

Managing Innovation: Leveraging the CFO Function

By Susan Abbott of Abbott Research & Consulting for Schulich Executive Education Centre, Schulich School of Business, York University. Roundtable discussion moderated by Alan Kay of the Glasgow Group and Rick Wolfe of PostStone.

This is one of a continuing research series that has been bringing senior managers and executives from diverse sectors together to uncover the best practices in managing innovation.

Executive Summary

The role of the CFO has been evolving for some time, and they are now seen – and see themselves – as business partner to the CEO, with a unique perspective and mandate to see across organization silos. For CFOs in public companies, responding to expanded governance and regulation mandates has pulled them away from strategic work.

As part of the senior executive team, they are cognizant of their role in creating a culture where innovation can thrive, and are committed to customers with a vigor that would surprise many.

Today's CFO is likely to be managing many performance metrics for the organization, not just financial performance, in order to provide the consistent, reliable and integrated metrics needed to run the business and support innovation. Too much focus on lagging indicators such as quarterly financial results can suppress innovation in the organization.

More than our other groups to date, the CFOs consider the need to innovate in the context of the business model. The organization needs to evaluate current performance against the business model, challenge the business model if necessary, and enable innovation within the business model. Scarce resources of capital and people need to be invested in the best opportunities, not in innovation for its own sake.

The best opportunities must be chosen from many good ideas, but saying no too often may stifle future idea flow. Rather than be the “black hats” of the organization, CFOs want to collaborate with the business units to develop the right projects by getting involved earlier in the process. To do this, they recognize the need to better communicate their evolving role, skills and ability to support the business.

“The CFO role is largely an untapped resource in terms of moving innovation forward”

“My role as CFO has evolved into keeping our VP sales or VP supply chain on the strategic path. My job is to really keep us moving forward as a team ... My skill from financial metrics together with a really solid understanding of the business and the strategy is a key thing for driving innovation for us.”

The evolution of the CFO’s role: from black hat to strategic partner

Together with the CEO and the senior human resources executive, the CFO is one of only three members of the senior executive committee that has a mandate to look across the organization.

This perspective gives them a potential role as facilitators of integration across product, distribution, sales, marketing, and individual business units.

While the role has actually been changing for some time, there is now wider recognition that the role has changed. As the right hand person of the CEO, finance can be an important driver for innovation.

Ensuring that the organization has timely and accurate financial and performance data to run the business continues to be the foundational mission; and finance is historically driven by a juggernaut of deadlines and routine reporting.

The explosion of performance data that most organizations now require to stay on top of their business has been one of the drivers of change in the CFO role.

Finance now repository of performance data

Over the last decade or longer, finance departments have gradually become the preferred repository for integrated metrics and data.

“Most position descriptions for a CFO would include some element of providing the infrastructure and support for business analytics to allow for good business decisions.”

Our panelists spoke of the critical need to have consistent, accurate data being presented to decision-makers. Without it, managers spend time debating the data instead of creating value in the business.

“If the CEO believes that they want one set of numbers, the CFO should control the performance management system and work with the business to make sure all these business metrics present a picture based on consistency. If they don’t, you have metrics all over – anybody can prove anything. When you have that dispersion, you can create absolute chaos. The business is not really moving strategically, everybody is just arguing over the numbers.”

“Innovation is about, on a regular basis, challenging whether the business has the right business model and is executing on the business model. The CFOs who have that understanding of the business model can bring that narrative to the table.”

This reliable library of information can support innovation in two ways: by aiding funding of the right innovations; and by supporting alignment from top to bottom of the organization.

First, better data means that the executive can select innovations to fund that are right for the business, not the ones that look good because of poor or inconsistent data. As one CFO put it:

“If the goal is to present five comparative cases to the executive and you want your case to be the one that gets funded, it’s in everybody’s best interest to work in partnership to make sure they’re comparing apples all the way across. The person that ... puts in the oranges ... puts the business at a disadvantage.”

The second reason for a strong central repository of performance information is that it can be filtered throughout the organization in a methodical way, helping everyone see the impact of their activities on the higher order goals and strategy.

Getting good information into the hands of people at all levels who can use it benefits the whole organization.

‘Stories in the numbers’

CFOs can support innovation in the organization by giving voice to the trends and patterns they see in the data. More than ever before, the right individual is needed for this work.

“There’s a perception that finance is perhaps not as innovative as other elements of the company, but... it really comes down to the individual. Can they tell the stories, can they see the possibilities?”

When complex metrics produced by the organization are distilled into something that every individual contributor can understand, the organization’s capacity to innovate rises.

“I take all the complicated metrics that are produced by our finance ... and other systems, and feed them out to employees so they can drive their own innovation by understanding the impact of what they do on themselves and us.”

By telling the stories in the numbers, the CFO can enable innovative thinking.

"In the last few years I've been dragged into this whole Sarbanes-Oxley thing - which is the exact opposite of innovation - dragged into dotting the i's and crossing the t's, and am hoping to get that behind us, and try to move innovation forward."

Metrics that drive innovation – or stifle it: 'what gets measured gets done'

One result of this shift towards having the finance function manage most performance data is that CFOs focus much more attention on key metrics of all types, not just financial metrics.

Key metrics can either support innovation, or inhibit it. As one finance specialist said:

"Measurements can have many positive influences, but they can also have unbelievable unintended consequences. So you have to be very careful because you can stifle innovation and have no idea that you are doing it."

Too much focus on past performance and quarterly numbers can detract from working on initiatives important to the future of the business.

One remedy is to shift the thinking behind performance incentives to include payment for leading indicators, not just lagging indicators, and put the focus squarely on driving the business forward two to three years down the line.

"The key is to align record keeping and reporting activities with the strategic goals for the business."

Our panelists wondered about the need to create new metrics that better capture the role of innovation in the business, and in individual investment initiatives.

"How do we as finance people measure intellectual capital, the human capital, the customer capital, and drive that forward from the financial end?"

Competing forces of governance

Even though the role has changed, today's CFO is pulled between competing poles of strategic focus and reporting.

"Governance issues [are] pulling CFOs even further away from any possibility of being innovative. They ... were starting to gain some momentum in terms of being a strategic partner on the senior management team ... things are not working in their favor."

"There are elements [of business] that change and elements that don't change. Innovation and change management is being pushed by marketing people a great deal as something without which you are negligent or deficient. I don't buy that."

The new emphasis on governance and compliance, driven by both regulation and market expectations, has only added to the number of items on the departmental to-do list.

Our panelists, however, were very consistent in their view that they needed to clear a space to focus on the future of the organization, on strategy and on innovation.

"The best CFOs are very cognizant of the need for change but find it difficult to implement."

The CFOs with private companies were relieved to be free of these duties, and able to focus more on what is needed to move the business forward. The pull between the public company quarterly reporting and the strategic work of the CFO was described by one as a *"huge conflict ... that makes private companies very attractive to me."*

Innovate within the business model, not at risk to it

Innovation shouldn't displace a successful business model that has not run its course. The organization needs to always be evaluating new ideas against the value remaining in the current business model, and comparing it to other opportunities.

Their role gives financial specialists clear vision on the topic of innovation for its' own sake: it's a bad idea. The finance specialist can never lose sight of business survival, and innovation is not always the right way to move forward.

"You don't have to be innovative. Depending on where you are in the life cycle of the business model, the question of whether you should be innovative or not has to be answered."

The CFO's role in innovation must be intimately tied to the business model. Pushing for innovation in every area of the business smacks of trendiness, for some.

"If you believe you have just introduced a business model that has a 10 year life, are you going to be an innovative company?"

Choosing is the challenge

Few organizations have the financial or management resources to pursue all their good ideas, so leaders are always faced with choosing which ideas to support.

“Smart business people build a relationship with the CFO so that the CFO can help them work on their business plans, so that by the time they come forward they are going to be funded.”

The CFOs who have been involved with young, growth-focused companies in emerging industries found this particularly challenging. They don't want to stifle the enthusiasm and ideas of an energetic workforce, but they cannot support most of the ideas that come up to them for funding.

They themselves are trying to read the market, read the business strategy, and balance current with future opportunities in an uncertain environment. Selecting which innovation opportunities to pursue is a central piece of the decision-making challenge.

Leave enough money for innovation

One panelist suggested that most organizations are not leaving enough money in the budget to fund innovation because they are so focused on current period performance or cost-cutting.

Another recommended leaving 10% of the scarcest resource – whether capital or people – available in the budget for innovation. Google was raised as an example of an organization that has created a culture where individuals are expected to spend 20% of their time on development projects.

For others, innovation cannot wait for surplus funds to be available, because they flow to the parent company.

“In the world I work in, we don't have 10%. Any extra we have goes south.”

Collaborate to innovate

CFOs often have to be “the black hat” who holds managers accountable for results, and asks the difficult questions. This perception can get in the way of working as part of the team to collaborate on the business.

The closer the finance team is to the heart of the business, the better able they are to help nurture and develop ideas that will need business-case support or capital. The CFOs were clear in their view that they want to be part of this process at the earliest stages.

Not only is this part of their role, in their view, but it is also the best way for the people in the business units to craft a coalition of support for their ideas. Finance can add their perspective, challenge weaknesses at the development stage, see links to other organization initiatives, and help shepherd concepts through the approval process.

"I think there is a lot of innovation in my world ... the world of understanding the strategic plan, interpreting it, and helping people implementing it. There is an issue of whether CFOs get credit for what they do."

This isn't "selling" the deal; it's about collaborating on the business.

Another trend that has paved the way for better collaboration is that basic financial knowledge among business management is much higher than it has been historically. Internal clients are much more "finance savvy" than in the past, and have better information and analytics to work with.

Can finance innovate?

Finance people know that they have a reputation that doesn't include being innovative, and they reject this notion, in part.

Innovation within the finance function itself can take many forms. As a process-driven part of the enterprise, process improvements through automation and outsourcing are a familiar part of the finance world.

"There's always been the threat of process changes; you work yourself out of a job."

Another challenged the notion that they are not sufficiently customer centric.

"Seeing yourselves as serving the customer would not necessarily be seen as more efficient in the role. Are you looking forward, for more efficient methods of handling the process?"

Leaders in this area recognize that they will lack credibility as business partners if they don't embrace process innovation in their own area. They see their efforts to change their own roles as innovative. Some of their work is less visible to other parts of the organization, such as raising capital in innovative ways.

"Innovative ways to raise capital is a major topic for CFOs. Doing it in ways that involve techniques that weren't around five or 10 years ago is a major theme."

The CFO perception gap: 'Finance people don't market'

CFOs see a huge misunderstanding of their role and how they and their team can contribute to innovation and business success. There is a need to market their emerging role to other parts of the organization, and the function has fallen short on explaining their value to other managers and leaders.

“As a profession, you guys need to sort out a broader definition that can start being filtered down into the organization so people can see how you are helping to drive innovation”

“There’s a huge stereotype of what the finance people do. The most visible output is the financial statement. Even though 5% of a CFO’s time might be on that, 90% of their public image will be based on that”

For non-financial managers, having a more collaborative finance function would be a welcome change:

“It would be nice to see finance being your friend and when you embrace it, you will get good ideas. More sharing of the numbers, and not making it so mysterious.”

CEO needs to set the tone

All our panels have agreed on the critical role of the CEO in setting the tone for the organization’s culture, with a direct link to innovation. The CEO needs to communicate clearly where innovation is welcome in the context of the business model. The CEO needs to insist on an integrated, reliable set of metrics, so that people focus on the business instead of debating the data.

While the CFO may be a trusted adviser to the CEO in private, too often their role is pushed to the background at the management committee table.

The public versus private debate continues

For the most part, our panel believes that strong leadership and access to resources are still a larger driver of the ability to innovate than whether or not a company is public.

While public companies may be too driven by the quarterly results, a firm that has no funds has to focus on survival. At the same time, a firm that has too easy access to funds may spend unwisely.

What the future holds

CFOs are as concerned as everyone else about shrinking markets and the crucial need to innovate to sustain the Canadian lifestyle. They recommend hiring CFOs who are good business people first and CFOs second.

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Resources mentioned by panelists included:

The World's Most Innovative Companies. BusinessWeek Special Report, April 24, 2006.

Gary Hamel, "Management a la Google". Wall Street Journal, April 26, 2006.