www.finance-ee.com | www.cfo-summit-ee.com

FINANCE

The Executive Magazine for Emerging Europe

Spring | 2011

EUR 12

How to be a Tiger

What emerging Europe can learn from East Asia

VTB A close-up on Russia's Goldman Sachs

Rating Agencies No access for new players

Voestalpine CFO Robert Ottel explains how to cut working capital in half

My Beliefs as a CFO – Revisited

We as CFOs usually regard ourselves as the conscience of our companies. We are used to challenging and questioning everything, but who questions us? Who challenges our models and beliefs? A financial crisis does. So it is time to reflect what the crisis means for me and for our entire profession.

By Marec Bela Steffens

The crisis that has held us in its grip for the last couple of years has challenged many of our long-held beliefs about the CFO job. It is impossible to describe all of the nuances here, but three topics stand out to me as central to the reconceptualisation of our daily work: forecasting and prognoses, corporate ownership, and globalisation and vulnerability.

The crystal ball

As is the case for many of my peers as well, my order-entry forecast depends on the business cycle of my customers. Hence, a reliable prognosis of their cycles is essential. Unfortunately, prognoses are far from reliable.

The most common practice is simple trend extrapolation. If there is a growth trend now, one can assume it will continue in the future. If there is a decline, business will go to the dogs. But there is an exception: the prophets of doom, or of turnarounds. In good times, they will not tire to warn of a turn for the worse. In a crisis, they actually predict recovery. And at the end of the day, they will always be right. If you repeatedly predict rain, even in the desert you will be right eventually. But when? The problem with these prophets is they can never pinpoint a time.

Admittedly, I am not very good at forecasting. I cannot make an accurate forecast of my order entry. Sometimes we win projects where we never thought we had a chance; sometimes it is the other way round. We try to balance this by weighing project values with probabilities. But this method is designed for large numbers of independent events. Unfortunately, big projects do not come in large numbers, nor are they independent events.

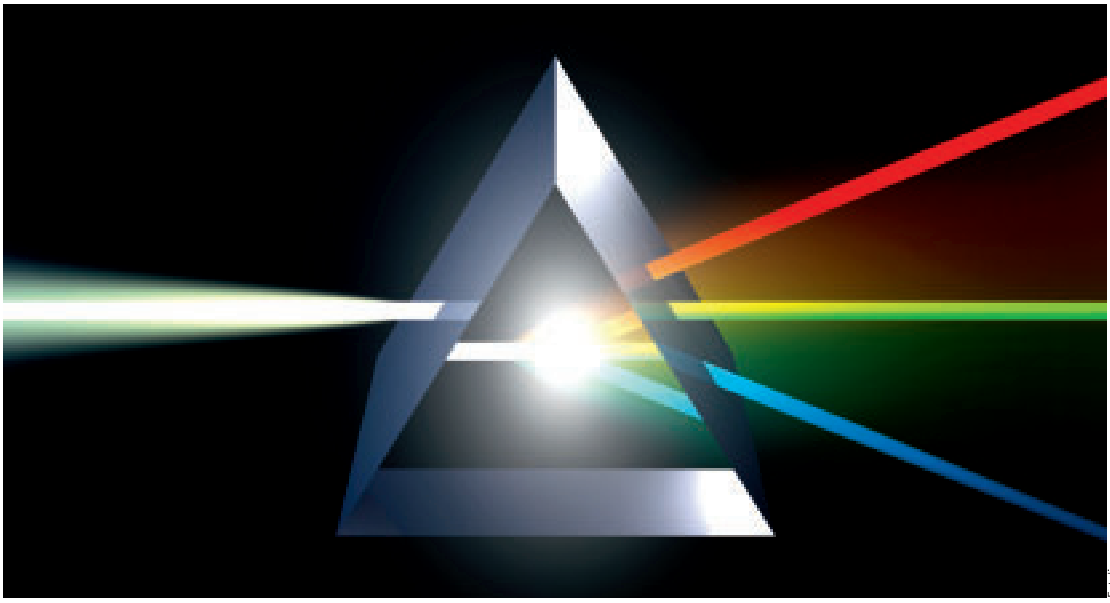
>> I used to believe that it should not matter whether a company is foreign-owned or not. This has changed. <<

We know now that the financial crisis was caused by such a mechanism: correlated events were treated as if they were independent. Of course, if Tom is run over by a truck and cannot repay his mortgage loan that does not affect the other lenders. But if every Tom, Dick and Harry loses his job due to the crisis, and all put their houses up for sale, there will be an oversupply of real estate. These events, assumed to be independent in the risk assessment, will reinforce each other. This is what we have seen happening.

My conclusion: I do not believe in forecasts, I believe in flexibility. It is my task as a CFO to have the most flexible cost structure possible, within reason. I need to be able to adapt to the business cycle. I must plan capacities that can be expanded and contracted. We cannot freeze and defrost people, but we can instate more flexible working hours. Investment projects can be broken down into modules, defining conditions that must be fulfilled before the next step is approved. A stress test can show how vulnerable a project would be if the business environment were to change. All this implies that I need early-warning indicators. Once they turn from green to red, I must react in time without overreacting in fear.

Country of ownership

I used to believe that it should not really matter whether a company is foreign-owned or not. Yes, the French care because of their mercantilist past. People in emerging Europe might care because they are not used to. But I, as an enlightened and well-trained economist, should not



Fotolia

All of a sudden, it is not that simple any more: like a prism, the financial crises has forced CFOs to revisit their beliefs in a more complex fashion than previously expected.

care, or so I had thought. Foreign or not, sensible owners would take proper care of their affiliates to become profitable.

Indeed, the principal-agent theory, which is common knowledge in economics, tells us it is the agent we have to worry about: the local manager's nature leads him to neglect the owner's legitimate interest and to serve his own selfish needs. So, the manager needs to be controlled, and the owner needs to be protected.

The crisis has proven that this "common wisdom" is not always reliable. Sound businesses became insolvent or instable in the wake of their parent company's financial difficulties. Even worse, we witnessed a very different breed of owners. Some did not try at all to build sustainable businesses or affiliates. Corporate scavengers bought undervalued companies with the sole purpose of selling the family silver, and the rest went bankrupt. Others maximised the parent-company's short-term profits at the expense of the subsidiary by overcharging on rentals or by charging disproportionate management and consulting fees.

Misbehaviour aside, in a competition between locations under restructuring, owners will often side with their home country at the expense of foreign subsidiaries.

I have been a manager in a multinational company for twenty years. Here in emerging Europe I have told people: do not worry about foreign ownership. You need influx of capital, technology and management methods. And even if rogues indeed do exist, they are rare.

Now it seems those who are suspicious about foreign ownership are not necessarily zealous nationalists. They may have a better case than I was ready to admit. I may not like this, but it is a lesson I have taken from this crisis. And the principal-agent theory needs to be expanded to deal with the self-interest of owners who act at the expense of their property.

Globalisation and vulnerability

With his theory of comparative costs and advantages, David Ricardo paved the way towards what we call globalisation. Economists used to take for granted that international trade and globalisation were good things.

Now, the crisis has shown that participation in the international division of labour makes companies, and indeed entire countries, vulnerable. They suffer from external shocks that they otherwise could have probably avoided.

Does this mean a stand-alone policy is better? I still doubt it. Autarky is a concept usually adopted in times of bitter need such as wars or boycott. It is not a policy of choice – the price is simply too high. Ricardo was right, after all: why should a country waste precious resources on something it could easily obtain at a lower cost through international exchange?

As professor Attila Chikan, a former Hungarian Minister of Economics, put it: relying on autarky to overcome a crisis is like the old story of Baron Muenchhausen of using his own hairs to pull himself out of a swamp. The lesson from the crisis should be that shocks cannot be avoided, but their harshness can be reduced by diversification. A return to more autarky, like some people called for in the wake of the crisis, has never been a serious option for development and growth. And this still holds true.

This is how the crisis changed or reinforced some of my beliefs as a CFO – so far, I should say. I am still in the process of sorting it all out. ||

Marec Bela Steffens is the CFO of Siemens Zrt. in Budapest, Hungary. Born in Hamburg, Germany, in 1964, he is an economist by education and holds a PhD from Hamburg University. The views expressed in this article are solely his own. The article is based on a presentation at the Institute for Social and European Studies (ISES) in Koszeg, Hungary.

marec-bela.steffens@siemens.com