What it Takes to be a Great CFO

These notes pull from two hour-long conversations with CFOs working at companies that benefited from strong growth under their leadership. Both companies grew from double digit millions of revenue to over a billion dollars in revenue. One company grew entirely organically and the other via acquisition. All names have been changed to fictitious characters from the movie *Wall Street*.

Bud Fox: Bud Fox has held the CFO role at three distinct companies across various industries. He joined [Company A] in 2011, and saw it grow from a lower-middle-market company to north of $1 billion in revenue.

Gordon Gekko: Gordon Gekko's experience includes a variety of leadership positions. Most recently he was the CFO of the fastest growing [industry] company in the country (grew from $50 million to $1.75 billion in 7 years). He is also an adjunct professor of finance.

The Base Requirement

The foundation, as described by Fox, is a thankless job that must be perfectly executed. The critical work, unnoticed by the rest of the organization, is the effort required to close the books, work with auditors, and produce information (examples, but not an exhaustive list). Of the basic, "thankless" functions, Fox also highlighted general ledger reconciliation as a responsibility frequently overlooked. Beyond the obvious benefits, the danger of compounding errors absent this process is that the gaps are plugged, and the discrepancy grows. His concluding comment on the subject, "Ignore at your own peril."

The basic functions of the finance department consume bandwidth and energy that make it difficult to think about the company's future and determine its trajectory. In response, the suggestion, perhaps somewhat ironically after emphasizing the need for these basic functions, was to "get away from the accounting." If the infrastructure is lacking for the basic record keeping required, it would be too difficult to have the time to execute the CFO role.

That said, it should be reiterated that the business is blind without this function. To emphasize this point, Gekko claimed that if he ever found himself overseeing a business that had an excellent controller and an excellent CFO and he could only keep one of them, he would "take the controller every time." This was stated with the idea that the role would ultimately be replaced, so it highlights who a business could operate without on an *interim* basis only.

Transition to CFO

Per Gekko, a CFO generally comes from one of two places: (1) the accounting side of the business, or (2) the finance / business strategy side of the business. As it relates to item one (in general only), accountants, controllers and CFOs see the world differently:

1. Accountants are historians.
2. Controllers struggle to explain what must be done in response to the information produced.

3. CFOs learn to deal with ambiguity and know how to get the CEOs attention.

If you fall into the first category, you must learn how to escape the associated functions and develop a comfortable framework for managing uncertainty. In this regard he echoed Fox's sentiments about getting to personally know all of the players and finding ways to interact with them regularly. Ultimately the transition involves moving from rules to explaining what the future could be.

Information

The CFO role is a bridge between finance and the rest of the company. In that vein it's important to interact with all functions within the organization. Both CFOs commented that they made it a priority to sit in on meetings taking place in other departments to better identify the variables driving growth and profitability. Without this connection, it is difficult to understand the value of the information a company is producing. And the challenge, is that everyone is a "liar" (*used light-heartedly*). Leadership might lead investors with exaggerated potential outcomes in the same way that sales agents will exaggerate the potential revenue derivative of their current pipeline. To understand the reality behind these claims requires interaction. "If the CFO doesn't interact with the rest of the company, then the CFO is a bookkeeper."

On the subject of how information is disseminated, Fox offered three guiding questions:

1. Who needs to know?
2. Who has access to the information and can extract it?
3. How should it be used?

On item three above, Gekko had an entertaining perspective: "Assume senior executives have the attention span of a gnat." The CFO's job is to distill, and if you want to influence change across departments, compelling single-page dashboards are required. You cannot communicate urgency with a 500-tab Excel workbook. Gekko mentioned a simple one-page slide that communicates sources and uses of cash over the course of the accounting period and / or an EBITDA bridge.

For an organization that is not yet producing the desired data, the question then becomes, "How do you blueprint the information desired and turn that blueprint into actionable steps?" This did not gain much traction on either call. [In my opinion we did not have the time to provide sufficient context for a proper assessment.]

Recruiting

While perhaps not stated explicitly, a strong recruiting practice is necessary to have the confidence that the basic functions will continue seamlessly if the CFO is promoted from within. Gekko's comment on the matter spoke to the value lost with a bad hire.[1] The time spent training and in discovery only to find yourself initiating another search for the same position is too costly. For this

[1] Geoff Smart and Randy Street, authors of *New York Times* bestseller *Who*, claim that the "average hiring mistake costs fifteen times an employee's base salary in hard costs and productivity loss." The example provided in the introduction to their book is that "a single hiring blunder on a $100,000 employee can cost a company $1.5 million or more."

reason, Gekko will only consider candidates that are within 1 to 2 degrees of separation, which emphasizes the value of a proper network. (Anecdotally, Gekko's preference is for one degree of separation. As we spoke, one of his analysts came into the office, she had previously been a student of his.)

Technology

On this topic the response was simple and nearly identical on both calls; invest in technology early and often. "Don't ever skimp on technology."

As a follow up question, the CFOs were asked how you get comfortable with the fact that you might not have the right solution, or that you may end up investing time working with software that will ultimately prove to be dated. The reaction to the latter was to get comfortable replacing technology. Proper reporting requires continued investment in systems. Making sure you are always working with the best solution requires a strong network of like-minded professionals. Build this network and find ways to add value.

On the subject of convincing employees to adopt new systems, the advice was to run parallel systems until you were confident that the new system was working and then "burn the boats."[2] The idea being that once you have confidence in the new system, you rip the old one out so that employees do not have a choice but to move forward with new technology.

Day One on the Job

What is your immediate priority day one on the job as the CFO of a new entity? Fox and Gekko had different reactions, which are outlined below.

Fox had two objectives: (1) find the skeletons, and (2) determine how you are going to be evaluated. In his experience, every entity has skeletons (e.g., information gaps, human capital voids, poor processes, etc.). Once you have worked through these issues, identify areas of opportunity and determine how to get leadership's attention.

Gekko also had two objectives: (1) break down the sales model, and (2) build a detailed cash flow forecast. His overarching comment was that you needed to understand how revenue came in the door and how the company generated cash. In summary, a thorough understanding of the three-statement model framework.

Going Public (IPO Criteria & Process)

Gekko grew [Company B] from $50 million in revenue to $1.75 billion in a 7-year window. The acquisition pace moved so quickly that he could not comment on the number of transactions closed or the amount of capital raised. They were moving at breakneck speed. His final responsibility before stepping down as CFO was to take [Company B] public.

On the subject of going public, his leading comment was that most private company management teams are not prepared for the reporting and scrutiny required for public markets. In his opinion,

[2] The quote comes from Spanish commander Hernán Cortés, who upon arriving in Mexico burned his ships. The objective of which was to create a point of no return for himself and his men.

from conversations he has had with other executives that have gone public, he believes that less than half would choose to do so again on account of the reporting burden it creates (a wordcount for "bureaucracy" would have suggested it was not his favorite). A public entity requires excellent systems, data, and processes (i.e., SOX reporting was mentioned frequently).

We had previously described companies with some paper systems and / or the age of a company's ERP system as variables in this process (with a focus on newly implemented ERP systems), to which Gekko responded that in either situation the management team would struggle immensely. Without the proper infrastructure, SOX compliance, or reporting satisfactory for public markets in general, would fall short.

Beyond the reporting requirements, the real variable to focus on was scale. The benefit of going public, in theory, is access to cheaper and cheaper capital, but this requires substantial scale. Without scale the benefits are lost. As a mental exercise he asked us to consider the float a small company would have post IPO. If there isn't enough float to trade, then insiders cannot sell, and there is no benefit from this newfound "liquidity." Pressed to comment on appropriate scale, he responded that $50 million of EBITDA would be too small.

Funding Sources for Smaller Companies

For smaller companies, Gekko suggested alternative sources of capital would likely be preferable, and he isolated large family offices as likely being the best solution (we were focused on situations where the management team did not want to give up board control). On this topic, he emphasized that board level interaction with a new partner should be heavily considered. Private equity, he quipped, would be the most aggressive new partner, followed by public markets with the family office being on the opposite end of the spectrum.

Final Thought

It has been my experience speaking with young professionals that the primary concern surrounding upward progression is their technical skill set. *What additional fundamental knowledge is required to continue climbing the ranks?* But by the time you are considered for a leadership role, the technical skill set becomes the absolute base requirement. It is the ability to communicate, effect change, manage uncertainty and create agency that becomes important.

This is not to say that the technical skill set becomes less important. As an analyst in M&A I recall learning that one of the primary roles of a managing director was to network and convince clients to work with them. It sounded far superior to my life in a cubicle, so I naively asked if anyone had ever managed to skip the analyst / associate drudgery and transition to M&A later in life in a more senior role. The managing director's response, without hesitation: "How could I possibly convince someone to work with us if I don't know everything about *my* industry?"

To echo Gekko's comment, on an interim basis he would "take the controller every time." You cannot operate without the fundamental skill set, but you cannot grow and tackle the many unknown challenges a business will face without leadership.