THE CFO, A MODERN BUSINESS VALUE DRIVER

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Abstract
The todays CFO is a business value driver for any modern business organization. For the evaluation of the created value, Economic Value Added (EVA) has been used to highlight and quantify the value contribution of the CFO activities to the business value creation process. The present paper is using a simplified EVA calculation model to determine that CFO activities are business value drivers that contribute to the business value creation process of the business organization.

Keywords: CFO, business value, EVA, value, business value creation

JEL classification: D46, M20

1. Introduction

Value and value management has been a long time in the focus and attention of human society. Academics and scholars have always tried and are still trying to develop and disseminate a commonly accepted theory that encompasses the value and value management. The main drivers in the development of the value concept have been always scientific development and discoveries. The value concept has probably reached its maximum potential and has become obsolete and needs a new update in the new technological advanced and transformed world of the 21st century.

The 21st century and information and data driven century, also known as the information age, has put new concepts as prime valuables in the economic business environment. Goods and services that are involving data, information and knowledge are redefining the “obsolete older value concept”, by asserting the new “valuables” of value and value management.

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The classical view of value as the objective intrinsic value of its constituents no longer applies in the context of the “new economy”. (Daraban, An empirical view on value theory and value-based management, 2016, p. 6)

Value and business value are the most important aspects that a professional, highly effective and efficient CFO has as focus on. The CFO must understand the needs, strengths, opportunities, weaknesses and threats of the business organization to be able to create and manage the efficient and innovative business processes that drive and create business value. To be competitive in the 21st century information and knowledge economy a company needs to be innovative and daring to assert its strengths and assure its needed sustainable competitive advantage.

One of the key roles in any business organization is the Chief Financial Officer (CFO) that contributes and determines, together with the Chief Executive Officer (CEO), the wellbeing of the business and delivers the, by shareholders, expected results. Driven and leveraged by the changes induced by the information age, the role of the CFO has evolved and has been transformed, he has become a pivotal subject in the management of globalized 21st century modern business organizations.

2. Role of the Chief Financial Officer

The “classical” role of “bean counter” or “record-keeper” of the Chief Financial Officer (CFO) has been transformed by macro-economic events like globalization and liberalisation and free access to several markets. Moreover, the role has been leveraged by the new technological breakthroughs of the information age that made data, information and knowledge acquisition, processing, storage and sharing more accessible and therefore more needed by business organizations, allowing them to use much more data, information and knowledge for the business management decision process.

KPMG Advisory Services, in one of their reports from 2017 made available on their global website, states and defines that role of the Chief Financial Officer has transformed and changed over the last decade. As reasons for the change they mention the last financial global crisis, digitalization and big data that have been enabled by leaps in IT&C developments.

Today, the role of the chief financial officer (CFO) is under greater scrutiny, internally and externally. Economic uncertainty increased regulatory requirements, financial restatements, and increased investor scrutiny have forced them into the spotlight. (Deloitte Touche Tohmatsu Limited, 2017)

KPMG, one of the world wide leading financial consulting and audit companies, emphasises the need for change of the CFO role by including to the traditional CFO tasks also the new and changed expectations of the CEO's and Board of Directors. The new view and expectations from the CFO role have come from the turmoil that the world has been going through in the last decade where a "new business partner and driver" was needed. The new demand came especially from the US companies that had to deal with much more finance and economic exposure that previously and that could not be covered by the CEO or Board of Directors.

Typically, the CFO (Chief Finance Officer) is responsible for all non-core company activities. This is coming from the fact that the CFO, by definition of the role, is in charge with the steering and assurance of the support processes and activities of the business. (Daraban, Outsourcing CFO activities as a competitive advantage, 2016, p. 6)

The CFO will be involved in many of the business activities, core and non-core, through the perspective of the finance function that implies the safeguarding of business assets and balancing of risk and revenue. Because of the multidisciplinary approach and involvement, the CFO role has transformed over the years, it has become more and more business oriented.

3. The no way out situation of the CFO

Value creation should be on the agenda of the 21st century "new breed" of CFO's. The "new CFO" must drop his "old role" of a bean counter and embrace the strategic view of business operations by supporting, endorsing and challenging the business decision process in all its operational units and components.

A capital markets perspective will help executives understand how the company is valued and therefore how it can create value. As chief performance officer, the CFO is someone who gets involved in setting targets and measures performance against targets. They also help conduct good rigorous performance reviews at the top level. As a strategic partner, the CFO brings a critical eye and good thinking to the table. All of that is a far cry from the traditional perception of the CFO as a naysayer. The pioneering CFO is forward looking, Karnani said, rather than a recorder of historical financial information. The new breed of CFO operates at a different level, understanding the economics of the business as well as its financials. (O'Neill, 2014)

The todays CFO is pushed to deliver performance by several stakeholders and business partners. The most important stakeholders of the todays modern and highly performant CFO are the CEO, the shareholders, the capital market and the own organization. All the stakeholders want to be more productive, efficient and successful by pursuing different convergent interests.

The central role is played by the CFO that must assure and maintain all business processes at maximum efficiency and performance by balancing the external and internal perspective of the business organization.

The role of the Chief Financial Officer (CFO) has been dramatically and irreversibly changed by globalization, technological leaps in information and data technology that have leveraged and transformed existing financial markets.

A more holistic view that integrates business and financial decisions is required in order to manage these challenges of globalization. (Hommel, Fabich, Schellenberg, & Firnkorn, 2012)

The classical role of the CFO or senior finance professional as a "bean counter" or "record keeper" is no longer viable in the modern, globalized and dynamic world economy. The competitive, modern and globalized CFO must embark the "information revolution train" and make the most out of the new data and information processing and managing capabilities.

The new role of the CFO or senior finance professional implies a value-based leveraging of the "old role" of safeguarding business assets and balancing risks and revenue. The value creation aspect supersedes the classical financial perspective of the finance function. The shareholder value creation process is the main purpose of the existence of any business organization that needs to be translated into operations by the senior management, the CFO being one of the main influencers and decisive factors.

A problem faced by the shareholders of a firm is that it is difficult to determine the effect of management decisions on the future share returns of the firm. (Erasmus, 2008)

The new value-based perspective cannot be quantified and benchmarked by using "classical" accounting-based performance indicators, new performance indicators are needed that consider the value creation aspect.

Value based management and value-based management tools need to be assimilated and integrated into the daily life of business organizations in order to assure and sustain the shift in paradigm, the shift from record keeper towards value creation driver of the finance role through its key representative the CFO.

4. Value based performance indicators

One of the key activities in the success of a business organization is the benchmarking and measurement of the current operational business activities. The classical approach to performance measurement based on accounting data and information is pushed to its limits when concerned with value creation through the business operational activity. The value creation by business operations cannot be assessed through accounting-based performance indicators due to their limited consideration of invested cost of capital. Therefore, more complex and more refined performance indicators are needed that show and consider also the cost of capital aspect and are aligned with the value management concepts.

The classical financial performance metrics, also known as key performance indicators (KPI's) are all based on accounting profits and perspectives. All key performance indicators recognize that profits are made when the business organization return on invested capital exceeds the weighted average cost of capital invested by their shareholders. The consideration of weighted average cost of capital in the evaluation of the business value creation process, through key performance indicators, transforms the classical view of business performance, that is accounting data driven, in value driven performance indicators by benchmarking it against the shareholders expectations.

The most widely used and relevant Value Based metrics are those based on residual income, such as economic value added (EVA). (Obermatt AG, 2018)

The value-based management metrics are an image of the business results viewed through the capital market perspective that is driven by investor expectations and their expected investment cost coverage. Value based management is transforming and leveraging the classical financial point of view of business results where profit or loss does not come in sync with value creation.

The todays known concept of Economic Value-Added concept was developed by Stern Value Management 1983 as a new way that supersedes the classical approach to measure business performance that translates to value creation for the business organization shareholders. The concept was developed based on the works of Merton Miller and Franco Modigliani and has as its main scope the maximization of value created for the business organization shareholders.

Economic value added can be understood as the difference between net operation profit after tax and the opportunity costs of the invested capital, whereas the opportunity costs of invested capital is calculated as the results of the multiplication of the invested capital and the weighted average costs of capital

$$EVA = NOPAT - CC = NOPAT - (IC * WACC)$$

Equation 1 - EVA formula

Where
EVA – economic value added
NOPAT – net operation profit after tax
CC – cost of capital
IC – invested capital
WACC – weighted average costs of capital

5. Value contribution of the CFO

The CFO's contribution to the business organization value creation process is difficult to isolate and to assess due to his multifaceted and multidisciplinary involvement and contribution to the business development and management. Classical performance, accounting data driven, indicators do not apply and are not suited for the determination of the CFO business value contribution.

The proposed value-based performance of the CFO activity is based on the EVA concept of Stern Value Management. The business value contribution of the CFO to the overall business value creation process must by determined by the analysis of all individual business processes that are controlled and managed by the CFO.

The value contribution of the CFO to the business organizations value creation process can be considered as being the sum of all value contributions of the business processes and activities controlled and managed by the CFO.

$$EVA(CFO) = \sum_{i=1}^{n} EVA(CFOn)$$

Equation 2 – EVA formula sum up

Where
EVA(CFO) =EVA of the CFO activities
EVA(CFOn) = EVA of the CFO controlled activity n

The formula above for the determination of the CFO's economic value added can be illustrated by using a calculation model based on a simplified profit and loss statement (P&L statement) with the following assumptions:

WACC = 10%
IC = invested capital = long term debt + equity = 90000 + 30000 = 120000
NOPAT = EBIT *(1-tax rate)
tax rate = 16%
Sales / Revenue, COGS, SG&A values are values used just for the exemplification of the EVA calculation model.

NOPAT = EBIT * (1-tax rate) = 200 000 * (1-0.16) = 168 000

Figure 1 - simplified EVA model

	XYZ Ltd	EVA(CFOn)
Sales / Revenue	800.000	80.000
COGS	500.000	
Gross Profit	300.000	80.000
SG&A	100.000	
EBIT	200.000	80.000
tax rate	16%	
NOPAT	168.000	67.200
IC	120.000	
WACC	10%	
EVA	**148.000**	**67.200**

Source: Author

The CFO controlled activities are indirect productive activities that do not have a sales or revenue part per se. The revenue part of the CFO controlled activities can be considered as being the total costs that are supported by the business organization for the CFO controlled activities. The total costs of the

CFO controlled activities can be considered the salary costs of the involved employees.

For the simplified calculation model all other costs related to the CFO controlled activities are considered immaterial and therefore calculated with zero value (like furniture, IT equipment, etc.). To have an accurate assessment of the minimal EVA of CFO activities the following adjustments need to be made:

- Assessment and calculation of the COGS of CFO activities
- SG&A assessment and calculation of the part belonging to the CFO activities

Based on the presented assumptions of the calculation model, the EVA of the value created by the CFO activities represents ~45% of the total value creation process of the business activity.

6. Conclusions

The evaluation and quantification of intangibles, like created value, is a daring task that cannot rely on the normal performance measurement indicators that depend on financial data. Value creation for its shareholder is the main purpose and scope of business organizations. The financial result of the business activities is just the outcome of operations and does not reflect the value contribution of its contributors. Financial business operations result is only one aspect that is reviewed by financial and capital markets. Another aspect of business operations that is reviewed by the capital and financial markets is the business value creation process of the business organization.

Because business value creation is important and cannot be assessed through classical concepts, value-based performance evaluation and measurement concepts have emerged and have gained more and more acceptance. Value based performance indicators consider the business value creation aspect that implies that at least the cost of opportunity of the business investment needs to be covered by profitable business organizations.

One of the value driven performance indicators is EVA (Economic Value Added) that has gained traction and is mostly used in the value-based evaluation of business performance.

Even though that the calculation is made based on simplified assumptions, the resulted EVA of the CFO activities is material and cannot be disregarded when talking about the value creation process and value creation contribution of business processes. The simplified model for EVA calculation is determining and showing the minimal EVA, the minimal value contribution, of the CFO activities that is determined only by the cost of the staff employment.

The additional value creation determined by the value created through experience, knowledge and information of the CFO activities can be considered and additional value multiplier that is achieved by and through the business organization CFO.

The modern, dynamic, flexible business organization of the 21st century, in an information and knowledge driven economy, must be aware of the sources of business value creation. Even more the modern business organization must have all the tools available to measure, control and use all business value drivers that are available and usable regardless of type of value drivers, internal or external. For an informed and economic management decision process business organization must use, evaluate and decide upon its business processes with regards to business insourcing or outsourcing. By applying the EVA concept for immaterial services, like CFO services, business organization go even further with the streamlining of business processes having an objective quantifiable tool for the benchmarking of business processes with regards to the ultimate goal, shareholder value creation.

In the information age, the 21st century, the value contribution of the CFO and the CFO activities is considerable and cannot be disregarded by a modern, efficient, fast-moving business organization if the organization intends to assure and sustain the best competitive advantage. This sustainable competitive advantage is transformed and morphed into the values of the 21st century, the information age, where information, data and knowledge can make or break the best business operations.

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