OLIVER WYMAN

Financial Services

Point of View

The CFO Role Revisited

Authors
Dr. Christian Pedersen, Partner
Tom Ivell, Senior Manager

In an earlier Point of View ("The CFO role: A catalyst for change in troubled times", December 2008), we argued that the crisis had exposed weaknesses in financial institutions' (FIs) financial steering and control. We called on Chief Financial Officers to integrate strategy and planning; to reinforce the operational links between finance, risk and line management; and to improve internal controls.

Oliver Wyman recently worked with several CFOs to make progress in these areas and found some common factors determining success. This prompted us to conduct an examination of the role of CFOs in 47 FIs across Europe and classify them into four types according to the scope of their responsibilities. We discovered significant differences in the performance of FIs with these different types of CFO, both during and after the crisis. This new evidence supports our view that CFOs must reach beyond their traditional, statutory duties and play a leading role in several strategic processes.

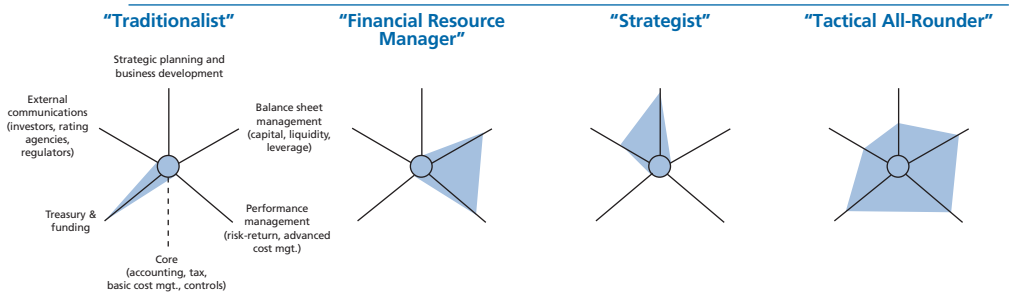
The financial crisis revealed several areas of financial management and control in need of improvement:

- Planning should account for, and effectively integrate, risk appetite, strategic ambitions as well as the impact of new regulations
- The balance sheet should be actively managed through a consistent approach to forecasting, stress-testing and execution, covering capital, liquidity and leverage
- Liquidity should be actively managed through product strategies
- Performance management should reflect the true cost of capital and liquidity, feed suitable risk parameters into compensation setting and provide management information that is forward-looking and actionable
- Clear separation between risk takers and risk controllers should be ensured
- External stakeholder communication and interaction should be closely aligned with internally-developed business and balance sheet strategies.

Achieving these improvements is difficult for most institutions because many of the relevant areas, such as top-to-bottom planning, balance sheet management and interaction with external stakeholders, lack clear "owners", often falling within the remit of two or more members of the executive committee. Yet, with few exceptions, institutions' organisational arrangements point to an obvious candidate to take charge of upgrading these processes: namely, the CFO.

Oliver Wyman recently examined the span of control of 47 European financial services CFOs. We characterised them by their areas of direct and indirect responsibility in five strategically important areas. Our methodology is described in detail in the Appendix. The degree of control CFOs exercise across these areas suggests that today's CFOs fall into four broad profiles, as shown in Exhibit 1.

Exhibit 1: Four CFO role profiles



	"Traditionalist"	"Financial Resource Manager"	"Strategist"	"Tactical All-Rounder"
Occurrence	9	10	9	19
Direct responsibilities/ reports for strategic area (all cover "core")	▪ Treasury	▪ Balance sheet management ▪ Performance management	▪ Strategic planning and business development ▪ External communications	▪ Balance sheet management ▪ Performance management ▪ Treasury
Typical indirect responsibilities/ influence	▪ Performance management	▪ Treasury	▪ Performance management ▪ Treasury	▪ Strategic planning and business development ▪ External communications

Our "**Traditionalist**" role profile comprises the statutory responsibilities which CFOs have traditionally held in financial institutions. We have labelled these the "core" responsibilities, to include accounting, tax, and statutory control duties as well as an overview of cost management. The impact of such core tasks on performance can be significant, an example being the clever use of hedge accounting by some banks during the recent market volatility. The "Traditionalist" can be found in a number of today's institutions and would typically also have solid line responsibility for Group Treasury and funding activities. "Traditionalists" may have input in planning and performance management, which typically sits with the CEO, Head of Strategy or COO.

Our "**Financial Resource Manager**" has solid line responsibility for balance sheet and performance management in addition to the core responsibilities described above, though usually does not directly own Treasury.

Our "**Strategist**" is the reverse type of the Financial Resource Manager. He owns strategic planning and business development but has little tactical responsibility.

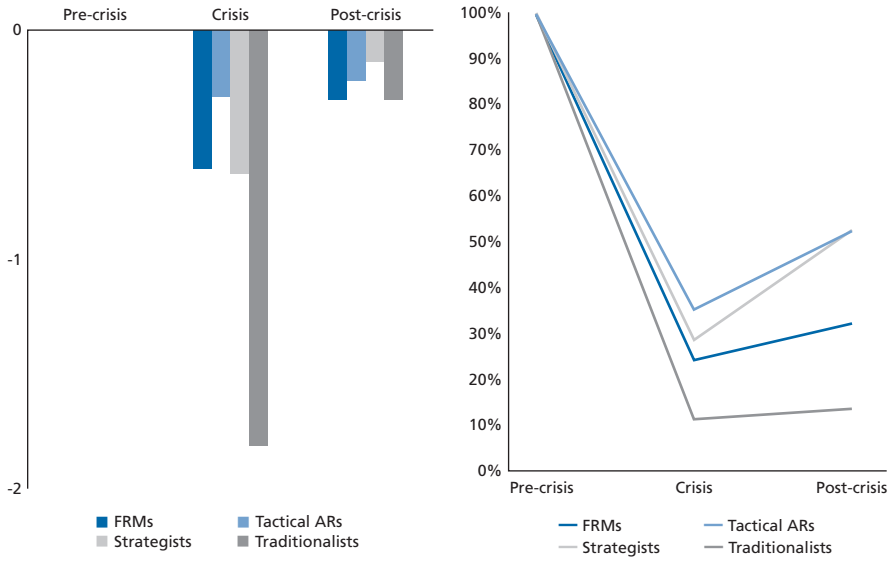
Finally, our "**Tactical All-Rounder**" covers all tactical areas and leads related processes, while typically working with a CEO who leads Strategy.

We observed only a couple of examples where the CFO fully owned all five spokes, pointing towards a potential limit on the number of areas CFOs are able to lead successfully.

These four types are well distributed across countries, types of FI and sizes of institution. Only the insurance segment stands out, showing a higher proportion of "Tactical All-Rounders". Despite this dispersion, however, the roles correlate with institutional performance during and after the crisis.

Our sample of "Traditionalists" entered the crisis in good shape and ahead of the rest in terms of both capitalisation (Tier 1 capital of 9.0% vs. 7.9%), credit ratings (average of AA vs. AA-) and lower than average loan-to-deposit ratios. In other words, these would have appeared to be conservatively run institutions in good standing. However, they fared badly in the crisis. Two-thirds of institutions with "Traditionalist" CFOs required government support versus just over a quarter of the total population. Both equity and debt markets responded strongly, making this sub-group significantly underperform any other in our sample (see Exhibit 2).

Exhibit 2: Rating change (notches) and share-price, showing sub-sample averages



Source: Thomson Reuters, Bureau van Dijk, Rating Agencies and Oliver Wyman analysis

Among our three remaining types, differences are smaller. We note that "Tactical All-Rounders" performed best as measured both in share price and ratings. Between the two narrower roles, "Financial Resource Managers" appear to have done slightly better than "Strategists" during the crisis, a result which reverses post-crisis.

Despite its limitations, this analysis provides evidence that institutions which provided their CFO with the organisational basis to link up key strategic processes were able to better navigate the volatility caused by the crisis and emerge in stronger shape than peers for whom these responsibilities were more distributed across the organisation. This thesis is further supported by looking at the prevalence of dotted verses solid line CFO reports. Across the 47 institutions, CFOs with one or more dotted reporting line for each solid reporting line underperformed peers in terms of both share price and ratings changes.

There are a few exceptions to the relationships described above. These relate to institutions that manage well by having clear processes governing planning, performance and resource management across a less integrated organisation structure. However, of our sample, no banks with "Traditionalist" CFOs are recognised European crisis winners, suggesting a minimum degree of control over strategically important areas is nevertheless required. Given our observations, we therefore contend that CFOs should have more influence over key strategic processes in European banks.

In the short term, funding gap initiatives, capital re-allocation, assessing the strategic impact of new regulation as well as re-assuring nervous investors and regulators are all near the top of the CFO agenda. In addition, larger transformation programs are being set in motion in many banks to re-invigorate finance functions in the medium-term. Finally, in light of Basel III, processes for managing financial resources and performance more dynamically will be a competitive requirement for years to come. We suggest the following areas of focus for different types of CFOs, a number of which are already ongoing at leading institutions.

Exhibit 3: Example focus initiatives by type of CFO

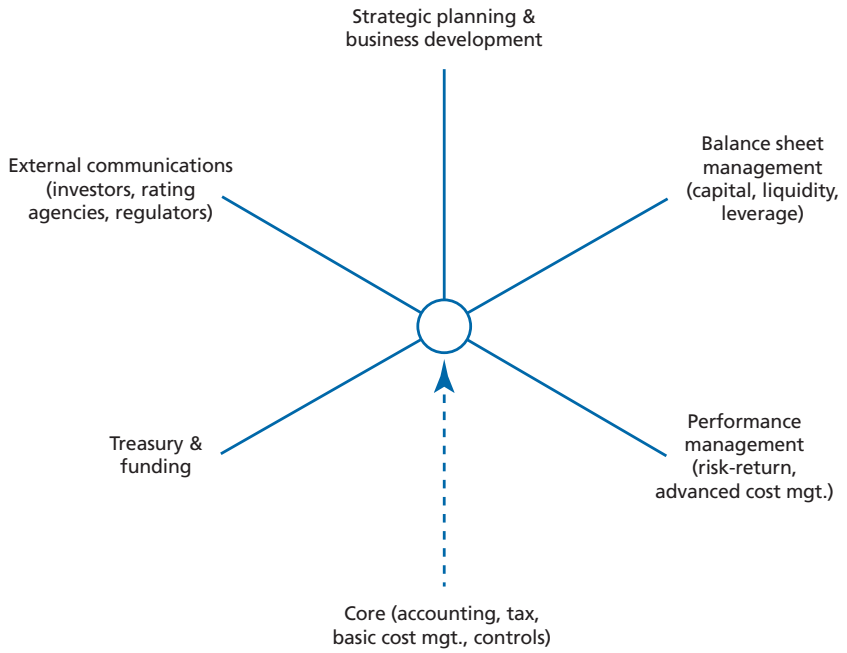
Role type	Improvements	Example initiatives
Traditionalists	Take advantage of Treasury ownership to influence key business decisions such as performance and balance sheet management	■ Own the process to integrate the management of capital, liquidity and funding; further build out Treasury ■ Support performance management through upgrade of compensation (e.g. inserting balance sheet metrics and risk charges into bonus pool calculations) ■ Use of forecasting and stress testing processes to improve management foresight into emerging risks and financial constraints ■ Upgrade skill sets in the Finance area
Financial Resource Managers	Use funds transfer pricing or capital allocation as means to better align business activity to the resource profile More influence on strategic decision-making	■ Upgrade performance management to provide business areas with better transparency on ongoing risk-adjusted performance of assets and liabilities ■ Use balance sheet management ownership to influence charges on contingent costs of capital and liquidity in both P&L reporting and target setting ■ Contribute to a review of the strategic planning process which ensures adequate capture of relevant balance sheet factors
Strategists	Make better use of balance sheet information in making strategic decisions	■ Strengthen the link to risk and balance sheet management by positioning risk appetite as a recognised constraint in strategic planning, e.g. by making better use of stress tests ■ Drive through business initiatives to curb increases in liquidity gaps, RWA consumption etc. ■ Assume a coordination role across external stakeholder communication, e.g. by setting up a "clearing house" for all regulator and investor dialogues
Tactical All-Rounders	Strengthen underlying processes Keep an eye on span of control becoming too wide	■ Review efficiency and effectiveness of bank steering processes and supporting organisation and infrastructure ■ Review overall CFO organisation and reconsider span of control vs. focus areas needing most senior attention

Whether these initiatives require culturally sensitive organisational discussions or primarily process improvements, CFOs need to step up and take the lead in driving through the necessary changes, supplemented by commensurate upgrades in their own organisation's mandate and capabilities.

Appendix: Methodology applied to CFO profiling

The analysis covered 47 CFOs in major European financial institutions, of which 12 were insurers and 35 were banks or bancassurers. The data was compiled at the end of 2010. We examined CFOs' role and influence over five areas of strategic importance as shown below (all CFOs owned the "core").

Exhibit 4: CFO role profile schematic



The degree of influence exerted by CFOs on the five strategic areas was scored using a simple approach based on looking at all relevant reporting lines. This is shown in Exhibit 5.

Exhibit 5: Scoring reporting line options

Reporting line options	Scoring
Direct and sole report to CFO	CFO as owner (3 points)
Sole report to CFO via someone else	CFO as indirect owner (2,5 points)
Direct to CFO solid line; dotted line someone else	CFO as leader (2 points)
Direct to someone else solid line; dotted line to CFO	CFO as influencer (1 point)
No reporting to CFO but reporting to someone else	No influence (0 points)
This area of responsibility/capability does not exist in the institution	

We then used the points to allocate CFOs to the profiles using the criteria shown below, in the order shown below (that is, a CFO not matching Profile One was next tested for Profile Two and so on). This rule is shown in Exhibit 6.

Exhibit 6: Allocation of CFOs to profiles

Profile type	Area	Points required
1. Tactical All-Rounder	Strategic planning & business development	
	Balance sheet management	2 or more
	Treasury & funding	2 or more
	Performance management	2 or more
	External communications	
2. Strategist	Strategic planning & business development	3
	Balance sheet management	
	Treasury & funding	
	Performance management	
	External communications	1 or more
3. Financial Resource Manager	Strategic planning & business development	
	Balance sheet management	2 or more
	Treasury & funding	
	Performance management	2 or more
	External communications	
4. Traditionalist	Strategic planning & business development	All others
	Balance sheet management	
	Treasury & funding	
	Performance management	
	External communications	

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For more information please contact the marketing department by email at info-FS@oliverwyman.com or by phone at one of the following locations:

EMEA	North America	Asia Pacific
+44 20 7333 8333	+1 212 541 8100	+65 6510 9700