The Defining Attributes of a Successful CFO: Finance

Finance uses the discipline and data from a strong Accounting team as the launching pad for planning and creating their company's future. A seamless handoff between the Accounting and Finance departments is critical in creating and executing an effective strategy. The Finance function is about creating the optimum analytical framework to make strategic decisions.

There are three main building blocks that make up a highly functioning finance department.

1. Budgeting and Planning: The first building block of a finance department is to provide the financial roadmap for the company based on the direction agreed to by the Board of Directors and the Executive team. Companies frequently refer to this as the Budget or Plan. The link between what has been and what we expect will be is the critical handoff that occurs between the accounting and finance teams. For continuity and understanding, the financial reporting structure between the historical financials and budget systems should be the same. You'll know this link is broken when the budget or plan can't be explained in the same terms you narrate your actual results.

Companies can use many techniques and tactics to develop their plan and build a budget. The important products from this process are:

- A narrative that explains the direction the company is headed.
- Forward looking Financial statements (Budgets) with enough detail and at the right intervals to add insight and allow for course corrections as the business environment changes. (Imagine how your GPS corrects your course when a road closes or a traffic jam lies ahead.)
- A sensitivity analysis to help stakeholders understand the expected or potential volatility in financial performance or position.
- Key Performance Indicators (operational and financial) and other ratios of critical importance (bank covenants, bonus targets, "caution signs", etc.)
- Support for the major themes included in your business plan

2. Forecasting: You may have heard this in the past, especially if you have been heavily involved in the planning process, "The budget is stale the day after its published". Unfortunately, that is often the case. Worse, sometimes its stale before its published. The implication in the statement is that the budget process isn't worthwhile. I don't believe that. The process the company goes through to plan for the next year or five years is extremely important. It simple means we need to create the business discipline and expertise that allows us to adjust our operations to real time. This leads us to the second building block of Finance, the forecast.

To develop the forecast the finance team integrates the company's current performance relative to budget with the real-time business environment. The budget to actual comparisons highlight where we have exceeded or not met expectations. Learning what is creating these differences is one of the most valuable insights we can give the company. The objective of the forecast is twofold: first, to build an understanding of how internal and external forces are changing the company's business opportunities and second, to assist the company in taking advantage of or providing a remedy for those changes.

The cornerstone of forecasting is the forecast model. It should be robust enough to capture the major moving parts of your business but nimble enough to be updated quickly. Scenario building and sensitivity analysis are important component of the model. To do this requires inputs such as historical data, trends, opinions, known ensuing variables and projected growth rates in terms of sales, expenditures and financing.

Forecasting to ensure your company is on track for future success should be an ongoing process. One way to build this discipline into your routine is to include a review of the forecast in your monthly management meetings.

3. Investment Analysis: The third building block of Finance is creating the framework to analyze new opportunities as they present themselves. Capital projects, such as an acquisition, building a new plant or licensing technology should be evaluated under a common set of financial criteria to make capital spending decisions effective over time.

This area of Finance is where the deep analytical skills are housed. Company policy on investment criteria originate in this area. The corporate cost of capital, return hurdle rates, tools to communicate investment opportunities, cash flow models to develop returns and the financial analysis of investments/divestments are prepared here.

The resources in this part of Finance are typically focused on the asset side of the balance sheet and must work closely with Treasury to be aware of the capital limitations the company may have.

One reader of an earlier post commented on the way I describe Finance. He said it's basically a traditional FP&A department with an added twist for forecasting. That is basically true. But the key message I hope to have communicated clearly in this series of articles is how each piece is connected to the others. For example, without the Forecasting piece, the Planning building block truly becomes "stale" at its completion. With Forecasting, the Finance process becomes a dynamic, near real-time tool to make your business better.

I have received some very insightful feedback and have had some great learning moments from your responses to our previous articles. Thank you for staying engaged in this discussion.

Catch up on the other 3 articles in the series - The Defining Attributes of a Successful CFO:

If you missed Attribute #1: Accounting? Catch up here.

If you missed Attribute #3: Treasury? Catch up here.

If you missed Attribute #4: Leadership? Catch up here.

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