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Corporate Finance Practice

Profiling the modern CFO: A panel discussion

Seasoned finance chiefs explore revamping business models and coping with new competitors, currency risks, and changing capital structures.

At McKinsey's annual Chief Financial Officer Forum, in London this June, CFO and chief operating officer Samih Elhage of Nokia Networks, Manik ("Nik") Jhangiani of Coca-Cola Enterprises, and former Alstom CFO Nicolas Tissot took up some of the challenges facing today's finance chiefs. Over the course of an hour, the panelists explored the pricing threat posed by a new breed of low-cost competitors now rising in emerging markets, the risks from the resurgent volatility of currency markets, and the brave new world of cheap debt financing and its implications for capital structures.

The discussion, moderated by *Financial Times* Lex column editor Robert Armstrong, shapes a profile of the skills and tactics that define the modern CFO. The edited highlights below begin with the question of whether CFOs should make challenging the existing business model part of their role.

Nik Jhangiani: A business never gets to the point where it has the ideal model. The world is changing so fast around us. Even in a business that you think is stable and predictable, the operating model needs to continue to evolve, just given what technology is doing. At Coca-Cola Enterprises, we don't conclude, at a single point in time, that the business model needs to change—that's something we challenge ourselves on through our long-range-planning process every year.

For example, we have probably the largest sales force in Europe of any packaged-goods company, and I almost *have* to challenge that. Is it

really bringing us the value today that it did five years ago? How many people want a salesperson calling on their stores or outlets helping them to place an order and to merchandise when so much more can happen through call centers and technology? You definitely don't want to lose the human touch and the relationships, but you do want to allow your sales force to be more efficient, effective, and focused on what the customers view as an added value.

This is something you, as CFO, need to challenge almost every day—to ask if your company's business model is fit for purpose today and, more important, if it is fit for purpose for the future. What do we need to change, without suddenly having to make a wholesale change tomorrow? It needs to be constantly adapted.

Robert Armstrong: *When you realize that a major change has to be made, how do you deal with your executive board?*

Nicolas Tissot: Among the members of executive committees, CFOs are probably best positioned to challenge the businesses. They are independent from operations. And they are the only ones, apart from the CEO, who have a comprehensive vision of the company. The role of a CFO who goes beyond being a bean counter is clearly not only to be a business partner but also to be a business challenger. This is not the easiest part of the job, but it is definitely a part of the modern CFO role.

Samih Elhage: In a fast-moving industry like Nokia's, technology life cycles are becoming very much shorter. In our case, the transformational aspect of the business is becoming a way of life. We can't say, definitively, that this is really my process; this is my business; this is how I sell; this is how I buy. We *can* say that we're in a continuous-improvement process—and the process itself has to evolve.

This isn't about squeezing the budget to reduce costs. It's about significantly changing the company's processes and mode of operation. In many cases, you have to change the way you sell certain products and the way you charge particular customers. And, in some cases, you have to exit specific areas of the business. When I first came to Nokia, we were operating in ten different segments. Since then, we've made

Manik ("Nik") Jhangiani

Education
Holds a bachelor's degree in accounting and economics from Rutgers University

Career highlights

Coca-Cola Enterprises
(2013–present)
Senior vice president and CFO

(2012–13)
CFO, Europe

Bharti Enterprises
(2009–12)
Group CFO

Coca-Cola HBC
(2000–09)
Group CFO

Fast facts
Married, with 2 children

Lives in Central London

incisive and, I think, courageous changes, divesting eight of these businesses to focus intensely on the two that would give us the operating performance we were looking for.

Competitive dynamics and pricing

Robert Armstrong: *Let's talk a little about competitive dynamics. Samih, you are in a unique position there. How do you manage the company when you are constantly under pressure from large, low-cost emerging-market competitors?*

Samih Elhage: Well, competition is undeniably an important element in our day-to-day operations, because of its implications for our cost structure and for pricing. But we resist being driven reactively by the actions of competitors. We have a strong pricing strategy and controls to ensure that prices are being set at the right level—one that ensures our customers are getting value for money and that we are able to fund investment in R&D and healthy performance for our stakeholders. And, in a competitive environment, our cost structure, which is extremely lean, gives us the means to fight when fighting is what's required.

Robert Armstrong: *Let's explore that pricing theme a bit. Nik, how does pricing feed into the finances of Coca-Cola Enterprises?*

Nik Jhangiani: It is a huge element. Fortunately, in the last couple of years we've benefited from

Nicolas Tissot

Education

Holds an MBA from École des hautes études commerciales (HEC) and graduated from École nationale d'administration

Career highlights

Alstom

(2015)
Adviser to the group chairman and CEO

(2010–14)
CFO and executive-committee member

Suez/GDF Suez/ENGIE

(2008–10)
Deputy CEO, global gas and liquefied natural gas

(2005–08)
CFO and executive-committee member, Electrabel

(2003–05)
CFO and executive vice president, Energy International

(1999–2003)
Head of group financial planning and control

French Ministry of Economy, Finance, and Industry

(1995–99)
Inspecteur des Finances, the senior audit and consulting body of the ministry

Fast facts

Married, with 4 children

Member of the French-American Foundation (and former FAF Young Leader) and the Société d'Economie Politique

Independent director at Euroclear Settlement of Euronext-zone Securities

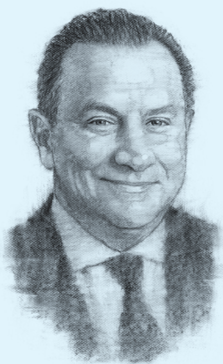
the more benign commodities environment. As recently as four or five years ago, inflation was high, and we had to find a way to pass that on to our customers and our consumers. Today, some markets in Europe are actually facing deflation, and your customers and consumers are looking at that, too. What we're not able to achieve through pricing, we have to do by reducing costs—finding better ways to be efficient at what we do.

The answer isn't always about the absolute price the market will bear. Sometimes, it's much more about what you can do from an overall revenue-growth perspective. In addition to cutting costs and increasing prices, how do you get the right mix of products to generate more transactions? How might you change your packaging strategy to increase revenue growth? For example, would consumers want—and pay a slight premium for—a smaller or differentiated or more premium package?

Nicolas Tissot: In heavy industries, the pricing environment is always driven by the business cycle. For several years, we've been in a crisis that also has some structural components. So we've had to adapt structurally to the emergence of new competitors from places with a lower cost base. We also need to adjust to the interest of our clients in our services, as well as our technology. The CFO is instrumental, for example, in launching performance and restructuring plans, setting up partnerships, allocating R&D money, and reorienting manufacturing investment.

On pricing, we need to adapt rapidly or we'll lose every sale. At one time, deals targeted a level of profitability that fully rewarded our investments. But when there is overcapacity in the market and when—to break even—competitors fight to keep factories running, sometimes you end up settling for the second-best price. At Alstom, the CFO, who personally approves every

Samih Elhage



Education

Holds a bachelor's degree in electrical engineering and in economics from the University of Ottawa, as well as a master's degree in electrical engineering from École Polytechnique de Montréal

Career highlights

Nokia Networks

(2013–present)
Executive vice president and CFO

(2013–present)
Chief operating officer, Nokia Solutions and Networks

Nortel

(2009–10)
President, carrier voice over Internet Protocol (VoIP) and applications solutions

(2008)
Vice president and general manager, carrier VoIP and applications solutions

(2007–08)
Vice president, corporate business operations

Fast facts

Married, with 2 children

Pastimes include world music, traveling, walking, and golf

bid above €50 million, has to take into account those specific periods and relax the margin targets appropriately.

Foreign-currency risk

Robert Armstrong: *Currency risk has returned to the corporate world's attention over the past year, with the strong dollar and the fluctuations of other currencies. How do you manage the risks?*

Samih Elhage: I start with how we should achieve our performance goals and then ask how we cope with the challenges of all external aspects, including currency fluctuations. In our business, we depend mainly on four currencies—the euro, the US dollar, the Japanese yen, and the Chinese yuan. We usually get our performance plan approved by the board in Q4 and make any changes at the beginning of the year. From there, I ask teams to develop their performance plans reflecting the impact of currencies. Their underlying business objectives have to be achieved from an operating-profit perspective, and that comes down to cash.

If the effect of currency shifts help the top line, that's assumed to be in addition to the team's performance goals. If currency shifts affect costs negatively, the team has to find some way of compensating for that.

Is that challenging? Absolutely. It adds to the pressure on teams to meet their goals. Are we making progress? Yes, we are. But costs associated with hedging have to be included in the accounting statements, and they have cash implications. Our teams know that they just have to make the numbers add up.

Nik Jhangiani: The countries in which Coca-Cola Enterprises operates give us a fairly natural hedge—because our revenues and a great deal of our cost base are local. In fact, we produce 90-plus percent of our products within a given market. It's difficult and expensive to transport water. Producing locally gives us another natural hedge.

The issue is more with our commodity exposures, which could be in different currencies. That's where we make sure that we're covering risk through transactional exposures, for which we hold teams accountable—having hedging policies in place and ensuring that all our transaction exposures are covered, at least on a rolling 12-month basis (with lower levels of coverage going out 36 months). Teams are responsible for making sure that currency risks are covered through pricing and cost structures and so on.

Our hedging strategy is very clear. We're not looking to beat the market. We are just trying to increase certainty around our cost structure. We do not hedge for translational currency conversion or exposure. When we communicate with the market, we actually give guidance and provide our performance data both on a currency-neutral basis and then with the impact of currencies. The transaction part is built into the information we provide.

You can't keep changing what you do in volatile times, as that volatility will always be out there. At times, translation or currency conversion works and has some benefits, and at times it doesn't. You have to try to ride through that cycle without being reactive and changing things, unless you see something that isn't working over the long term.

Nicolas Tissot: We see our business as being a supplier of industrial equipment and associated services, not playing games with the fluctuations of currencies. As soon as an order is firmed up, we have a full analysis of the currency flows. Then that exposure is systematically hedged over the horizon available in the market, with a rolling forex strategy. We have pretty significant activity in that

respect. To avoid paying too much in fees to the banks, we use an electronic platform. The banks own the platform and it is competitive for any forex trade that we handle to hedge our exposure.

Capital structure

Robert Armstrong: *One of the ironic consequences of the financial crisis is that debt financing is cheap and easy to get unless you're a bank. It's so cheap, why have any equity at all? How do you make capital-structure decisions in this context?*

Nicolas Tissot: Regarding debt financing, over the past few years there have been times when we've needed to think fast, act fast, and be opportunistic. There are imperfections in the market, and many of us have seized the opportunities they create. But at the same time, you always have to keep the long-term view in mind.

Alstom is in a very cyclical industry, and sometimes you can lose sight of your position in the cycle. When things are good, there's a risk of leveraging too much; when the hard times come back, you burn a lot of cash and quickly deteriorate your financial structure and therefore your rating, which leaves you little if no access to debt markets. We manage our financial structure—the structure of the balance sheet—with that in mind. At the peak of the cycle, we want to have almost no leverage, while at the trough we accept more.

Samih Elhage: At Nokia, our capital-structure decisions are guided by the principle that we should always do our best to give back to shareholders. In the past two years, as we purchased Siemens's share of Nokia Siemens Networks and sold the device business to Microsoft, we put in place a program to improve our capital structure and to return €5 billion to shareholders over three years.

Why have equity at all? Our philosophy is that there should be a balance. You should go to the market when you must, but you also need a very strong capital structure to defend the business and to drive the right investment at the right time.

Nik Jhangiani: We sold the US business back to the Coca-Cola Company in 2010 and formed the new Coca-Cola Enterprises. That included much of the debt we had, as well. We continue to generate a great deal of free cash flow, but at the same time we also realized that we were very underleveraged and didn't have the most efficient balance sheet. So we set a leverage target of two and a half to three times net debt to EBITDA, compared with where we were before the sale, which was closer to one to one and a half times net debt to EBITDA. It could have been lower, but we picked a level that we saw as the right starting point for the journey we wanted to make. We would slowly lever up toward that level, so this wasn't a big one-shot bang, and we wanted to make sure we had enough dry powder for potential activities.

The leveraging up, along with the free cash flow that we continue to generate, and a strong focus on that cash-conversion rate gives us a solid pool of free cash flow. In the absence of M&A, the best way to use it was to return it to shareholders. Over the last four years, from the formation of the new Coca-Cola Enterprises through the end of 2014, we have returned approximately $8 billion to shareholders. ■

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