into that of strategic leaders for the organization that provide relevant data and analytics to draw actionable insights in the way of changing business situations.

Further augment their strategic focus on talent management because retaining and attracting talent will be key in a volatile marketplace.

(Source: EY.com)

The report further notes that in the years ahead, the CFO's role in talent management could become mission-critical in how the enterprise perceives and goes about value creation. Though the same could hold true for every enterprise across every industry vertical, what varies would be the definition of value creation in these diverse sets of enterprises. Besides achieving sustainable cash flow growth through organic means such as optimizing the existing business, deepening market penetration, and expanding customer offerings, while also keeping their eyes peeled for inorganic asset growth through acquisitions or integrations.



A HARD LOOK AT VALUE CREATION AND ITS ROLE

In the current global milieu with no dramatic collapses (such as Lehman Brothers in 2008) or housing market meltdowns, the uncertainty is what makes the CFOs role more important. As inflation refuses to let go of North America and Europe and interest rates remain high, the CFOs have no choice but to manage higher costs through optimization options. McKinsey's analysis of Q2 2023 corporate results indicates that inflation remains the top threat to growth. However, the good news is that finance leaders aren't hunkering down but appear keen to adapt to these economic headwinds, says the latest Mckinsey's CFO Pulse survey. PE-funded companies find themselves in an unenviable position where they need to maintain cash reserves while going after new markets or new solutions to assist growth. Does it mean the CFO now needs to wear the Chief Marketing Officer's (CMO) hat as well?

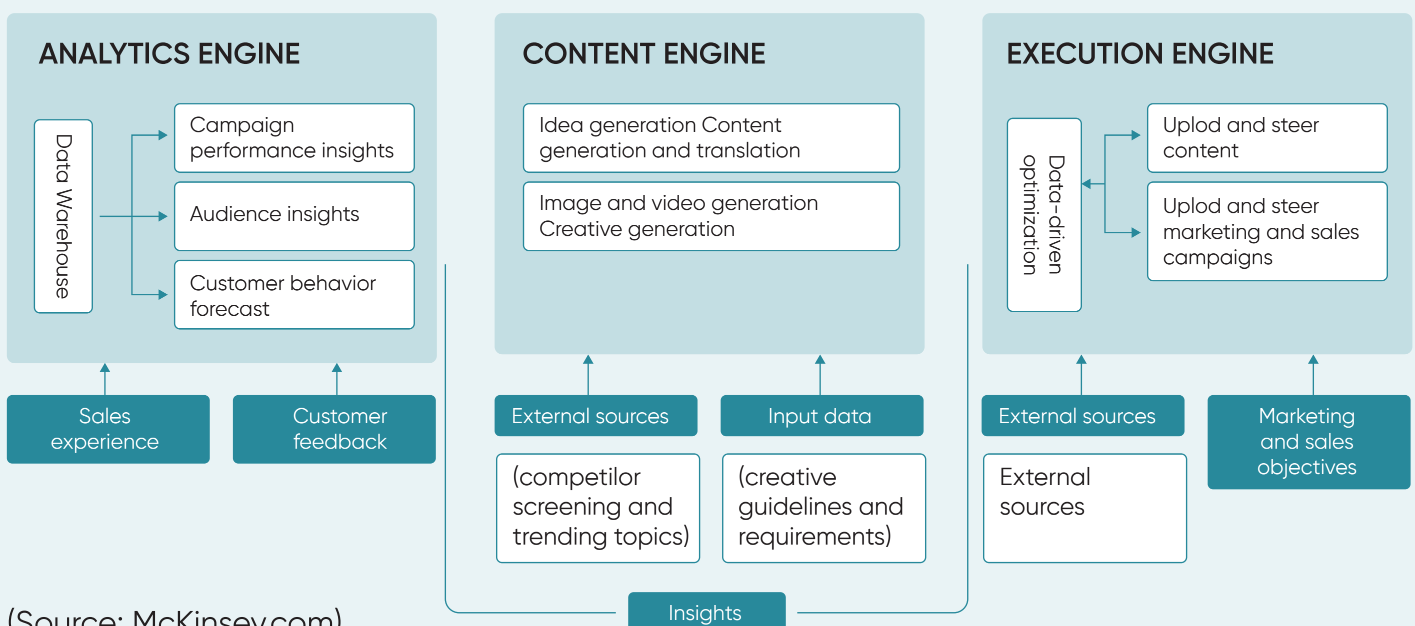
Not really. But they would compulsorily need to become part of discussions that help maximize sales. Creation of a single revenue engine that starts with lead generation in digital marketing to closing the sale is all the more imperative when the markets aren't conducive. And this is not just about marketing; the entire customer journey landscape needs to be mapped as part of strategic growth plans. To do so, there needs to be an understanding of customer success so that business development initiatives get the right alignment vis-à-vis people, processes, and technology and then broadens it across the entire revenue cycle, irrespective of a company's size or turnover. In other words, the CFO must harmonize people, data, and measurements across their sales and marketing teams too. From addressing valuation questions related to key business events and routine transactions to guiding stakeholders in understanding the true meaning of "value," these CFOs have their jobs cut out. Their sharp assessment of value creation at any point in an organization's journey now becomes the guiding force.

ADAPTING TO CHANGE... FAST

In the wake of the economic downturn, numerous organizations are reevaluating their core principles and business models. This unprecedented threat to value creation has compelled businesses to prioritize employee safety, consumer satisfaction, and closer collaboration with suppliers, governments, and communities. The way CFOs respond to these challenges will significantly impact investors' and society's perceptions for years to come. The old mindset was that financial information and returns to shareholders are the only indicators of success. However, for long-term success and building strong relationships and trust, it is crucial to adopt a broader perspective on value creation that encompasses the interests of multiple stakeholders, not just shareholders. The Business Roundtable's statement on the purpose of a corporation supports this idea.

In recent times, the one idea that has enchanted the industry revolves around Generative AI and the multiple roles it can play across operations. So the first question that a CFO could probably ask is how can it help take total responsibility for revenues, even at the business unit level? Of course, there is no need to broaden the scope before finding a solution to one business unit. The CFO can deploy a member of the finance team to oversee processes around analytics and automation and go-to-market strategies. This is where a Generative AI engine could play a significant role, says a McKinsey report that highlights the importance of a Chief Revenue Officer in the C-suite.

Generative AI supports the automation and acceleration of the content engine, illustrative example



(Source: McKinsey.com)

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A VALUE CREATOR IN PE-BACKED VENTURES

To transform from a perceived back-office function to a trusted business partner, it is essential for CFOs and finance functions to focus on value creation. This means understanding and effectively communicating how their organization generates and safeguards value in both the present and the future. The CFO's team are integral to effectively navigating the intricate challenges of achieving long-term viability and short-term stability. To effectively guide a company towards sustainable growth, they should consider a diverse array of stakeholder interests and external factors that can influence financial performance and shareholder value. While traditional financial metrics such as the balance sheet are important for accounting purposes, they are not the best indicators of performance or value.

Today, success goes beyond satisfying shareholders, and involves establishing and presenting value for all stakeholders, while also meeting societal expectations for sustainability and larger impact. CFOs have to guarantee that critical information on value creation performance, opportunities, risks, and trade-offs is accessible to internal decision-makers, investors, and capital sources. Thanks to digitalization and data capabilities, CFOs can now become more effective business partners within organizations. According to the International Federation of Accountants (IFAC), a corporate performance and value scorecard should encompass three perspectives of value creation – organizational, shareholder, and community perspectives. By adopting this holistic approach, it fosters shared value and accountability for all stakeholders involved.

A comprehensive value creation process requires a careful balance of financial, nonfinancial, and pre-financial measures and indicators. These encompass both book business metrics and societal value metrics. Key Value Drivers (KVDs) capture the crucial factors that influence future net cash inflows to the company, along with associated opportunities and risks. However, relying solely on metrics and KVDs that track private gains and losses is not enough. Businesses should focus on social value, the broader impact on customers, employees, communities, and the environment. Quantifying these effects helps organizations assess their influence on important stakeholders and make informed decisions. Let us dive deep into these approaches:

Be done with the basics

The balance sheet is a crucial financial statement for evaluating a company's book value and reflects historical transactions. GAAP and IFRS accounting standards are essential. However, it lacks accounting for strategic assets and intangibles essential for gaining competitive advantage and creating expected value.

Beyond fund allocation

The CFO of the future needs to go beyond merely allocating funds strategically across product development, marketing, and sales. They need to collaborate with the sales and marketing teams to develop comprehensive marketing strategies and monitor their progress, while raising the requisite flags for slowing down or speeding up.

Expanding perspectives

A fact-based perspective to evaluate assets, support structures, and operations that drive value demands stronger alignment with other operations teams and the Board. CFOs need to analyze the impact of past decisions and future events and encourage critical thinking by overcoming decision biases. Questioning existing structures, processes and budgets also form a part of this expanding perspective.

Action-oriented mindset

Generating data, analytics, and insights alone won't get the job done; CFOs in PE-funded enterprises need to strategize for action around risk profiles, incentives, and measurements beyond short-term goals. Which means that avoiding tough decisions and postponing decisions can hurt shareholder returns, as noted by McKinsey.

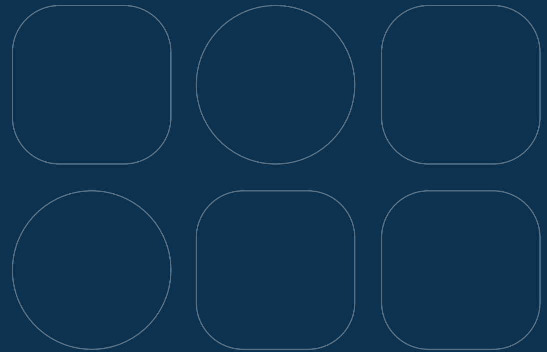
Explaining the numbers

While the numbers themselves are important, their criticality comes into play only with the proper context. As business complexities grow in the wake of competition, it is becoming imperative the CFOs discuss data and its consequences while sharing their concerns early enough to instigate solutioning.

Investor's Perspective

Business (expected) value – derived from strategic and intangible assets that create future growth and serve as the foundation for residual revenue, long-term profitability and valuations, and risk reduction.

THERE IS MUCH MORE A CFO CAN ACHIEVE



While these specific changes listed above ensure a business-as-usual approach, enterprises are now awake to the fact that non-tangibles are as valuable as the tangibles for growth. The likes of ESG scores will play an increasing role as businesses struggle to control their expenses on valuable and limited resources required for their growth. Forward-thinking organizations recognize this importance and incorporate non-financial value drivers into their strategic objectives through approaches like the balanced scorecard or similar performance management approach.

However, it is not just ESG scores that a CFO needs to be concerned with while driving value creation for the stakeholders. These intangible assets include customer and supplier relationships, extensive research and development efforts, intellectual property, innovative ideas, talented individuals, expert knowledge, data analytics capabilities, and advanced technology systems. A study conducted by intellectual property merchant bank Ocean Tomo reveals that intangible assets are the driving force behind over 90% of business value. In other words, the traditional book value pales in comparison to market value, as the true hidden worth lies within intangibles. To tap into this hidden value, CFOs should implement appropriate measurement techniques and gather qualitative information.

IN A NUTSHELL

THE CFO IS RESPONSIBLE FOR VALUE CREATION

As discussed earlier, the CFO's ability to use past experience translates into actionable inputs that provide valuable lessons, constant enhancements, and repeatable actions. At the end of it all, it is the CFO's role to create a single revenue generation engine that can fulfill cash flow requirements and build up reserves for growth – both organic and inorganic – or even an exit that provides private equity investors with substantial profits and creates an industry-leading business model. Towards this end, the CFO needs to focus on three steps:

Data management

related to marketing, outbound sales, and inbound activities should be a part of the finance team's oversight function, whereby dashboards are created, tracked, cumulated, and stored in a data warehouse in the form of inputs for the entire business.

Decision-making

must be linked to the above data repository with the CRM functioning as the heart of the revenue generation engine. Use of AI-led tools that run analytics and generate actionable insights form a crucial part of this process led by the CFO's team.

Action coordination

comes immediately thereafter as the CFO must have an oversight on GTM strategies, communication, customer success, sales, and marketing activities. All of these activities contribute to the eventual revenue generation goals of a business.

That these measures result in tangible outcomes were forcefully represented when a leading German industrial powerhouse started a new venture. In parallel, they developed an AI-based revenue generation engine that used more than ten million data points from multiple sources – from web analytics to sales channels and external databases.

Taking a data-driven approach to value creation, the CFO would always remain in control of their company's ability to attract investments and be ready with answers for prospective investors or buyers. Over the past decade, exit opportunities have also grown and range from an outright sale to joint ventures for business divisions and creating value centers of excellence. It falls on the finance team and the CFO to prepare the groundwork for such instances. In fact, a Deloitte paper describes the modern CFO as playing diverse roles based on the milestone that their company has reached. Starting off with a bullish streak that stops at nothing, the CFO needs to become credible and articulate at the first stage and become detail-oriented to entertain a collaborative work culture at the C-suite, before adopting a forward-thinking approach as the business matures. Here is how they describe the characteristics:

The Bullish CFO

Confident in current market conditions, driving value during exit

The Credible CFO

Articulates the business model effectively, instilling buyer confidence

The Detailed CFO

Ensures financial accuracy and reliability, delivering tangible value

IN CONCLUSION...

As global economies emerge from the current impasse of high interest rates and growing inflation, the CFOs will find themselves playing a larger role in managing the increasingly data-driven world of artificial intelligence and machine learning models. Those that can strike a balance between playing doomsday predictors and champions of growth would find it easier to traverse the journey of ensuring robust growth without sacrificing financial prudence. We will see CFOs become more agile and play a mix of strategic and consultative roles to different operational segments in the business. The siloed approach of yore could spell doom for a business in the absence of a common revenue-oriented goal that requires better customer experience and faster go-to-market opportunities. Whether it is a boot-strapped startup or a scaled-up enterprise, the CFO needs to harmonize all these efforts constantly while shifting their role definitions based on the outcomes expected by other stakeholders. This way, they can use the appropriate strategies at the appropriate time to strike a harmonious balance between maximizing stakeholder value and maintaining sustainable growth.

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