

## Finance & Performance Management

# Finance mastery (IV): How high performers become effective financial stewards

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An effective finance organization is a faithful steward of the general financial health and direction of a company but, more specifically, of its financial capital. Generating returns above the risk-adjusted cost of capital is essential to achieving and sustaining high performance. In fact, recent Accenture research has demonstrated a strong correlation between a high-performance business and mastery of a suite of five finance capabilities that includes sophisticated capital stewardship<sup>1</sup>. More than two-thirds of the finance masters studied scored as pioneers in the area of capital stewardship using Accenture's finance and performance management mastery scale.

Creating an effective capital stewardship capability can be challenging in today's marketplace. Balancing short- and long-term needs, investing in the right capabilities to sustain superior operating performance, managing intangibles—these and other issues can present obstacles even to the most experienced finance executives. Our research has found, however, a distinctive set of competencies underlying capital stewardship, as well as common processes and approaches followed by the "masters of finance."

### The foundation of capital stewardship

Capital stewardship refers to the ability to deploy, preserve and build capital resources to maximize returns to shareholders. High-performance businesses are able to embed a capital management capability within their core processes and organization to create a value-centered culture capable of making the tough decisions about where and when capital is invested.

Five competencies underpin effective capital stewardship:

- **Capital investment:** Effectively managing new financial investments with the goal of maximizing total returns to shareholders.
- **Capital structure oversight:** Maintaining the right balance between debt equity to efficiently finance investments and growth strategies.
- **Existing capital management:** Managing working capital and other capital deployed within the enterprise to an optimal level to free up capital for new investment.
- **Tax management:** Proactively managing tax liability and associated risks based on access to a trail of solid, timely data for quarterly or annual financial statements, tax returns and audits.
- **Intangibles management:** Recognizing, managing and leveraging the value of intangible capital and off-balance-sheet transactions (brands, customer pools, operating leases, take or pay contracts, etc.).

Successful capital management requires constant trade-offs and tough decisions between competing options. This challenge is well recognized by the finance executives at world-class companies. UnitedHealth Group, for example, has grown dramatically while increasing its stock price tenfold since 1998. Pat Erlandson, the CFO of UnitedHealth Group, makes the connection between value creation and capital stewardship: "We have a capital management process that helps us figure out how best to deploy scarce resources. Capital management is critical in this business: Deploying investment across five businesses in an efficient and effective way is central to

<sup>1</sup> The essential capabilities of finance mastery are explored in more detail in a new book from Accenture: *CFO Insights: Delivering High Performance*, by Mike Donnellan and Mike Sutcliffe (John Wiley & Sons, 2006).

making sure that we get good returns across each one of these businesses.”

## Building a capital stewardship capability: Lessons from the masters

Accenture experience, as well as our research into finance mastery, has uncovered several important lessons from successful CFOs when it comes to creating a finance organization that shows capital stewardship mastery.

- **Balance the requirements of delivering both current and future value.** Start with an in-depth understanding of the drivers of both current and future value—something that requires a complete analysis of the competitive landscape, industry trends, new threats and emerging business models, and requirements of both tangible and intangible assets. Identify the key capabilities required to deliver both current and future value, and assess gaps with existing capabilities to prioritize where investments are required across the business. Set measurable, specific, and prioritized high-level targets to balance current and future value delivery. Articulate enterprise strategy clearly and communicate its impact on investment decisions.
- **Minimize the capital required to compete effectively.** A combination of small changes in the assumptions built into common operating models can frequently redefine which players in a given value chain must invest capital and how much capital must be consumed within a specific company. A clear understanding of industry economics, value drivers associated with current strategies and leverage points across the value chain can substantially reduce the capital required.
- **Optimize capital structure and mix of sources.** The answers to both capital structure and cost-of-capital questions differ significantly by industry and also by phase of development in the enterprise lifecycle. Constant attention to capital structure optimization can lower total cost of capital while providing adequate capital flexibility to capture emerging value opportunities and weather unexpected competitive challenges.
- **Develop a risk-adjusted capital management program.** Include a risk and sensitivity analysis with a common framework and measurement approach. The project evaluation process should be designed so that all relevant risks—including implementation and forecast

risks—are assessed and a risk mitigation plan is developed to address them. Once separate risk profiles and experience curves are documented and understood, different return rates can be assigned to individual capital investments to create a risk-adjusted capital investment plan that is integrated with the strategic priorities of the business and which optimizes both short-term and future value growth. Design capital allocation and management processes using a cross-functional approach to create accountability for delivery of expected results across the business. This approach can eliminate the common error of assigning a single hurdle rate for investment decisions across individual opportunities and sub-optimizing the potential returns to the business.

- **Implement rigorous processes to stage gate approvals for individual investments.** It is important to establish multiple gates (phases of work with specific expected outcomes) for major investments and to schedule future investment approvals around completion of each major gate. For example, at the business case stage, it is possible to eliminate much of the gaming commonly found in the capital decision process by improving the consistency and quality of the business cases for each investment. It is also important to make tough sourcing and divestment decisions required to minimize required investments—and shed unprofitable assets or stop investments that are not performing as expected.
- **Integrate operating and capital budgeting processes and link specific changes to operating results with approved investments.** Create performance management programs with multiyear views to balance delivery against both operating results and investment programs. Link business unit and individual performance contracts and compensation plans to the delivery of a balanced set of operational metrics.
- **Create the right mix of tangibles and intangibles.** Prepare to explain how and when investments in intangible assets will convert to income statement results. Adjust investment criteria to balance strategic and pure finance hurdles to ensure that the portfolio of investments selected will generate the mix of capabilities needed to grow the business and capture new opportunities as the competitive space continues to change.
- **Learn from experience.** Create a consistent approach to post-investment reviews. Encourage learning across the

organization to improve the accuracy of future investment forecasts and business cases. Identify the most common causes of investment failures and the leading indicators that existing investments are not going to achieve the desired returns.

- **Focus on skills development.** Develop the skills of future leaders in the business by allowing management teams to finalize capital investment decisions and manage delivery within the boundaries set forth in the corporate strategy and high-level capital allocation process.

## Managing a journey of change

These leading practices associated with capital management processes illustrate the techniques employed by the finance masters. Developing the most effective capital management processes within a specific company requires finance executives to consider an array of factors, including culture, decision-making processes and financial acumen across the organization. Look for the leaders in your organization who are skilled at managing multiple phases of work as part of a long-term journey of change, with a special focus on the human and cultural dimensions of change. Substantial effort is required to develop the skills and competencies to create a culture that embodies the best principles of capital stewardship, but the impact on future profitability is well worth it.

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