What Keeps CFOs Up at Night, 2015

By Ramona Dzinkowski

The 2015 global economic outlook has never been so divided. One positive prediction for stable growth in North America is offset by gloomy numbers in Europe, combined with what seem to be irrational fears of China and India grinding to a halt. Instead of attempting to untangle the macroeconomic mystery this year, we've taken a decidedly micro view and looked at what's keeping CFOs up at night in four very different companies operating across the globe.

Waiting for the Green Light on Black Gold

Freemont Resources is a small, privately owned Canadian oil company with land and production assets in eastern Alberta and Saskatchewan. Its revenues are typically less than $5 million annually. As Freemont CFO Helmut Hauke explains, commodity prices fuel his industry as well as the rest of the Canadian economy. So any global risks to those markets have a significant impact not only on Freemont's revenue but on the gross domestic product (GDP) of the entire country.

What Hauke is concerned about today, however, isn't so much the external risks that could limit demand for Canadian oil and gas—such as conflict in the Middle East or a slowdown in the U.S. economy—but homegrown issues that could curtail production or affect his company's longer-range production strategy.

As Hauke explains, the Canadian government is currently in the evaluation stages of building two pipelines to the east and west coasts of Canada, thereby allowing Canadian oil producers to be cost-competitive overseas. "Effectively," he says, "this will open up the Chinese and European markets to us, thereby limiting our reliance on U.S. demand and giving us greater pricing power."

At the moment, Canada doesn't export any oil to China because it just isn't feasible, Hauke explains, and, while these projects are longer-term, Freemont has a long production planning phase. "Anything could happen in 2015 to make this a 'go' or 'no-go' situation," he adds.

Hauke also notes that Canadian oil producers are vulnerable without access to the wider international market. "We sell pretty much all of our oil to the U.S., and whenever you only have one customer you're a price taker, not a price maker. Once those pipelines are built, that all changes, but until that happens we're in a very precarious situation."

The environmental hurdles that have to be cleared are one of the greatest risks to expansion, Hauke says. As he explains, both the Canadian and Alberta governments are under huge pressure from environmentalists to not only prevent the pipeline but to also block companies from using hydraulic fracturing or "fracking" (a widely used but controversial technology) in developing their oil and gas reserves. "In my company, and in the industry as a whole, most wells are fracked," he advises. "If it turns out that the government is going to restrict fracking, our productivity goes down. At the same time, they could continue to allow the use of that technology but increase their royalty rates. Or they may decide to decrease the income tax incentives available to us. This could make everything look less favorable for the oil industry. So that risk is always there."

Another risk, Hauke adds, is that much of the land that the pipelines would cross is owned by native Canadian tribes or "aboriginal bands," as they're commonly referred to. "There are also legal issues that could derail the whole program, and this will have an impact on the planning for our industry sector beginning in 2015. So we have great expectations from the potential to open our markets to China and Europe, but there's also a lot of risk and uncertainty around it. In 2015, I'll be keeping close watch for any signs that we can start our planning cycle for raising capital and drilling new wells in a reasonably predictable environment."

Keeping Pace in India

MedPlus is the second-largest pharmacy chain in India, with 1,200 outlets and more than 8,500 employees. For CFO Atul Kumar Agarwal, capitalizing on the rapid growth in the Indian pharmaceutical retail sector while complying with new corporate legislation is top of mind for 2015 and beyond.

According to recent estimates by McKinsey & Company, the pharmaceutical industry in India is expected to grow from its current market value of US$12 billion to a potential of US$70 billion in 2020. With the country's current increase in personal incomes and strong overall growth, there's a lot of spending power, Agarwal says.

A healthy increase in India's foreign direct investment (FDI) cap is also giving the insurance sector (and, therefore, the domestic retail pharma sector) a huge boost. "Before the country opened up, just a few companies provided health insurance, and there was very little awareness of what insurance was all about," Agarwal explains. "Now, since the government has planned to lift the FDI limit to 49%, many foreign insurance companies have entered the market. A lot of awareness—and a lot of market share—has been created all over India."

More buying power and greater access to health insurance means that bigger and more organized players will be entering the industry. That translates to more competition for MedPlus.

To date, Agarwal says, the retail pharmacy sector in India has been made up mainly of small local chemists, with only 3% of the providers organized as chains. "While we don't expect a great deal of competition to come from overseas at this point, within India we expect a lot of new companies to come in and take their share."

Does he have any concerns? "Access to capital is the number one thing keeping me up at night," Agarwal notes. "From a strategic finance perspective, any growth industry requires a lot of quick capital. However, typical banking and financial institutions are very cautious, highly regulated, and often slow to respond. Foreign direct investment in retail pharma is not permitted, so all that remains is local private equity. I'm constantly looking for good local partners."

Meanwhile, he explains, with any growth company you have to exercise a great deal of discipline in terms of the control function. This challenge is compounded by the new corporate governance legislation in India that will keep many CFOs focused on compliance issues in 2015, he adds.

"There are a lot of changes in the laws of the country that resemble the SOX-like regulations mandated in the U.S. several years ago," he says. "For instance, the revised Companies Act is one area in particular where I lose sleep. The laws have become so strict that most of my time goes into trying to understand and implement them." For example, the Companies Act now has made public and private companies accountable for earmarking 2% of their three-year annual average net profit for corporate social responsibility (CSR) activities.

Planning for Uncertainty

For CFOs like Atul Kumar Agarwal, making sure the company can keep pace with both rapidly expanding markets and the changing regulatory landscape will consume much of their time in 2015. Others have a very different story to tell. Many CFOs whose companies mainly serve the North American markets are challenged to maintain market share while facing rising input prices and changing consumer preferences.

This puts ever-increasing pressure on CFOs to improve operational efficiencies, explains Kathy Liu, CFO of Kizan International, Inc., a global apparel manufacturer and distributor based in Brisbane, Calif.

"CFOs have to be forward thinking, be able to help the business to foresee, to forecast, to predict. More importantly, we have to be value drivers."

—*Kathy Liu, Kizan International*

"What's changing our focus for the coming months relates directly to the conditions on the U.S. retail consumer side," she adds, as her company does most of its business in North America. It isn't necessarily about the consumer's income or spending, she explains, but more so about the change in spending behavior. "Consumers these days are increasingly more interested in high-tech gadgets rather than apparel. So not only do we have to compete within our industry, we have to compete with changing preferences between spending categories."

In response, Kizan is examining its investment options going forward. "For 2015, we definitely have to expand our e-commerce," Liu says. "We would like to develop this channel of distribution and invest in social media marketing, then try to sell more directly to consumers rather than have total reliance on the retailer."

At the same time, Liu will be keeping careful watch on the actions of the U.S. Federal Reserve in the coming months, anticipating the impacts of potentially higher interest rates on Kizan's costs of production. "When it comes to hedging, we do have some concern about the probability of high interest rates," she notes. "As you know, when interest rates go up, that increases the cost of production and also puts pressure on inflation in general. This will indirectly cause pressure on salaries and wages in all other areas, including transportation costs. That's something we're very concerned about."

Liu also explains that the potential for higher interest rates and the associated inflationary impacts will place Kizan's pricing and cash management strategies under increased scrutiny. "Our plan is to be a little bit more aggressive in 2015, with frequent, small price increases. We believe it's a better strategy than trying to catch up at some point with one big jump. We'll also continue to build cash reserves. It's important, particularly in periods of inflation, to stay vigilant in collecting receivables until we're able to pass along price increases to our customers. We've seen one or two retailers change their payment terms—such as from net 30 days to net 45—and we have to be very careful about managing our cash flow."

Another way to stay ahead of inflation, Liu says, is to perform an effective supply chain forecast. "Depending on which country we import from and inflation pressures in those jurisdictions, we might even stock up inventory before prices from our suppliers increase. But we have to do it very carefully without jeopardizing our cash reserves."

Investing in Technology and People

With an abundance of cash and increasing pressure to contain costs through improving process efficiencies, other CFOs will be spending 2015 in the weeds of implementing the right technologies to keep their companies competitive.

As CFO of TENTE Inc., a global manufacturer of industrial casters and wheels for the international institutional, medical, industrial, and heavy-duty equipment markets, Ben Mulling's focus for the coming year is to ensure his company makes the right investments in technology and people.

As he explains, automation on the production floor is key to remaining competitive in this sector, and "from our standpoint, 100% automation is going to play a really big part in our cost competitive strategy going forward. A lot of times, especially in a production environment, you hire people specifically to manufacture a certain good, and they end up spending 80% of their time doing it. The other 20% of their time, however, is spent working on administrative tasks and things that could be automated." Technology needs to be brought down to the production floor, to distribution, and run all the way through the company, he notes.

At the same time, Mulling adds, the competition for manufacturing talent is ramping up. "We've seen manufacturing come back to the United States over the last three years, so, as a result, there's a higher demand for technical talent, and there's a gap right now on the production floor." For this reason, he says, TENTE is reexamining the capabilities of its entire management team. "We're really making an effort to step up our capabilities in terms of production management in order to push efficiencies on the production floor."

Meanwhile, business automation isn't being limited to nuts and bolts. Going forward, utilizing technology effectively will be key to improving the efficiency of the finance function at TENTE, as well as central to monitoring and controlling the company's overhead costs. As Mulling explains, TENTE can increase its operational capabilities, including finance, by improving administrative technology. "The more business processes we can automate, the better," he says. "That's my rule of thumb."

The Role of the CFO: 2015 and Beyond

For Helmut Hauke, one of his key roles as CFO of a Canadian oil and gas producer is to make sure his company is in a position to raise capital and plan for changing demand patterns for its product. Similarly, for Atul Kumar Agarwal, the role of the CFO in India's rapidly growing retail pharmacy market will also be to act as growth strategist, securing the necessary financing to fuel expansion while making sure his company is compliant with new corporate laws and governance requirements.

Kathy Liu's evolving role in the apparel industry will focus on forecasting and analysis to meet the challenges of changing consumer buying behavior and to understand and capture the opportunities presented by alternative marketing and distribution channels, while attempting to hedge against potentially shrinking margins. Meanwhile, Ben Mulling sees his role as CFO of a large manufacturing company as increasingly operational, making sure both the technology and the necessary talent are in place to remain competitive in an environment of ongoing production and process automation.

The CFOs interviewed for this article may be focusing on very different issues in 2015, but they clearly have one thing in common: Their role as CFO extends well beyond the core practices of accounting, control, and compliance into all areas of operations and corporate strategy. And they are enjoying the challenges. **SF**

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