The finance director and the treasurer

Professor Daniel Hodson explains why he thinks British institutions have missed out on tapping the talents of a highly skilled cadre of trained financial decision makers.

The finance director (or chief financial officer) and the treasurer are two key financial positions in today's business environment. The former has been a key board appointment since early on in the history of joint stock companies, whereas the latter is a relatively new and often underestimated role, which has spawned a new profession – treasury management – and a new professional body, the Association of Corporate Treasurers.

Here I will examine the salient aspects of each role and look at the key skills required. In general, I believe British institutions have not got the best out of their finance directors and in rarely promoting treasurers to the CFO job have missed out on the opportunity to tap the talents of a highly skilled cadre of trained financial decision makers.

Financial director's role: not all about beancounting

Whatever else it is about, the financial director's job is only marginally about beancounting or the physical business of accounting. This may seem counter-intuitive, but it is worth pointing out that the title is *Finance* Director, or Chief *Financial* Officer, or sometimes Director of Corporate *Finance*.

The position is in part about the *presentation* and *interpretation* of the results of basic accounting. A thorough knowledge and analytical understanding of financial accounting is the essential ingredient for a successful CFO. The ability to undertake the more detailed requirements of an accounting qualification and of professional accountancy is a bonus but not a *sine qua non*.

What is perhaps more important for a financial director is to appreciate what dashboard instruments each level in the organisation needs to drive the company forward – to learn from the past and make decisions for the future. This management information, summarised in the form of key performance indicators (KPIs) may be in part but not exclusively based on standard accounting techniques and books of account. In particular, the provision of appropriate management information is of huge importance to boards.

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Nonetheless, I believe that the issues which really count are rarely about accounts, accounting and/or the provision of management information, or even their concomitant, control and compliance. The world of financial and regulatory management is full of talented accountants, controllers, internal auditors and compliance officers. The CFO's skill will be to select and subsequently to manage them successfully. This responsibility should be entirely routine in terms of the successful fulfilment of their office.

Daniel Hodson

Shaping corporate and financial strategy and decision making

Where I believe the biggest contribution can be made is in helping to shape the organisation for today and for the future. If a key role of the board is to determine and ensure the implementation of corporate strategy, it is clear that a vital ingredient of the latter is bound to be financial strategy. Financial strategy is not about the past, it is about:

- the continuing relationship between debt and equity, target and maximum;
- the source of that equity and the structure of the debt;
- the hurdle rates of return for projects and acquisitions;
- the organisation's willingness and ability to accept financial risks generally; and
- the steps to be taken to mitigate risks.

Such matters lie at the heart of corporate strategy and boards will look to the CFO to make the dominant contribution in their determination. It is a totally forward looking task.

Other key roles stem for the most part from the various elements of financial strategy set out above. For instance, the quality and depth of project and investment appraisal is of great importance to the organisation and it usually falls to the CFO to create and maintain the project appraisal framework, ensure adherence to its rules, and in particular to safeguard the integrity of the financial projections and

In the financial director's driving seat

I have served in the role of financial director and chief financial officer. In 1976 I was appointed group treasurer of Unigate. I was sent for after a few weeks by the chairman, a business grandee called Sir James Barker. "Good morning Hodson", he said, "I've seen you wandering about. What do you do?" "I'm the group treasurer," I replied, rather pleased with myself. "Group treasurer, group treasurer", said he, "What does that mean?" Deflation of eager young party, and strong indication of ignorance on the part of great and good person.

Over the next five years I watched no less than three finance directors, accountants all, collect their cards and depart, increasingly realising that I somehow was not CFO material at least in the eyes of the board, despite getting to grips with the treasury side of things. Friendly headhunters continuously told me that you had to be an accountant to be a finance director, and I therefore thought that I was the victim of a cruel joke when Sir James's successor summoned me and asked whether I wanted to drink from what was clearly a poisoned chalice.

He was serious, but I thought privately (and still do) that the board had simply run out of options. I was also lucky that they could find my office.

It was a stroke of luck, but I must have done something right because I survived six years in the job and departed of my own volition. I subsequently had the best part of four years in the same job at Nationwide Building Society, again exiting quite unaided.

Ten years a finance director is some people's idea of purgatory, but I thoroughly enjoyed it. ■

assumptions implicit in it, as well as verifying, criticising and supporting the financial analysis.

It requires someone with grit and courage to stand up to a chairman and/or CEO with the bit between his teeth, the sap rising and the opportunity there for the taking – with only the time needed for careful and thorough appraisal between him/them and capturing the prize. But it's a vital task.

It is this role of counterpoint which can be enriching and creative. I am a great believer in top executive teamwork, my example usually being modern football teams where all positions bar goalkeeper are to a degree interchangeable.

So it is with boards. The most effective will contain a financial director who will be supportive but at times display his specialist skills, those of financial analysis, and who will ensure that the appropriate decision, control and governance framework is in place and adhered to, and who will be, as it has been so aptly put, "the conscience of the organisation".

The combination of these skills should produce a healthy and productive dialectic discussion at executive and board level, and in these the financial director will be at his best. But there will be extreme cases where they will feel it necessary to say, as Charles de Gaulle was wont famously to do, "*Non*".

Risk perception and management

A key part of the skill is the financial director's perception and understanding of risk as well as his ability to assist in its mitigation. Although seen, at first flush at least, as a bureaucratic burden, I believe that the current strong movement towards risk identification and analysis is one of the most useful items that has come out of the increasingly prescriptive governance environment in which we live. This should bring out the CFO's prime skills, both in ensuring that the risk review is regularly and appropriately undertaken, and probably in most corporate organisations being responsible for it, but also as a strong contributor to its content, both in extent and detail, well beyond his natural territory of financial risk.

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Get the best out of the markets

Another vital contribution will be in his understanding of financial markets, debt and equity, cash and derivatives: how they work, who the key players are, how to get the best from them, and how to communicate with them.

There was a time not so long ago when the financial director's function in this regard would boil down to 'corporate finance' – in reality not much more than working with the merchant bankers on acquisitions and rights issues and 'investor relations'. That is, talking to financial journalists and investment analysts and ensuring that the latter were suitably close to the mark in terms of forecast results, and also keeping the big investing institutions happy and informed.

It is a far more complex world these days. Ratings agencies, focused on debt, are just as powerful as analysts and journalists, focused on equity. Debt markets are increasingly securitised, relationship banking is under greater pressure and multibanking is the norm, exchange traded and over-the-counter (OTC) derivatives markets, are providing ever more sophisticated methods of balance sheet and financial risk management.

Simply, financial directors face a vast range of products, from a vast range of markets, offered by a vast range of intermediaries and principals. Understanding, selection, communication at many levels and focus are key skills for the financial director of today.

Internal financial literacy and structure

The financial director's job description also includes ensuring that his executive colleagues are financially literate to an appropriate level, and that the internal financial structure optimises the incentives for what was for a while called 'intrapreneurship'. This is something which I keenly believe is valuable in the context of corporate groups.

So far as financial literacy is concerned, they have to be a proselyte, or at least employ one, as I did, taking the view that what they would not believe or take from me, would be easily assimilable from somebody else. The person I found for the purpose during my time at Unigate meant that by the time I left at least the top 100 executives in the business had a working knowledge of accounting, balance sheet management, the financial aspects of project appraisal, including required rates of return, and cashflow management.

This made the second, internal structure aspect of the task much easier. Some companies, even very large ones, are so integrated, that an internal structure with self-accounting profit centres is difficult to achieve. Most, however, lend themselves to a number of such units.

In their context, internal structure and targets become an interesting part of the financial director's job, for example:

- provision of notional equity, particularly in financial service organisations where capital requirements play such a large role; and
- target rates of return on equity; and
- cashflow targets and the like.

In creating and supervising such an internal structure, a financial director will be greatly assisted by a high degree of financial literacy on the part of each of the unit management teams.

Contrast the treasurer

The financial director will inevitably be called upon to record and present the past, but his principal requirement will be to manage today in the light of his view of the future, particularly in terms of market developments and risk. In short he must be a decision maker in his own right and a participator in decision making, always looking forward, not back.

What is so interesting about this analysis is the extent to which the requirements parallel the job description of the treasurer. Briefly, the latter's role is about the management of the balance sheet (the level and structure of debt, equity and investments) of cash (liquidity, transactions and flow) of currency (arising from export, import and overseas holdings) and of financial risk generally (a combination of all these facets, as well as the use of the insurance market).

In this, he will make ever increasing use of technology, and particularly intelligent systems, emphasising the critical and strategic decision making nature of the role. He should (but not always will) have significant commercial interaction with his colleagues, particularly at board level because his role affects financial strategy, and at many managerial levels because it affects their commercial activities, and specifically in respect of currency exposure.

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Stated in broader terms, treasury management is about the use of financial markets, banks, OTC and exchange-traded, to the benefit of the organisation, as well as managing the relationships inherent in them. It is also about financial risk management, but above all about a view of the future and making decisions in respect of it.

At the same time, the treasurer will, by professional training, have more than a working knowledge of financial accounting, and, as a decision-maker, he will be more than familiar with the need for effective management information. Often his responsibilities will include investment appraisal. His job is already intertwined with financial strategy and his understanding of financial risk will give him more than a head start in the identification and mitigation of risk generally.

Without a doubt therefore he potentially has the bulk of the professional, managerial and personal requirements required of a successful financial director. It is this recognition that has meant that, in the US, the treasurer himself is usually designated the chief financial officer, whereas the controller is seen principally as the head of the accounting and control function, without the broader responsibilities.

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He may be an accountant, but the chances are equally that he will have come from another financial profession, probably banking. This is in stark contrast to the UK where the CFO is conventionally an accountant from the accounting/control division of the financial function, or comes direct from practice.

Why not the treasurer for the financial director's role?

The first and most superficial reason for this discrepancy is convention. The conventional wisdom among headhunters, senior executives and directors, both executive and non-executive, is that CFOs should not only be accountants but should come immediately from an accounting background.

This trend is complemented by what might be called professional momentum, the natural advance of a corporate career based on accountancy towards the financial director's role. The accounting profession is geared towards two parallel pinnacles, senior audit partner or CFO. Put another way, if you want to be a financial director, get an accounting qualification, and convention and your profession will support you in your upward progress.

One fundamental problem is that the treasury profession ranks alongside the actuarial one in obscurity and also, deliberately perhaps, obscurantism. For many corporate executives, the physical output of asset, liability and currency management is clear, but the methods of arriving at it are opaque. For them, it is a 'black box' profession, and some treasurers like to keep it that way. There is no real external understanding of the detailed aspects of the job or of the skills and qualities needed, particularly by those who have the dominant influence on the selection of financial directors: non-financial senior executives, the general cadre of non-executive directors and headhunters

In this, the treasurer is to some extent a prisoner of his position, but to a degree he also has himself to blame. It is not his fault that his natural relationships tend to be more outside the organisation, with, for instance, his suppliers in financial markets, than with his corporate colleagues. Nor is it his fault that the board rarely sees the treasurer, unlike, for example, the company secretary, the corporate lawyer or the financial controller. In short, although the treasurer may be naturally transparent in the way in which he discharges the role externally, his internal perception may be the very antithesis of transparency.

The keys to the future

The fundamental issue, however, is one of education, for all those involved in the selection of financial directors, and at two levels: the nature of the job itself, and the suitability of a professional treasurer to fulfil it.

Here, serving financial directors, treasurers and the treasury profession itself have a key role to play. It is essential the financial director is not seen only to be a risk-averse safe pair of hands with a control mentality – although these may be characteristics he may have, *inter alia* and from time to time. Rather he should be forward looking, a team player, but with a critical decision making role, and a detailed understanding of risk management and financial markets.

At the same time, the treasurer should be increasingly presented and seen to have these qualities and more, including analysis, persuasiveness and leadership qualities, not just in decision making but in management and communications. Talking to rating agencies requires at least as skilled and as subtle an approach as that of talking to analysts and the financial press, as well as the personality and drive to do the job.

Some will inevitably fail the test. The nerdish, techie loner is no more typical of today's treasurer than the desiccated number cruncher is of today's accountant, although there are a number who have these characteristics. However, the corps of today's treasurers makes a rich but basically unmined seam of talent, many with the ability to bring a different dimension of skills and insight to the CFO position.

How will the change occur?

I would argue that the real nature and value of the role will be increasingly appreciated as a normal evolutionary process and as the pressures of modern business hone the perceived requirements of every member of the top team.

Treasurers can help, too, by taking on far greater responsibility in increasing the treasury literacy of their colleagues at every level – communicating in a far more proactive way what the function does and its importance to the organisation, in the context of a fresh view of the key responsibilities of the finance function, and therefore their potential to discharge the latter at the highest level.

In not using more of the skills and talents of the treasury profession, a great opportunity has been and continues to be missed. I do not deny accountants their place in the sun, nor do I underestimate their magnificent contribution to British industry. However, in continuing to hand them a virtual monopoly over the financial director's role, a great and potentially costly mistake may be being made. Here are the main points we have covered :

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- the financial director's job is only marginally about accounting, and then principally about presentation and interpretation. More important is their responsibility for the availability of appropriate management information at all levels in the organisation, and particularly to the board, much of which will not be based on books of account;
- the key functions, however, are in helping to shape corporate and specifically financial strategy; board level decision making; risk management; the use of and communication with all financial markets; enhancing internal financial literacy; and setting an appropriate internal financial framework;
- treasurers potentially have most of these skills, the function being embedded in financial decision making and risk management, as well as the in-depth understanding of financial markets;
- whereas in the US the CFO is likely to be the treasurer, he is likely in the UK to be drawn from an accounting background. It is a matter of convention, professional momentum, perception and education; and
- treasurers are an underestimated and underutilised source of top financial talent. It is essential for the benefit of board level UK financial management, and inevitable, too, that treasury management skills are seen to be an appropriate background for CFOs and that more treasurers move up to be CFOs.

As one noted commentator, writing in *Financial Director* a little while ago, predicted for the year 2014: "ICAEW members will be the second largest institution represented by FTSE 100 financial directors. They will be overtaken by the Association of Corporate Treasurers." ■

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