Leadership for India Inc: Practical Concepts and Constructs
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Week - 08
Functional Leadership Models
Lecture - 39
Finance Leadership

Hi Friends, welcome to the NPTEL course Leadership for India Inc: Practical Concepts and Constructs. We are in week 8 discussing Functional Leadership Models. In this lecture, we will discuss Finance Leadership. As in the case of R&D leadership, operations leadership, and marketing leadership which we covered in the last three lectures. We will first focus on the domain and the various factors that drive the domain, and then come to finance leadership per se.

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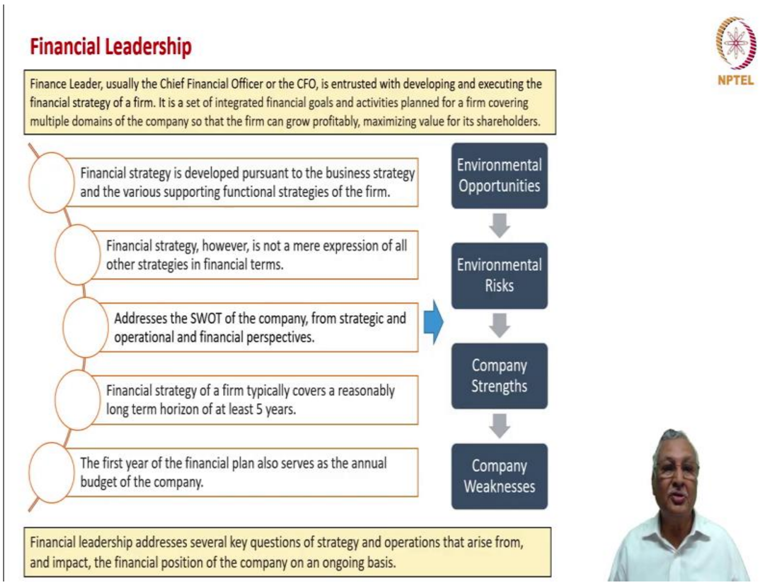

Finance leader usually the Chief Financial Officer or the CFO is entrusted with developing and executing the financial strategy of a firm. It is a set of integrated financial goals and activities planned for a firm covering multiple domains of the company so, that the firm can grow profitably maximizing value for its shareholders.

Financial strategy is developed pursuant to the business strategy, and also the various supporting functional strategies of the firm. However, financial strategy does not mean, all of these things have to be just converted into numbers or into financial terms, it is broader than that. It addresses the SWOT of the company, from strategic and operational, as well as financial perspectives.

The financial strategy of a firm typically covers a reasonably long term horizon of at least 5 years. The first year of the financial plan also serves as the annual budget of the company. Financial leadership addresses several key questions of strategy and operations that arise from and also impact the financial position of the company on an ongoing basis.

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Financial leader needs to be a business partner as well as an ombudsman for the company. The leader has to be a partner of the business, he should also be the protector of the business, he should be approver of expenditure and investments. But, should also be monitor of all financial matters of the company.

Financial strategy as I said has linkages with every other strategy of the company be it product strategy, technology strategy, operations strategies, sales and marketing strategy, human resource strategy or the business strategy. The financial leader must play multiple roles from enabling to disabling, to ensure that the finances of the firm are managed in a prudential manner. The fiducial responsibility must weigh heavily on the financial leader.

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Financial strategy of a firm addresses several key questions such as, what are the assets and liabilities of the firm? What is the profit or loss arising from the firm's operations? The profit and loss account and the balance sheet of the company provide a picture of the financial health and strength of the firm at a glance.

These also reflect the integrity of finances in a company. What is the profitability of each of the products and the product portfolio as a whole? Establishing product profitability, based on analysis of product wise prices and cost is an important driver of both tactical and strategic operations of the company.

Another question that finance addresses is this, what are the implications of different manufacturing options in terms of breakeven levels, profitability parameters and the means of finance? In the post COVID situation, many companies have encountered, severe loss of production and some of the companies also had almost zero sales. In matters such as these finance plays a huge strategic growth.

The finance department should not say that it is zero sale therefore, everything must be at zero cost level it is not possible. The financial person has to have the long term perspective to look at the recovery aspects and also sustaining the growth aspects. However, the financial leader has the responsibility to ensure that the costs are taken out, particularly the wasteful costs are taken out, making use of these developments.

Another important question for the finance leader is the funding of the business, it could be through equity or debt or a combination of both. And, it should also have a good measure of internal generations. And finally, the question for the financial leader along with the leadership team is, how will the firm maximize its value to the shareholders? Firms are moving away from singular measures of firm's performance, and instead use a set of measures that lead to wealth maximization.

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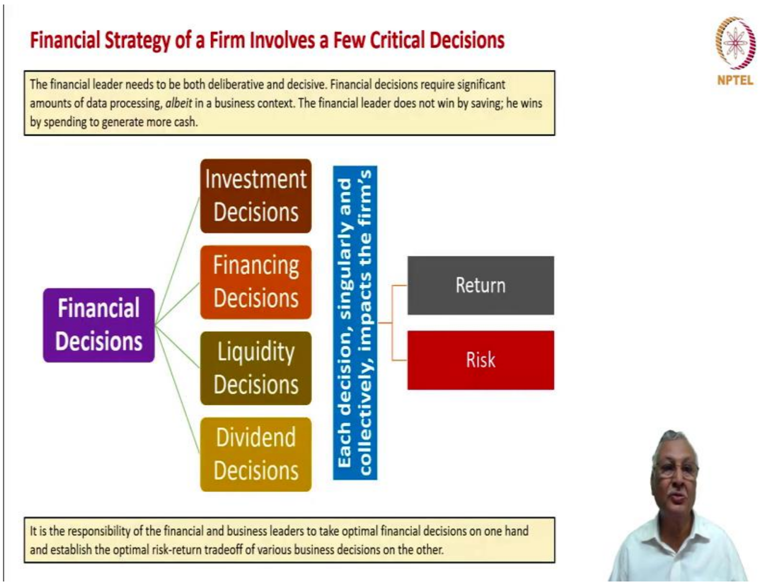

Financial strategy of a firm involves a few critical decisions. And, these decisions are led in terms of both deliberation as well as resolution by the financial leader. They require significant amounts of data processing although in a business context. The financial leader does not win by saving, he wons by spending to generate more cash, key financial decisions of a firm or the investment decisions, the financing decisions, the liquidity decisions and the dividend decisions.

Investment decisions deal with putting money into the company for growth. Financing decisions mean financing the working capital cycle of the firm, as also several operations of the company. Liquidity decisions relate to the cash levels that could be generated and that need to be maintained, dividend decisions relate to the money that could be paid back to the shareholders.

So, that their investments fetch some returns, each decision singularly and collectively impacts the firms return as well as the risk. It is the responsibility of the financial and business leaders to take optimal financial decisions on one hand. And, establish the optimal risk-return tradeoff for various business decisions on the other hand.

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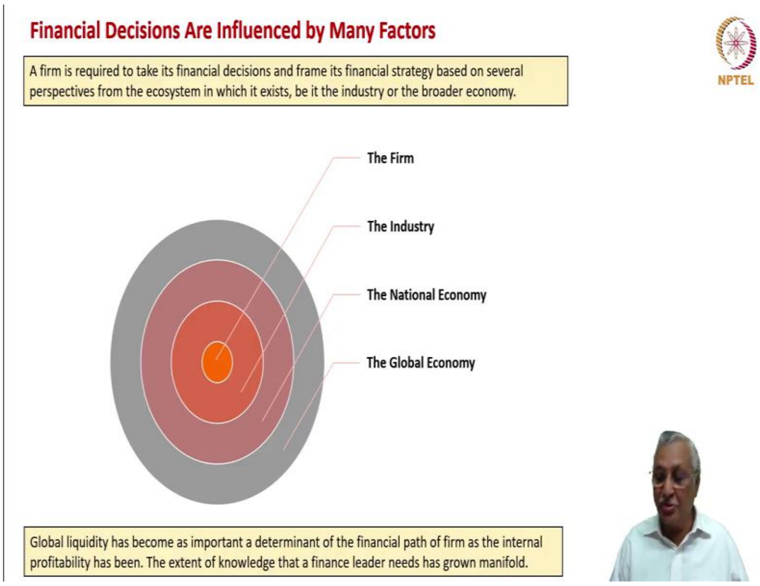

Financial decisions as I said are influenced by many factors, and these factors again through this concentric circle model are the firm being at the core and center of the ecosystem. The firm operates in an industry and the industry has certain characteristics, the firm cannot completely escape from those characteristics; but at the same time, the firm can be better than the industry average on many counts.

Then, we have the national economy the macroeconomic factors, the microeconomic factors, impact the financial decisions of the firm and finally, the global economic factors. Global liquidity has also become a very important aspect of the financial path of the firm. Because, that is as important as internal profitability today, when the firms can raise finances globally, the firms should be well positioned to raise those finances.

But, it cannot come in as gaffe, it requires appropriate rating of the firms physical and financial performance by independent rating agencies, which means that the company has to be run on prudential principles. And, the company should have good growth prospects. Therefore, the extent of knowledge that finance leader needs has grown manifold over the last several years.

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A financial leader must be savvy about both business and economy. And, the number of factors, which he needs to take into account for developing financial strategy are a huge number, some of these are mentioned here in a 25 factor matrix.

Consumer optimism, GDP growth, inflation, demographics, subsidies, consumer spending, sectoral growth, unemployment, formation of jobs, purchasing power, gross domestic savings, money in circulation, inequalities credit availability, gross capital formation, interest rates, financial market stability, international trade, balance of payments, foreign direct investments, exchange rates, international ratings, overall debt, government debt, similar global economic parameters.

The nature of each business influences, the pattern of correlation between economic and business factors. If there is a company which has got manufacturing and R&D sites across the globe. And, also sells its products across the globe, then the requirement of the exchange rate regimes in various jurisdictions and the related tax regimes is an important aspect of the financial leadership in that company.

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Financial strategy is closely linked to other factors, corporate governance, ethics, compliance, business continuity, risk management and even the broader ESG leadership are now integral to financial management. The CFO must therefore, set the highest standards of probity in the firm. Corporate governance ensures that the companies run on prudential lines, ethics and compliance ensures that the firm is an honest corporate citizen.

Business continuity and risk management ensures that the business is made robust against potential disruptions and risks including cyber attacks. Financial management is relied upon to ensure operational integrity and business continuity of the firm not merely wealth maximization for the current situation.

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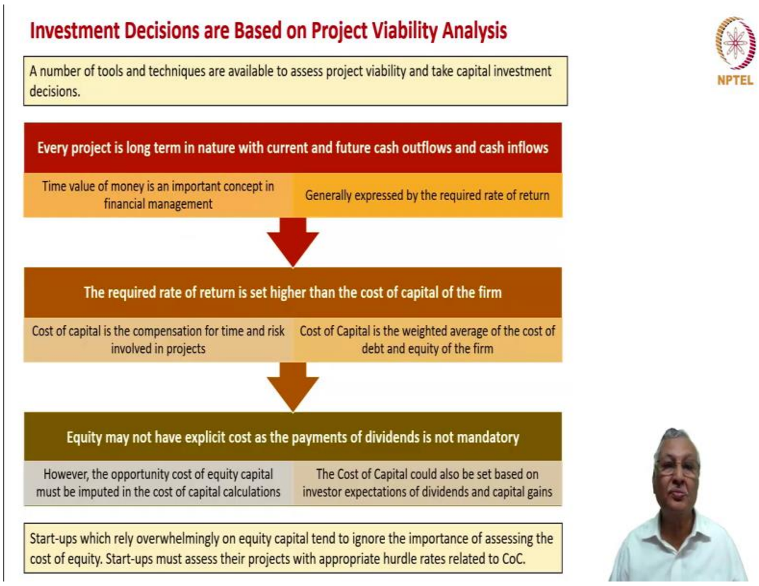

As we all know, investment decisions have to be taken by firms all the time, but investment decisions are based on the project profiles that the teams generate and project profiles are approved only when they are considered feasible and viable. While the technical leaders provide guidance on the technical feasibility of the project, the financial viability is carried out by both the financial leaders as well as the operational and technical leaders.

Every project is long term in nature with current and future cash outflows and cash inflows. Time value of money is very important, in financial management which is generally expressed by the required rate of return. The required rate of return is set higher than the cost of capital of the firm. And, cost of capital is the compensation for the time and risk involved in various projects. And, cost of capital is defined as the weighted average of the cost of debt and equity of the firm.

There is no one fixed cost of capital for a firm, it keeps varying depending upon the cost of equity as well as the cost of debt. Equity may not have explicit cost as the payments of dividends is not mandatory. However, the opportunity cost of equity capital must be imputed in the cost of capital calculations. The cost of capital could also be set based on the investor expectations of dividends and capital gains.

Startups which rely overwhelmingly on equity capital tend to ignore the importance of assessing the cost of equity. Startups feel that equities available at high premia endless, which is a wrong notion. Startups must assess their projects with appropriate hurdle rates related to cost of capital, then only they will understand the, viability of the project on an expected commercial run.

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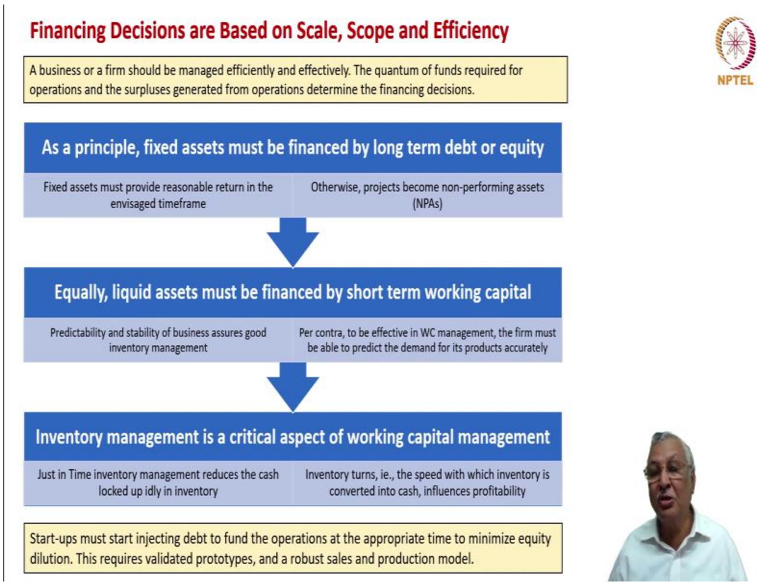

Financial decisions are based on scale, scope and efficiency. If the business or the firm is to be managed efficiently and effectively, the quantum of funds required for the operations. And, the surpluses generated from operations have to be managed diligently. As a principle fixed assets, which are long term in nature must be financed by long term debt or equity.

Fixed assets must provide reasonable return in the envisaged time frame, otherwise projects become nonperforming assets. Equally liquid assets must be financed by short term working capital, when we say liquid assets we talk about inventory. Predictability and stability of business assures good inventory management.

Per contra to be effective in working capital management the firm must be able to predict the demand for its products accurately. Inventory management is a critical aspect of working capital management, just in time inventory management as we have seen reduces the cash locked up idly in inventory.

Inventory turns that is the speed with which inventory is turned around that is converted into cash influences profitability. Again coming to the issue of startups, startups also must start injecting debt, to fund the operations at an appropriate time. So, that the equity infusion is minimized and stake dilution is also minimized. And, also getting debt into the company ensures that the product and marketing decisions, as well as the manufacturing decisions are made with an eye on prudential commercial principles that is every product must have to pay for itself.

This requires of course, validated prototypes and a robust sales and production model. The first two principles which I mentioned that is the long term assets must be financed by long term debt or equity. And, the short term assets must be financed by short term working capital is extremely important.

When, company start directing the long term capital for short term financing or use of the short term financing into long term asset creation, the company gets into a debt trap. And, it would be kind of log jammed in terms of the use of debt in running the operations or investing for the future.

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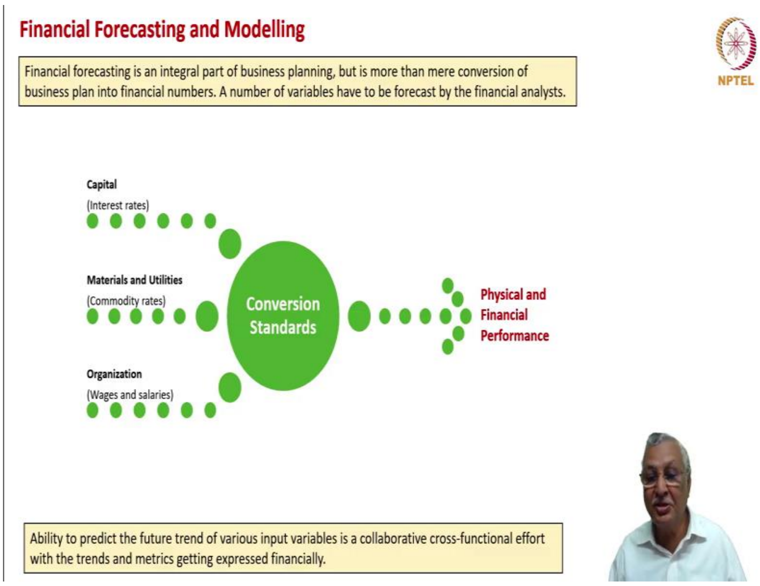

Financial forecasting and modelling is as important as demand forecasting and modelling, it is an integral part of business planning. But, is more than conversion of business plan into financial numbers. A number of variables have to be forecasted by the financial analyst, for example, the interest rates that the capital demands, the commodity rates which materials and utilities demand.

And the wages and salary levels in an organization, these are just three of the input factors. And, the conversion standards have to be determined with respect to each firm's capabilities and aspiration. At the end of this analysis, you get fiscal and financial performance of the company. Ability to predict future trend of various input variables is a collaborative cross functional effort, with the trends and matrix getting expressed financially.

A finance leader will not be able to predict, the commodity rates all by himself or herself. It requires inputs from the supply chain management. Therefore, operations and finance have to work together in generating the commodity rates. Similarly, finance and HR have to work together to generate the wage and salary rates.

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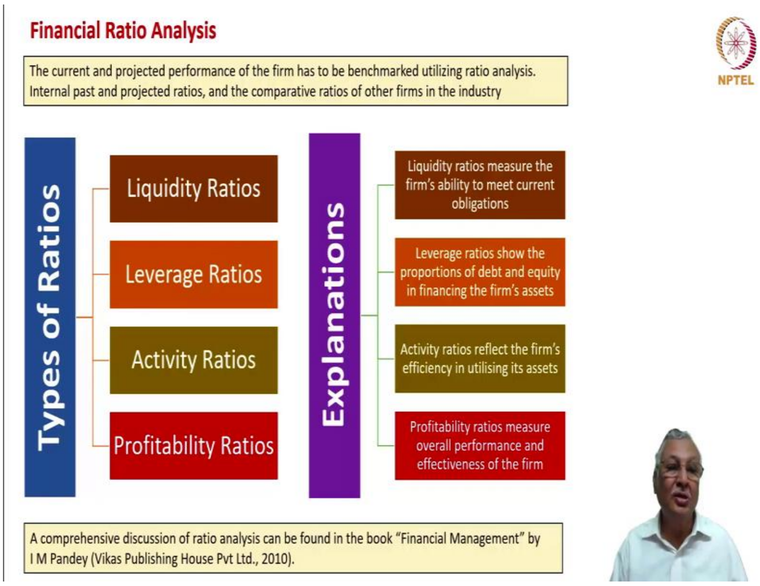

Let us look at financial ratio analysis, while this lecture is not about financial management, I thought that you must understand how the financial ratio analysis can be a great lever for the finance leadership to govern the financial health of the company. There are four types of ratios liquidity ratios, leverage ratios, activity ratios and profitability ratios.

Liquidity ratios measure the firm's ability to meet current obligations, it is like a current ratio. Current assets by current liabilities. Leverage ratios mention the proportion of debt and equity in financing the firm's assets, activity ratios reflect the firm's efficiency in utilizing its assets.

And finally, the profitability ratios which are probably the easiest to look at, measure the overall performance and effectiveness of the firm, if you want to have a comprehensive ratio analysis discussion. Please refer to the book Financial Management by I M Pandey, which is an authority on this subject.

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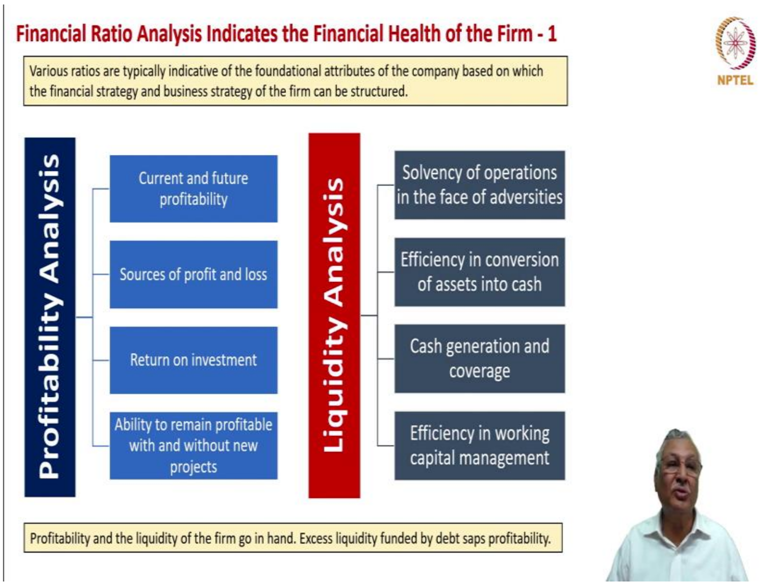

Financial ratio analysis indicates the financial health of the firm I said. And various ratios are indicative of the foundational attributes of the company based on which the financial strategy, and business strategy of the firm can be structured. And, mind you, the strength of the ratios and the predictability of the outcomes is based on the integrity of the data that is put into those ratios.

So, profitability analysis tells us the current and future profitability, sources of profit and loss are also provided by that, return on investment is brought out through those ratios. And, ability to remain profitable with and without new projects can be measured by profitability analysis.

Liquidity analysis tells us about the solvency of operations, in the face of adversities. That is how many days of debt cover do we have, how many days of interest cover we have? These are the important aspects that come from liquidity analysis, efficiency in conversion of assets into cash, cash generation and coverage, efficiency in working capital management.

Profitability and liquidity of the firm go in hand, excess liquidity funded by debt saps profitability, because profitability is net of all the interest expenses. This so called strategy of accessing funds at low interest costs, could be beneficial when the interest rates are low, but could boomerang when the interest rates firm up.

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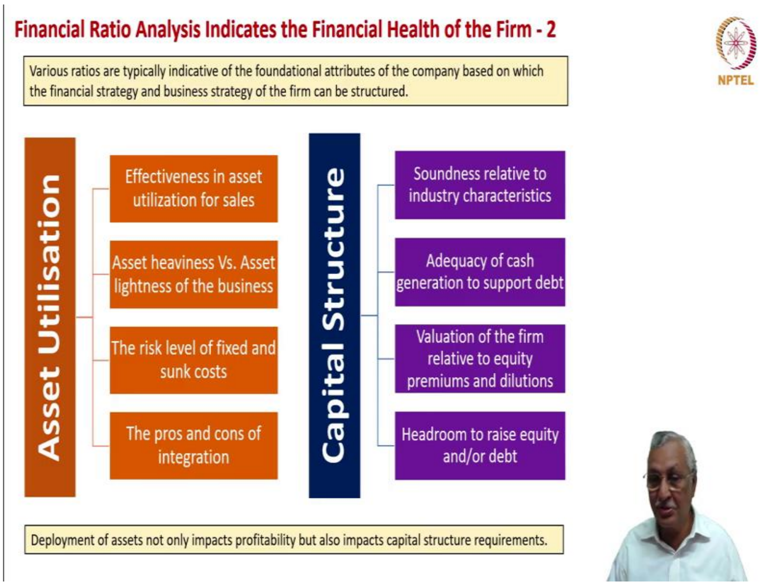

Asset utilization that is effectiveness in asset utilization for sales asset heaviness versus asset lightness of the business, the risk level of fixed and sunk costs, the pros and cons of integration are measured by asset utilization ratios. Similarly, capital structure ratios that is the soundness with reference to the industry characteristics, debt equity ratios for example, adequacy of cash generation to support debt, valuation of the firm relative to equity, price earnings ratio and also book value to market cap ratio.

These are all the ratios which help understand the strength of the company in terms of its capital structure and market capitalization. And, they also provide a head room to raise equity and or debt. If the debt equity ratio is highly favorable, that is very low debt level relative to equity you can raise more debt.

On the other hand, if you are debt laden with a debt to equity of 2 is to 1 or 3 is to 1 it is time you start raising the equity before the company goes down under. So, capital structure ratios are extremely important, deployment of assets not only impacts profitability, but also impacts capital structure requirements.

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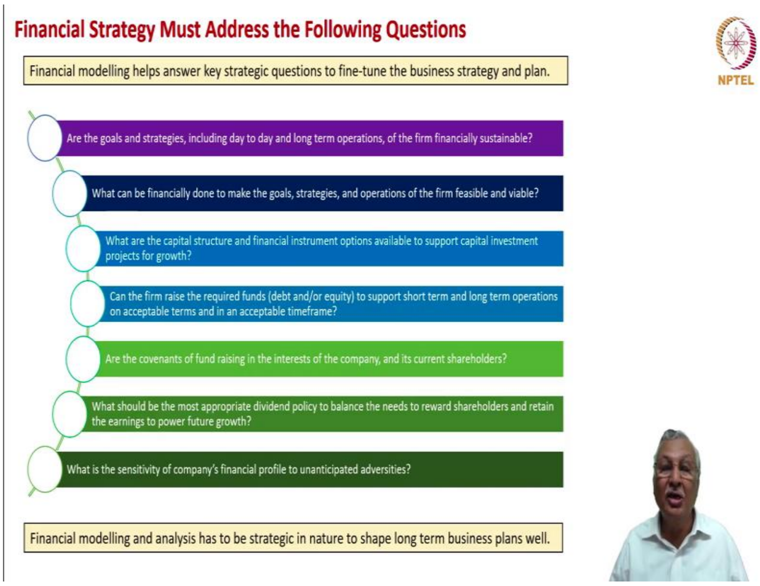

So, given these background perspectives, financial strategy must address the following questions, are the goals and strategies including day today and long term operations of the firm financially sustainable. From a business point of view, from the mega trend point of view, from the operational feasibility point of view, from the technology backbone point of view other leaders answer.

But, it is the sole responsibility of the financial leader to say whether the goals and strategies including practical and strategic operations, are financially sustainable for the long term that is very important. Long term sustenance without taking care of the short term sustenance is also not advisable that also has to be focused upon.

What can financially be done? To make the goal strategies and operations of the firm feasible and viable, how would I reduce the breakeven level. How would I make the cash generation cycle better, those are the kinds of questions which the finance leader should ask and also answer in collaboration with the other leaders.

What are the capital structure and financial instrument options available to support capital investment projects for growth? A whole number of equity options are available including direct equity, preference shares convertible debentures. Similarly, various options of debt available, non-convertible debentures, vanilla debt from the banks or debt that is having long gestation period with a moratorium.

Many aspects can be considered, in addition, you can have global depository receipts, from the overseas investors wherein the coupon rate could theoretically by zero. But, actually there will be a cumulative of the nominal coupon rate, which will need to be paid at the end of the 5 year term.

So, depending upon your outlook on what the exchange rate would be 5 years down the road, and what the business could be 5 years down the road? A financial leader can make a judgment on taking a zero coupon bond. But, the bet may go wrong if the business does not work out properly or if the exchange rate regime is adverse to the company.

So, the appropriate capital structure and financial instrument options is matter of significant experience in the financial leadership system. And, also can the firms raise the required funds, we would like to have, but can we raise it and what are the pros and cons of rising debt and equity at various points of time.

Are the covenants of fund raising in the interest of the company and its current shareholders that is also important, because each GDR issue comes with multiple conditionalities. So, reading the fine print and making sure that the firm's position is protected is the job of the finance leader.

Similarly, dividend policy, what should be the most appropriate dividend policy to balance the needs to reward shareholders and to retain the earnings to power future growth. Generally, companies are preferred for their high dividend yield. But, some companies try to conserve cash by minimizing the dividend and hoping that the increase in the market valuation of the company more than offsets the so, called short term loss of dividends.

Therefore, what is the most appropriate dividend policy that should be adopted by the firm? And, also dividends may be declared even when the company is not doing so well. In exceptional circumstances, if the company has had no record of any break in the dividends and only 1 year there is situation of loss at times. The companies dip into the general reserves to pay the dividend.

Because, they are signaling to the investors and shareholders that the management and the leadership of the company are optimistic of the future sustainability of the business. So, dividend decision is a very important strategic decision. Another question is the sensitivity of company's financial profile to anticipated and unanticipated adversities. Financial modelling and analysis should not be a number game; it has to be strategic in nature to shape long term business plans as well.

So, as you talk about these points, you can understand the strategic role of the financial leader, he is no longer an accountant, he is no longer a gate keeper. He is one who makes strategy happen, and he is also the one who understands the strategic implications of the financial decisions.

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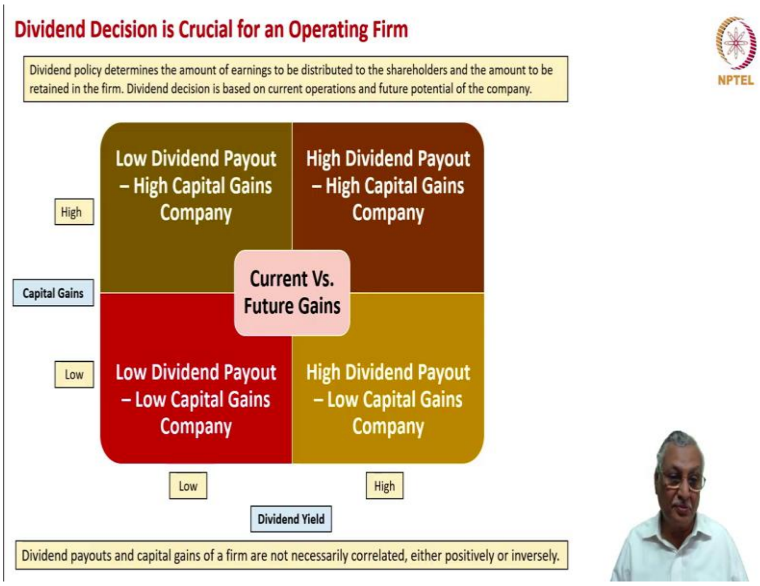

As I said, dividend decision is crucial for an operating firm. And, dividend policy determines, the amount of earnings to be distributed to the shareholders and the amount to be retained in the firm. Dividend decision is based on current operations as well as the future potential of the company. There, could be two types of dividend yield companies low or high.

Similarly, the capital gains that is appreciation in the stock price could be low or high. Low dividend payout, low capital gains companies are not preferred by the investors. On the other hand, certain class of investors prefer high dividend payout even if the capital gains is nominal. Some investors, who have got really a long term horizon particularly the private equity investors and others, may prefer a low dividend payout and high capital gains company.

Ideal of course is a high dividend payout and high capital gains company. This is the company with the virtuous business model, which is highly profitable and highly growth oriented. Again dividend payouts and capital gains of a firm are not necessarily correlated.

Just because a company pays high dividends, it does not mean that the company would be appreciated in terms of market value significantly. So, there is no specific relationship, because the market value of a particular stock is a function of several other factors. Apart from today's profitability that enables payment of dividend.

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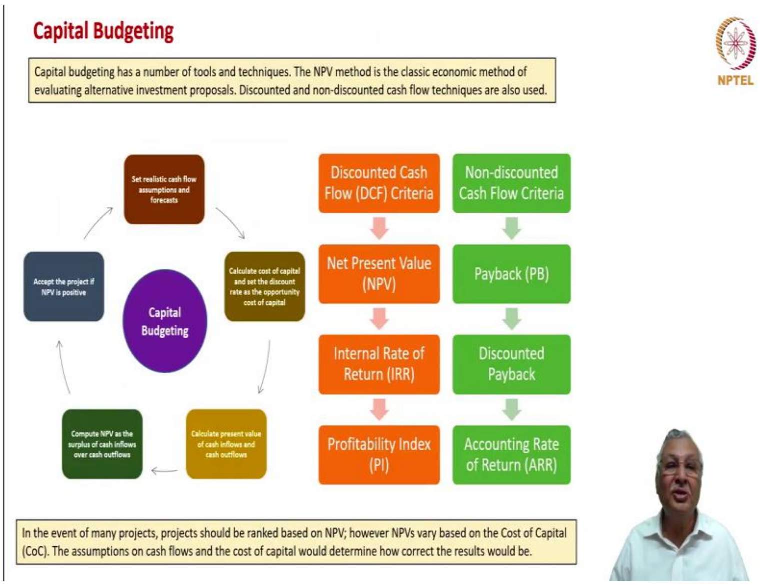

Capital budgeting is another very important aspects of financial leadership, capital budgeting is the allocation of capital into futuristic projects. Capital budgeting domain sets realistic cash flow assumptions and forecast for the company. It calculates cost of capital sets the discount rates as the appropriate cost of capital.

It calculates the present value of cash inflows and cash outflows, computes Net Present Value or NPV as the surplus of cash inflows over cash outflows. And finally, guides us whether the project should be accepted if the NPV is positive. So, discounted cash flow criteria or the net present value, internal rate of return, profitability index. There are non discounted cash flow criteria as well payback period discounted payback and accounting rate of return.

In the event of many projects, projects should be ranked based on NPV, but NPVs themselves may vary based on the cost of capital assumptions. The assumptions on cash flows and cost of capital would determine, how correct the results would be.

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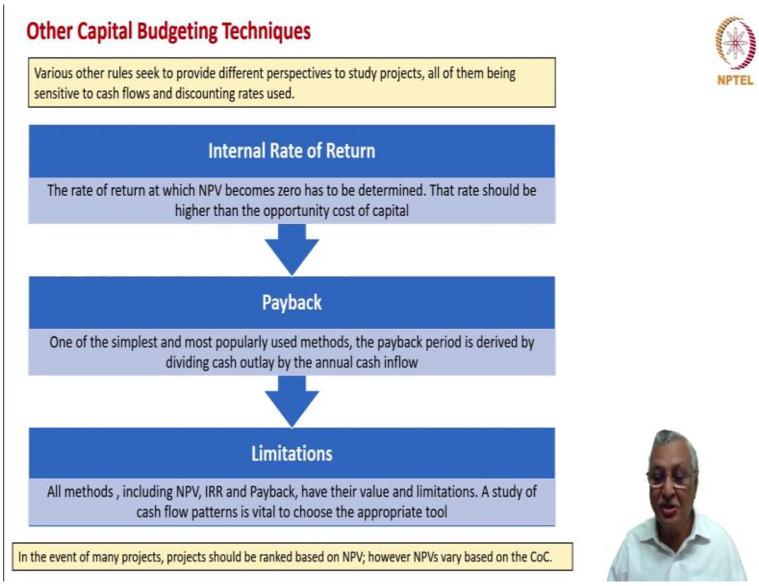

There are other capital budgeting techniques as well, various other rules seek to provide different perspectives to study projects all of them are sensitive to cash flows and discounting rates that are used. Internal rate of return looks at the NPV becoming zero, and the point at which the NPV that is net present value becomes zero that rate should be higher than the opportunity cost of capital.

In the payback period, which is the simplest and most popularly used method, the period is derived by dividing cash outlay by the annual cash inflow. If total cash outlay on my project is 1000 crores and every year, 100 crores is being brought in, the payback period is 10 years.

And, in long term projects payback; obviously, would distort the picture. All methods including NPV, IRR and payback have their value and limitations, a study of cash flow patterns is vital to choose the appropriate tool. How the cash flow patterns increase? What is the curve that would happen? In the event of many projects, projects should be ranked based on NPV as I said, but NPVs could vary based on the cost of capital.

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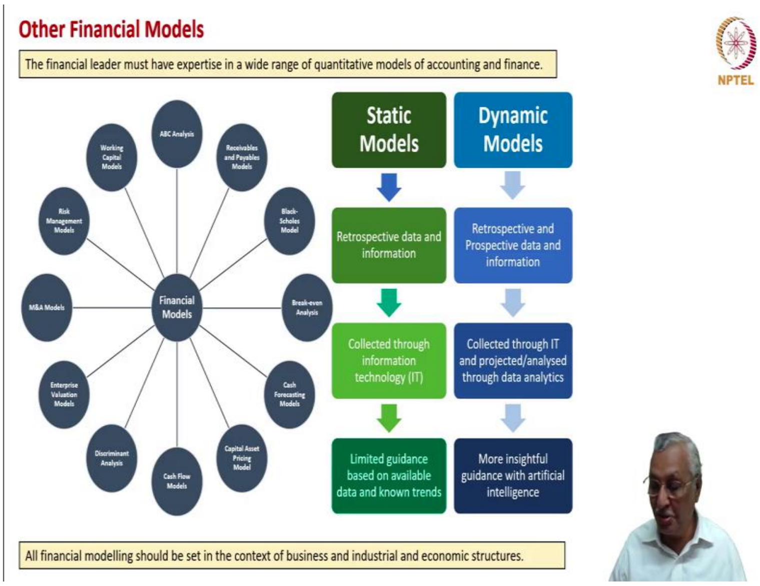

There are various other financial models also and the financial leader must be expert in those models, I have given those models here ABC analysis, receivables and payables models, Black-Scholes model, break-even analysis model, cash forecasting model, capital asset pricing model, basically for portfolio selection, cash flow models, discriminant analysis, enterprise valuation models, merger and acquisition models, risk management models, working capital models.

The sum and substance is that financial leader must be a wizard in modelling. And, the models could be static models or dynamic models. Static models are those that are based on retrospective data and information, which are usually collected through the information technology system of the company. And, where there is very limited guidance available on the future trends related to the current data availability.

In the dynamic models, we have both retrospective and prospective data and information these are collected not only through the IT systems. But, also projected through data analytics and these provide more insightful guidance with artificial intelligence. However, all financial modelling is one of simulation of one scenario or a number of scenarios.

The business leader's judgment comes in as a very important factor in deciding, which model needs to be accepted. Because, what looks financially very attractive may not be the best strategic approach to be adopted under certain circumstance. So, intuition and the wisdom and the judgmental capability of the financial leader as well as the business leader are extremely important.

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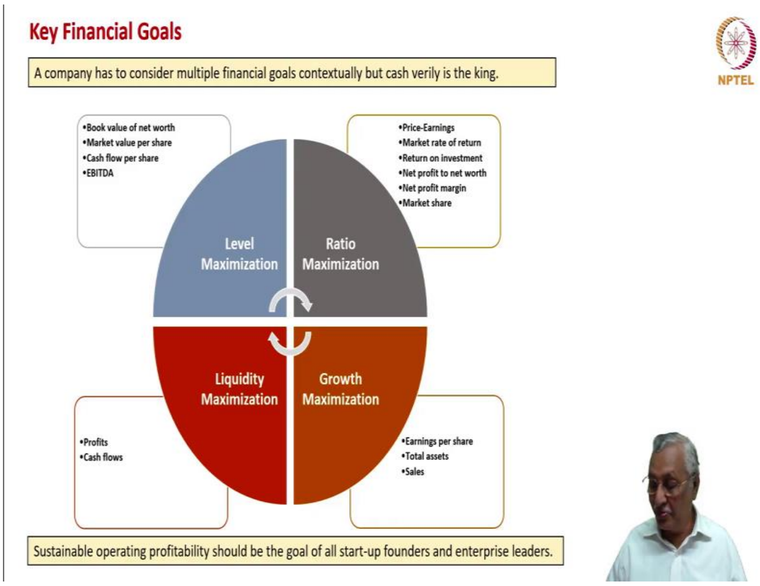

What are the key financial goals? I would say that there are four types of goals one is the level maximization, which means the book value of my net worth should be the maximum, market value per share should be the highest, cash flow per share should be the highest. I should have the highest gross margin or EBITDA.

On the other hand, you may look at ratio maximization that is price earnings ratio must be very good; market rate of return should be the highest. The project should give the maximum return on investment, net profit to net worth should be the highest. Net profit margin should be leading in the industry and market share should be the highest.

You may look at liquidity maximization approach that is profitability itself should be of very high order, cash flows must be of very high order. This is the liquidity maximization approach, there could be also a growth maximization approach of maximize the revenues, asset base and earnings per share.

Sustainable operating profitability should be the goal of all startup founders, as well as enterprise leaders, whether they are of established companies or family owned companies.

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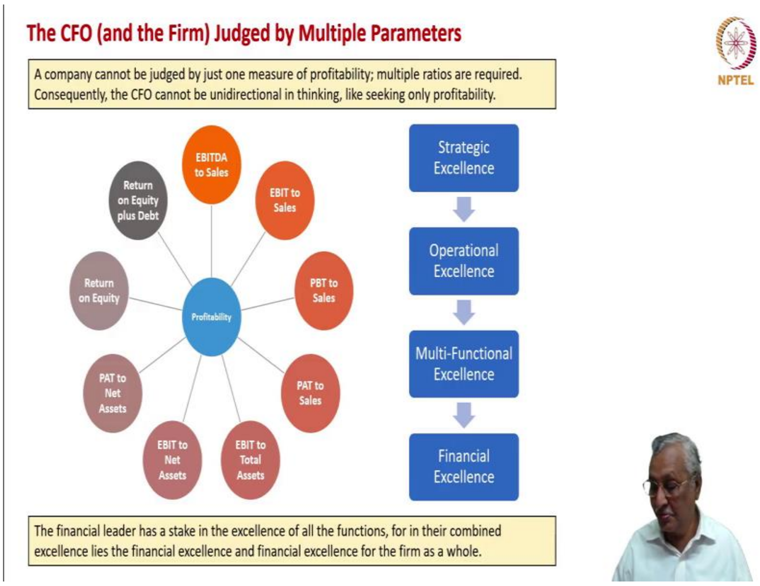

The CFO and the firm are judged by multiple parameters, not just one measure of thinking. I have listed here certain measures, nine to be precise as to what could be such strategic and operational judgment factors. So, EBIT to sales is another important criterion, PBT to sales, then profit after tax to sales, EBIT to total assets, R to net assets PAT to net assets, return on equity and return on equity plus debt all of these things are important.

Many times we make judgment by looking at return on equity, but that is not so, enterprise value is nothing but equity and debt together. And, if you have non prudential build up of debt, your return will have to show a lower level in judgment with respect to the industry parameters that is important.

Again, all these ratios reflect strategic excellence, operational excellence, multi functional excellence and finally, financial excellence. The financial leader therefore, has a stake in the excellence of all the functions because; their combined performance is contributing to the financial excellence for the firm as a whole.

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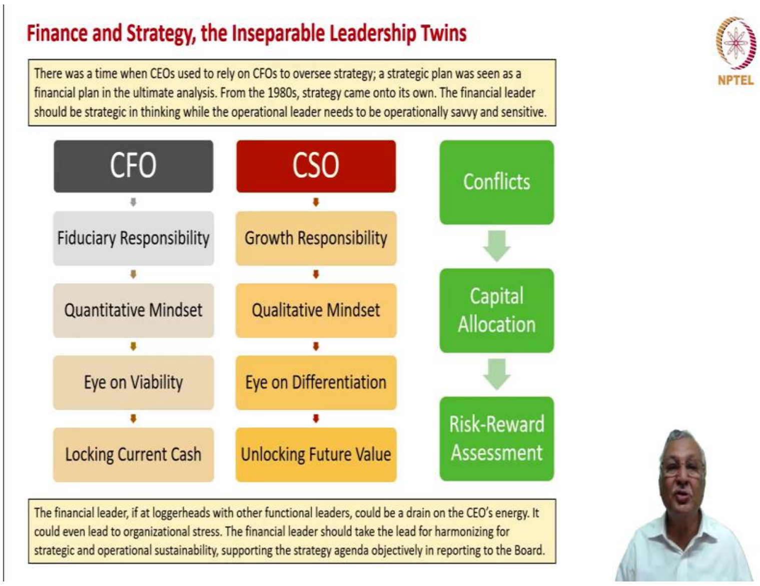

Finance and strategy these are the two inseparable leadership twins, there was a time when CEOs used to rely on CFOs to oversee strategy. A strategic plan was seen as a financial plan in the ultimate analysis; however, from the 1980s strategy has come on its own. The financial leader should be strategic in thinking while the operation leader needs to be operationally savvy and sensitive, but also be strategically oriented.

CFO has the fiduciary responsibility, quantitative mindset, eye on viability, locking current cash whereas CSO that is the Chief Strategy Officer not to be confused with chief scientific officer, he has the growth responsibility, qualitative mindset eye on differentiation and unlocking future value.

The conflicts could arise in terms of capital allocation and the risk reward assessment. The financial leader if he or she is at loggerheads with other functional leaders could be a drain on the CEO’s energy. It would even lead to organizational stress; the financial leader should take the lead for ensuring that there is harmony amongst various domains.

And, the harmony is often disrupted by the requirements for investments by the various domains, by the way they operational costs are built into the company's model and the way the actual performance pans out so, these are the causes of stress. But, if these stressful factors are not resolved amicably between the various domains and the CFO, the company itself will go into distress.

It is important therefore, the financial leader has the ability to interact with all the functional leaders for operational sustainability as well as strategic sustainability. And, he should also therefore, take the lead role in supporting the strategic agenda objectively while reporting to the board.

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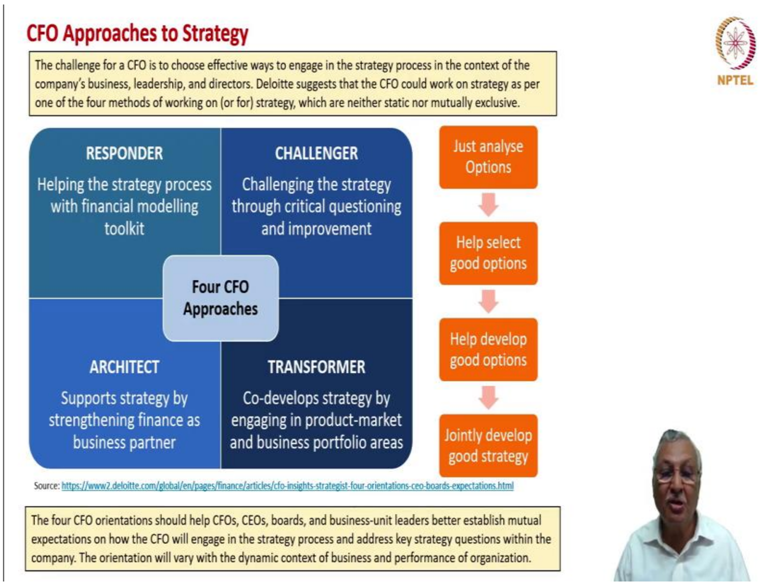

CFO approaches to strategy are varied, Deloitte has made a good study of the various approaches CFO take to strategy in large companies. The challenge for CFO is to choose effective ways, to engage in the strategy process in the context of the company's business leadership and directors.

The CFO has to be independent, because he is ultimately responsible for the fiduciary performance of the company. But, at the same time, he or she cannot distance himself or herself from the strategy execution or the strategy planning itself. Therefore, the CFO has a tough balancing act, there are four ways in which the CFO would act and these approaches are neither static nor mutually exclusive.

The first way is to be a responder that is helping the strategy process, with financial modelling tool kit. All these tool kits which we discussed in the previous slides, whether it is the capital budgeting tool kit or the ratio analysis tool kit, or financial modelling, these could be made available to the strategy planning, person. And, say that I am available at your service to develop an excellent financial plan out of your strategy plan.

The role is just one of responder, the CEO could also assume the role of challenger that is keep challenging the strategy through critical questioning and improvement, why should you invest so, much in this particular plant. Why cannot you raise the level of production in this current plant, why cannot you utilize the contract labour in place of fixed labour, why cannot you de-bottle neck through marginal investments rather than look at a brand new plant.

So, these are the kind of critical questions which the CFO comes up with to challenge the strategy. But, rarely the CFO may not provide complete solutions the idea is to challenge the domain to come up with its own solutions. There, could also be the architect approach, that is the CFO supports this strategy by strengthening finance as a business partner, that is finance and the domain works closely together. And the finance leader is very empathetic to the needs of the domain and sees how the finance function could respond to support those needs.

Transformer, he co-develops the strategy by engaging in product market and business portfolio areas as well. So, he helps transform the business of the company by being one with all the product market actions, all the R&D, operational, marketing and HR actions that the company would need to take.

So, these are the basic four approaches that CFO could take. And, all the four CFO orientations are relevant under various circumstances, one could be a challenger and also an architect. One could be an architect as also a transformer. But, being just a responder is hardly doing justice to the role of CFO in current circumstances.

So, the option analysis is also a four step process, analyze the options, help select good options, help develop good options, and jointly develop good strategy. So, these are the ways you can conduct yourself as the CFO. These four CFO orientations will help CFO, CEOs, boards and business unit leaders. Establish mutual expectations in a much better fashion.

It will also put some kind of service level arrangement between the CFO as the accounting gatekeeper, and the financial gatekeeper vis-a-vis a CFO who also has to support the business through investments and expenditure commitment. So, these two can be merged together in a very harmonious way, when the CFO adopts each of these four approaches in an appropriate manner.

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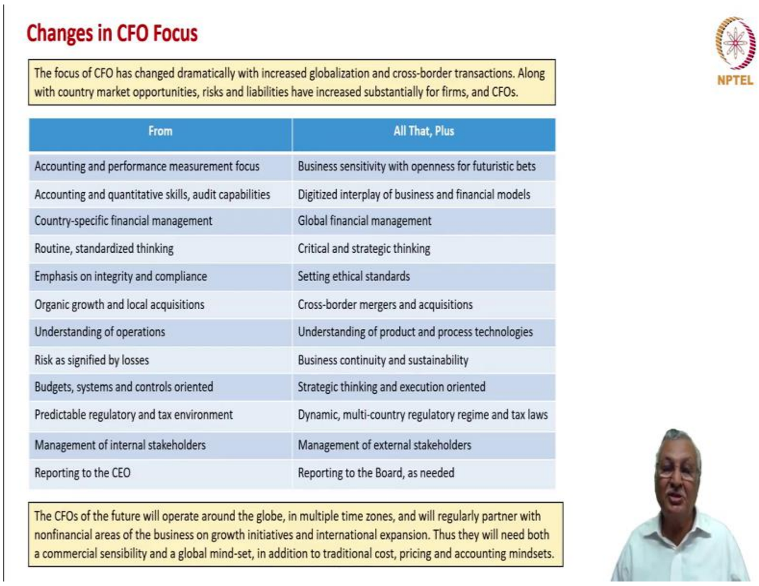

What are the changes in CFO focus that have happened over the last several years of increased globalization and cross border transactions? From an accounting and performance measurement focus, now we have that as well as business sensitivity with openness for futuristic bets.

Today's CFO is not expected to possess only accounting and quantitative skills and have only audit capabilities. A digitized interplay of business and financial models should also be the superstructure over these accounting and quantitative skills. Country specific financial management gets added by global financial management.

Routine standardized thinking has to be actually substituted by critical and strategic thinking. Emphasis on integrity and compliance must continue to be there, but the financial leader must be able to set ethical standards. Organic growth and local acquisitions get enhanced by cross border mergers and acquisitions.

Understanding of operations, that needs to be drilled down further into understanding of product and process technologies, what does this technology mean? Why are the operations leader asking for updating of manufacturing technology? Why does the R&D leader wants a completely different product profile? What are the merits and demerits?

Those appreciations must come naturally to the CFO of today's situation. Risk is signified usually by losses, but risk has to be measured in terms of business continuity and sustainability. Budget systems and controls orientation is the strong point of traditional CFO, but that should be supplemented and moderated, where required by strategic thinking and execution orientation.

CFO is very comfortable in operating in a predictable regulatory and tax environment, while that is good the CFO must be brazing himself for dynamic, multi-country, regulatory regime as well as tax laws. Management of internal stakeholders is not sufficient, management of external stakeholders is very much important.

Today investor relations as well as media communications are being increasingly handed by chief financial officers, at times of course, supported by CSO or COO. Reporting to the CEO is getting added with reporting to the board as needed and certainty to the audit committee of the board. The CFOs of the future will operate around the globe in multiple time zones, and will regularly partner with non financial areas of business.

They would be focusing on growth initiatives and international expansion, as much as making the current operations solid and sustainable. Thus they will need both a commercial sensitivity and sensibility. And, also a global mindset in addition to the traditional cost, pricing, accounting and audit mindsets that is the change that is required.

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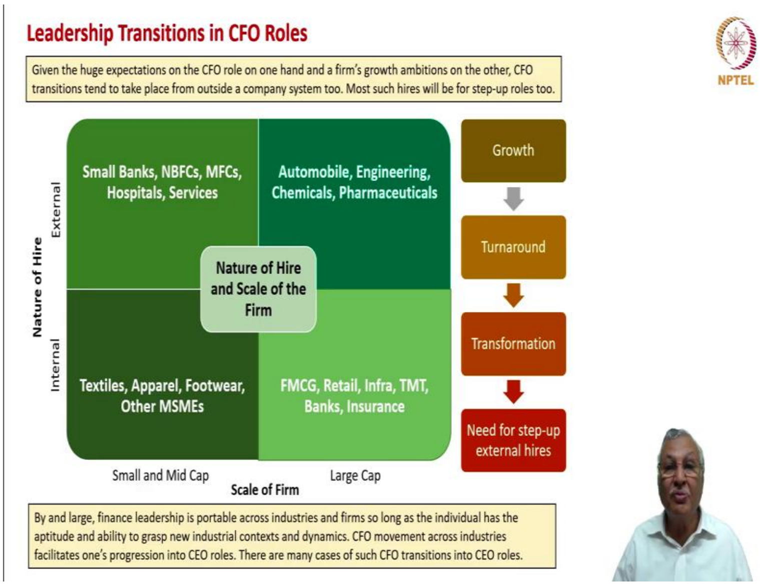

Having come to this we should also talk about the transitions in CFO roles. Earlier CFO used to stop at the pinnacle of his career as the CFO only, but given the huge expectations on the CFO role on one hand. And the firm's growth ambitions on the other CFO transitions have become extremely important. And, companies are resorting to CFO transitions from outside the company system also, if the growth impulse can be generated through such CFO transitions.

If the scale of firm is small and mid cap, there could be adequate internal CFO talent examples textiles, apparel, footwear and various other macro, small medium, enterprises. These companies need not look around too much for getting the appropriate talent because, mostly the existing talent be sufficient, because the strategic scope is somewhat limited.

But, let us look at some large cap companies such as FMCG, retail, infra, technology, media, banks, insurance these are large cap companies. But, they are so large again in their operations adequate internal talent is likely to be available in terms of growth, that is why Hindustan Unilever, Larson and Turbo. And, such other companies have been able to get the chief financial officers from the internal systems.

Then, you have, may have a small and mid-cap, but they are in fields which are just emerging like small banks, non banking finance corporations, mutual fund industries, hospitals, service industries, these are not very large in terms of scale of operations. But, they require a new type of expertise therefore, small banks may look into talent that is available from banking system.

Similarly, NBFCs, hospitals may look for service oriented people from FMCG. So, the external input is required for such companies then of course, there are large cap companies, which want to transform themselves. Automobile, engineering, chemicals, pharmaceuticals these are highly global companies with much greater potential for transformation. They may look for CFOs from external industrial situations.

We have had several CFO transitions that are around for example, Royal Enfield's latest CFO addition he is from the beverages industry. We have those examples, people from consulting industry come into the automobile industry, we have seen also that amongst various skills that are portable across industries, finance happens to be one such domain apart from human resources.

So, the portability of skill that is there assuming that the leader has the requisite grasp, people could be brought in from other industries to power the growth of the firm in one particular industry. So, growth, turnaround, transformation increase the need for step up external hires. Those external hires are expected to step up in their own roles.

And, also help the company step up to a new level, and also one more important aspect is that the CFO transition from outside the industry facilitates one's progression into CEO roles. Because, by doing that the CFO gets a multi industry perspective, there are many such cases of CFO transitions into CEO roles.

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I am giving you some examples Rajesh Gopinathan, he became CFO to CEO and it was an internal move. Sunil Mathur he has moved from CFO position to CEO in Siemens India that is an internal move. S Sridhar he was the CFO at Pfizer limited in India and he moved into CEO role. But, he came in externally into the CFO role and moved into the CEO role internally.

Umang Vohra CFO to CEO he came from doctor Reddy's into Cipla as CFO and then move on into the full-fledged CEO role. N S Kannan CFO to CEO ICICI Prudential it is an external move. Kevin as CFO from elsewhere and became this ICICI. S K Nag CFO to CEO in Quess corporation, it has been an internal move.

So, typically CFOs who perform step up roles internally or inducted from outside to support growth, turnaround or transformation seem to be top picks for moving to CEO roles in the high performance firms. That is, if the CEO sees the CFO performing admirably well in turnaround situations, or powering growth, or powering transformation of the company.

The CEO will be very happy to recommend such a CFO in as a CEO, the boards also will be accepting such propositions. In an environment that traditionally favored heads of operations or heads of sales to move into CEO positions. The increasing trend of CFOs staking their claim for CEO positions is certainly interesting. The leadership characteristics of individual financial leaders play a significant role in such up moves.

We cannot say as of today that this is a very defined clear path for the CFOs, but those CFOs who have unshackle themselves of the traditional accounting and audit mindset. And, those who have acquired the flair for being strategic partners, for being business partners, while retaining the accounting and audit capability these people are stepping up as the potential CEOs in companies.

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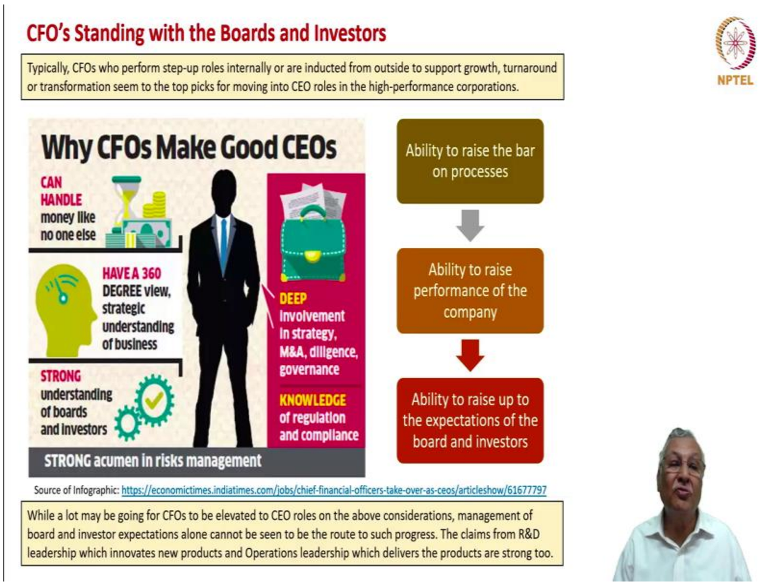

There has also been an article Why CFOs make good CEOs, a few reasons. One, they can handle money like no one else and cash is the king at all times. Have a 360 degree view strategic understanding of business, because every financial plan has to be expressed in financial terms at some point of time or the other.

And, the execution is also related to the financial aspects; there should be a very strong understanding of boards and investors in any CEO appointment. And, CFOs interact with the board almost as much as the CEO does. Therefore, a strong acumen in risks management comes up in the CFO mindset, which makes for good CEOs.

And, as I said if they have deep involvement in strategy, mergers and acquisitions, due diligence and corporate governance, that makes them even more qualified to become good CEOs. And, as I said the CFO should understand, the investor mindset and be able to influence it in a positive manner, based on the positive performance on the company.

Similarly, the CFO must be able to interact with regulators and discuss various aspects related to the financial position and strategy of the company. So, ability to raise the bar on process, ability to raise performance of the company, ability to raise up to the expectations of the board and investors are key parameters in CFO making the grade as a good CEO.

While a lot may be going for the CFOs to be elevated to CEOs roles on the above considerations. Management of board and investor expectations alone cannot be seen to be the route to such progress. The claims from R&D leadership which innovates new products and operations leadership, which delivers the products, are strong too.

The lesson from this is that if those leaders that is the technical leaders the R&D leaders, and the operations leaders have that financial acumen. And, if the financial leaders have the necessary technical acumen, all of them will be on a level playing field as far as the contending process for the leadership of the company goes that is the main lesson.

And when you go back to the senior leaders I discussed, I talked about technology leaders being very financially savvy and vice versa, that is how CFOs could make good CEOs as well.

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Financial strategy should guide, but not dictate business strategy. Any amount of financial analysis cannot be the sole criterion, for deciding whether the financial analysis is superior to the business strategy. Because, a company cannot be governed only by profit maximization principles or shareholder wealth maximization criteria.

Financial priorities can dramatically change with volatility in economic and business environment, but sound technology and sound operations continue to play a lead role. And, they provide sustainability for the organization. Therefore, finance cannot dominate the basic foundational requirements of technology or operations.

A company's strategic enterprise values is determined not merely by the financial value, but also by various other intangibles including brand equity, infrastructural strength R&D capability, and many others which cannot be given in a financial value, but they all will be assessed by the investors.

Financial strategy without relation to business realities could be draconian and destroy long term investor wealth. So, while analyzing the financial strategy, the business strategy also should be given equal importance. And, ultimately it is the business strategy that should prevail with appropriate inputs from the financial strategy.

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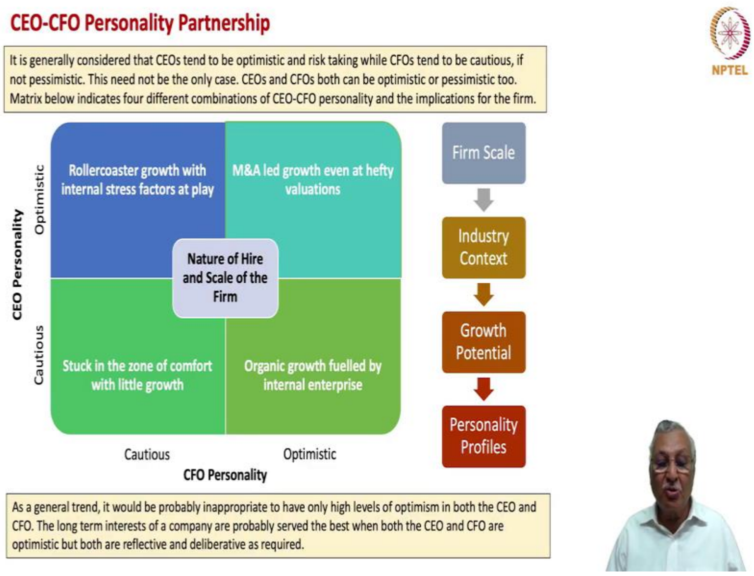

The CEO-CFO personality partnership is again a very important aspect, given the key role finance place. It is generally considered that CEOs tend to be optimistic and risk taking, while CFOs tend to be cautious if not conservative and pessimistic. This need not be the only case, CEOs and CFOs can both be optimistic or pessimistic too.

Here I have presented a matrix. When I tried to map the CFO personality and the CEO personality in respect of cautious and optimistic as the case could be. If the CFO is a cautious person, the CEO also is a cautious person that firm is bound to get stuck in the zone of comfort with little growth. If the CFO is optimistic and the CEO is cautious, the firm lays a good plan for organic growth fueled by internal enterprise, internal cash generation.

On the other hand, if the CFO is very cautious, but the CEO is very aggressive or optimistic the companies bound to see rollercoaster growth with internal stress factors at play. If the CFO is optimistic and so is the CEO, then you will have merger and acquisition led growth even at hefty valuation.

Because both are optimistic that they would make the acquisition succeed. Growth, turnaround, transformation, they have these requirements for different kinds of personality makeup’s by and large finance leadership is portable across industries and firms.

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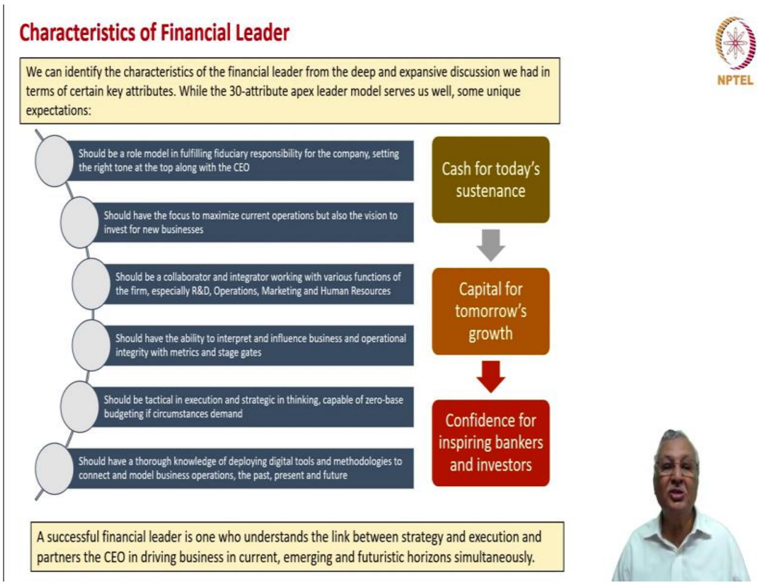

Having looked at all of these things, I come to the characteristics of financial leader. We can identify the characteristics of financial leader from the deep and extensive discussion we had so far. And the key attributes can be expressed as follows, should be a role model in fulfilling fiduciary responsibility for the company, setting the right tone at the top along with the CEO.

Should have the focus to maximize current operations, but also the vision to invest for new businesses. He should be a collaborator and integrator working with various functions of the firm, especially R&D, operations, marketing and human resources. The finance leader should have the ability to interpret and influence business and operational integrity with metrics and stage gates.

Should be tactical in execution and strategic in thinking, capable of zero base budgeting if circumstances so demand. Should have a thorough knowledge of deploying digital tools and methodologies to connect and model business operations, the past, present and the future. The financial leader should have the ability to generate cash for today's sustenance in working tandem with the operations leaders.

Should be able to generate capital for tomorrow's growth, and should have the ability to inspire confidence on the part of bankers and investors. A successful financial leader is one who understands the link between strategy and execution, and partners the CEO in driving business in current, emerging and futuristic horizon simultaneously.

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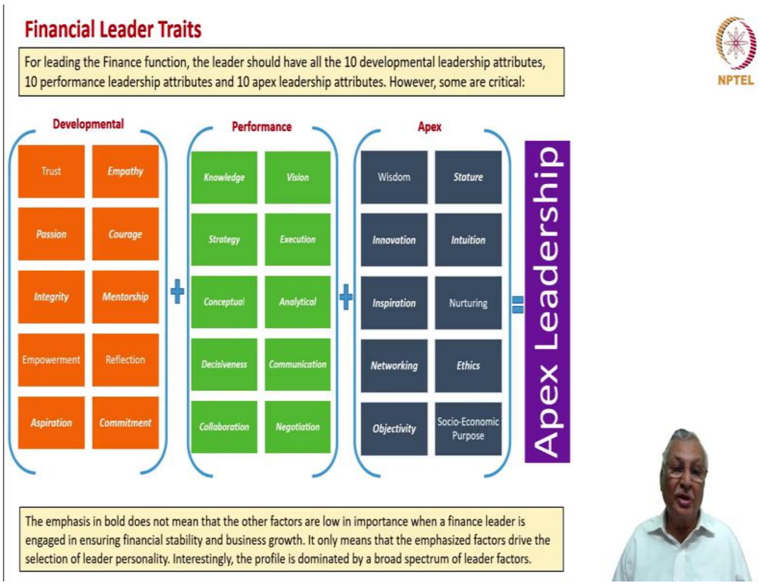

And to be able to lead the finance function, if those are the special characteristics. There are certain characteristics of the 30 attribute cluster, which would help you. All the 30 characteristics the 10 developmental characteristics, the 10 performance qualities and the 10 Apex qualities are equally important.

However, to be a finance leader possessing those special characteristics, you need to have certain extra emphasis on certain characters. For example, the finance leader should be empathetic towards the requirements of the various functions. A finance leader should have the passion for business, and courage to call a spade when it needs to be called out.

Integrity certainly should be of the highest order, ability to mentor other domains, should have the aspiration to grow the business or turn around the business matched by commitment. So, the development attributes come out in this fashion. And, when they are converted into the special characteristics the financial leader will be winning leader.

Similarly, within performance dimension several characteristics which we have talked about are extremely important. Several qualities of performance are required, such as knowledge, vision, strategy execution, conceptual, analytical, decisiveness communication, collaboration as well as negotiation.

As in the case of operations leader a finance leader also requires the whole set of performance attributes. And, from the Apex cluster the financial leader would require stature, innovation, intuition, inspiration, networking, ethics, objectivity. Again, as I said irrespective of the other three leaders, the emphasis in bold does not mean that the other factors are low in importance, when a finance leader is engaged in ensuring financial stability and business growth.

It only means that the emphasized factors drive the selection of leader personality to a greater degree. And, worth repeating the performance aspects of financial leader are extremely important, for the finance leader to succeed as much as the developmental factors and certain select apex factors.

Financial leader is kind of glue or the bond that holds all the domain leaders together. And the greater the non financial acumen, the finance leader displays the greater would be the potential to move into a CEO position. Again, as I said in the beginning nobody has grown by cutting down businesses or conserving cash.

Companies have grown by increasing scale of operations and, also deploying cash in a worthwhile manner, in a strategic manner, and in a profitable manner. The financial leader must have that strategic outlook along with operational rigor to be able to step into the CEO shoes. So, with this we will come to this end of this lecture and we will meet in the next lecture.

Thank you.