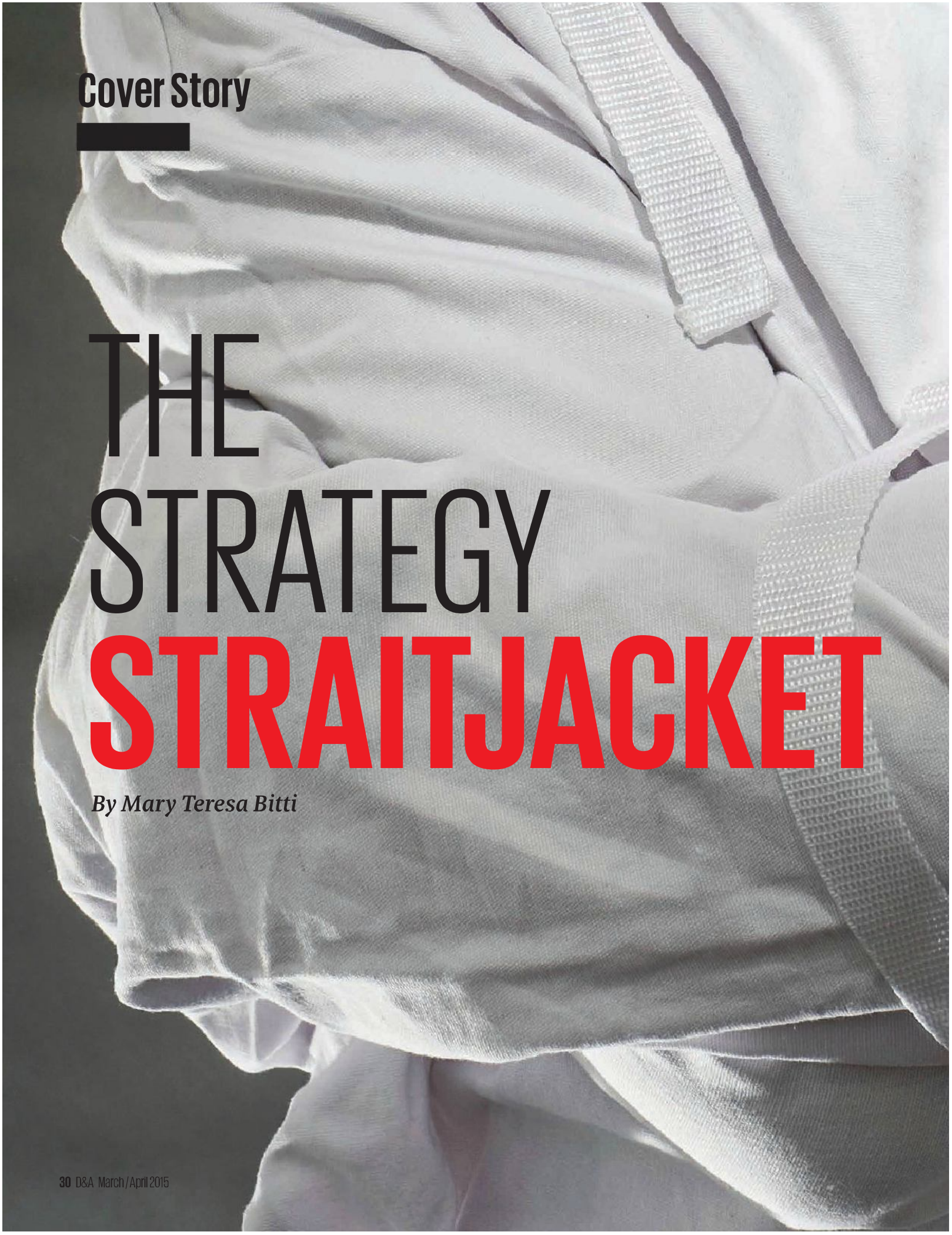
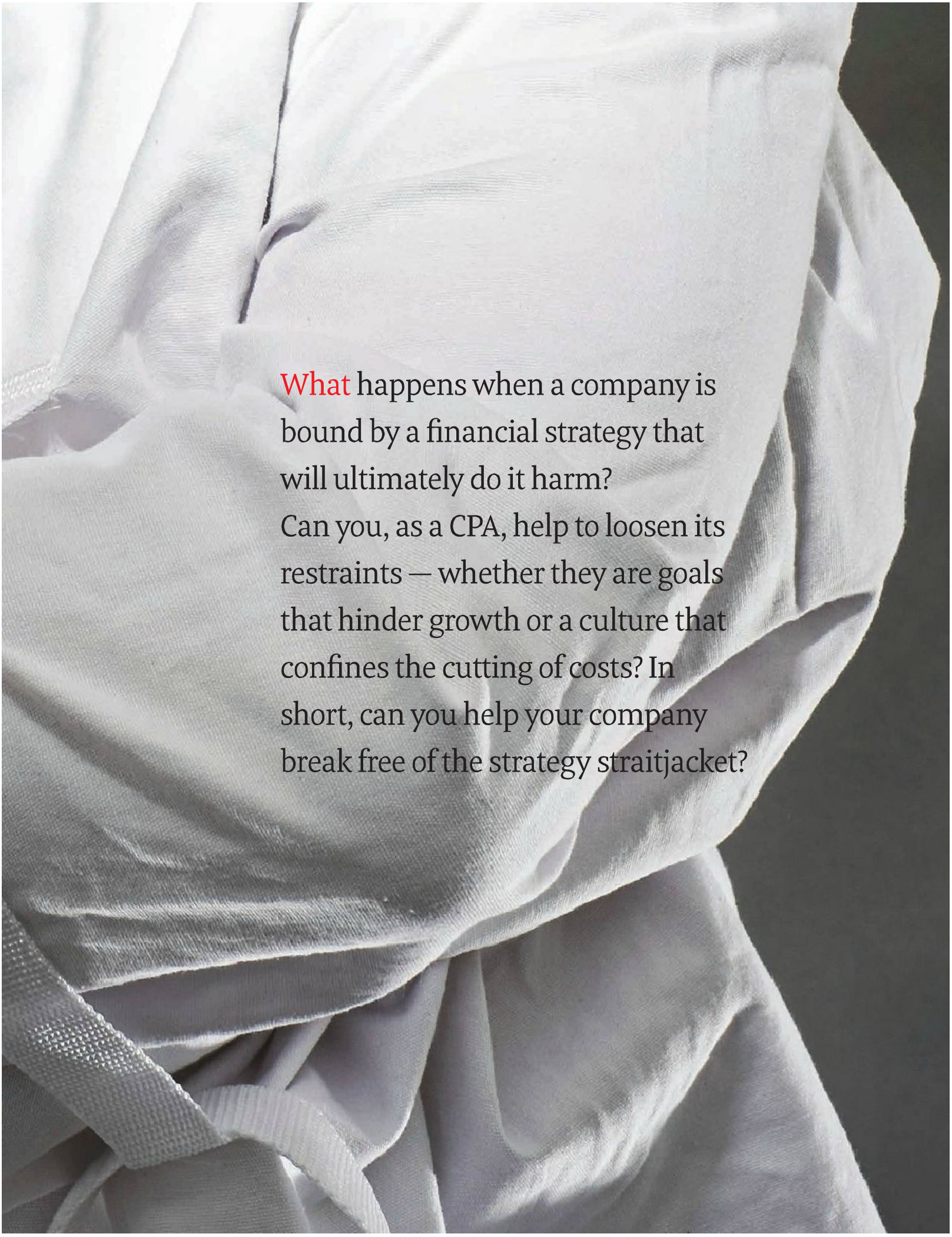


THE STRATEGY STRAITJACKET

By Mary Teresa Bitti



What happens when a company is bound by a financial strategy that will ultimately do it harm? Can you, as a CPA, help to loosen its restraints — whether they are goals that hinder growth or a culture that confines the cutting of costs? In short, can you help your company break free of the strategy straitjacket?

Last October, IBM President and Chief Executive Officer Virginia (Ginni) Rometty, who was appointed in 2012, announced that IBM was abandoning Roadmap 2015, a five-year financial strategy that led Big Blue to aggressively cut operating costs in order to meet a $20-per-share earnings (EPS) promise by the end of 2015. Dubbed "Roadkill 2015" by many of its employees, the strategy sacrificed revenue growth at the expense of dividend increases, stock buybacks, tax avoidance and tactics dismissed by some investors as financial engineering.

Chief Financial Officer Martin Schroeter, who stepped into the CFO role in January 2014, has never criticized Roadmap 2015 publicly. Still, in an interview with Forbes Magazine, Schroeter stated IBM is unlikely to put another absolute earnings per share roadmap in place any time soon. The new goal is to achieve modest single digit revenue growth alongside high, single-digit operating EPS growth in the longer term.

Meanwhile, 2015 began with the former tech giant denying rumours of layoffs in the range of 100k — not surprising, given IBM's 10 straight quarters of declining revenues and status as the worst-performing stock in the Dow Jones 30 Index in 2014.

Why did it take changes at the highest executive levels for IBM to admit that it was bound in a strategy straitjacket? And what can this cautionary tale tell Chartered Professional Accountants caught in the same situation?

CASE: KEVIN O'NEIL

THE HIGH COST OF EMOTIONAL ATTACHMENT

"If the reports of massive layoffs are accurate, then IBM waited too long to abandon [its] strategy," says Chartered Professional Accountant Kevin O'Neil. Prior to becoming founding partner of Sapient Capital Partners, a Toronto-based business advisory firm, O'Neil was CFO and later CEO of a rapid-growth manufacturer and retailer for six years.

"If you have to justify poor results [in] multiple quarters, something is wrong. It's up to you as CFO to make sure you have a voice and express your concern first to the CEO and then to the board."

As a CFO in the retailing industry, O'Neil faced such a showdown over strategy. "We had branded franchise storefronts and we manufactured the bulk of the products sold. Our thinking was that by being the only stores able to sell those products, franchisees had a competitive advantage because there was no price pressure," explains O'Neil. "But our manufacturing facility was only operating at 50 per cent capacity and we could not push the cost of that excess capacity through our chain of retail stores.

"The relationship between a CEO and CFO is one of push and pull. The CEO will push the envelope and the CFO will present the implications of a potential strategy."

"There was no way to remain profitable by continuing to follow that strategy. It was just too costly."

O'Neil says his toughest job was getting the senior team to agree that the strategy was not working and the company had to change course. Leaders can get emotionally attached to the strategies they devise. "It takes work and persistence but you need to be open minded through the period of analysis," says O'Neil.

"It helps to have alternative scenarios, which allow for further collaboration to find the right solution. My role was to present options that I felt were viable and that the team could narrow down to focus on the ones that were executable."

In the end, the senior team chose the strategy that was closest aligned to its original plan. They decided to create additional brands marketed to independent and mass retailers. This allowed them to use more manufacturing capacity and to direct the profit from those new brands to further develop its own branded stores. "We looked at it as a source of funds to continue down the path we started because we believed we would get there."

KEVIN'S ADVICE

Ask the question: Is it the right strategy for the company? "The market will tell you. Review results frequently with an eye to understanding the likely near-term and long-term outcomes. Do those results justify a tweak or a wholesale change of strategy?"

Don't act too soon. "Give the strategy enough time to take effect. If the financial results are laying out a story that is different than the one forecasted, then it's incumbent on the CFO to say so."

Keep emotion out of the analysis. "When you're pushing to re-evaluate or change, you don't want to get emotionally attached to the notion that change is required because you may be wrong."

CASE: TIM ZAHAVICH

IT'S ALL ABOUT GROWTH

"Staying still is a recipe to shrink and disappear," says Chartered Professional Accountant Tim Zahavich, when asked about IBM's Roadmap 2015. "To say we're going to grow EPS by cutting costs for five years is more about making the company an attractive buy than it is about building financial strength in order to grow." Zahavich retired last year as CFO of St. Joseph Communications in Toronto. Over the past 25 years, he has been CFO of six different companies across several industries.

"At a high level, it's rare to see a strategy that isn't about growth," says Zahavich. "Once the overarching view is 'we are going to grow the business,' then the question is 'how.' That's where you can have differing opinions."

That's exactly the situation Zahavich found himself in when the public company he was with wanted to grow operations in another country by expanding an existing operation. "I was able to demonstrate that the financial results of the foreign operation would have a negative impact on our overall share price and the CEO decided not to move forward," says Zahavich.

"The relationship between a CEO and CFO is one of push and pull. The CEO will push the envelope and the CFO will present the implications of a potential strategy so the company can move forward in the best way for that business."



TIM'S ADVICE

State your case. "You have to support the CEO but that doesn't mean you can't stand up and say 'here are the implications of what you are about to do.' "

Present alternative strategies — the more the better. "It means you have presented a problem and a solution and you are looking beyond the books."

CASE: JANET CHANG

NUMBERS SPEAK LOUDER THAN PASSION

"Roadmap 2015 caused IBM to create incentives to pursue short-term opportunities to hit their targets, which actually compromised the investments they needed to achieve longer term growth," says Chartered Professional Accountant Janet Chang (not her real name). "In abandoning the strategy, IBM made a courageous move — the right move."

Chang worked for many years as a senior finance executive with the Canadian subsidiary of a multinational corporation in the pharmaceutical industry. She recalls a time when the company was preparing to launch a new line of products. The senior leadership team was passionate about the product line but the net present value was based on a number of what Chang believed to be aggressive assumptions — and new solutions were coming to market that would have cut into anticipated sales.

"When I probed into the forecasts, I learned that they were based on a guess from a member of the sales team," says Chang. As the lone dissenting voice and the person with the least experience on the team, Chang found herself in a David and Goliath scenario. She followed her instincts and reached out to another country's sales team for more information around the forecast. "They agreed there was no way we could make any money [from the product line]."

Armed with hard data, Chang was able to successfully make her case to reset strategy. The company did not invest in the new product line and the senior team later thanked her for helping them avoid what would have been a costly mistake, as competing products captured the market.

JANET'S ADVICE

Trust in your skepticism. "You can pull numbers and forecasts out

of thin air and make a project viable but the question is, 'how likely is it to occur?' Any good accountant will ask what's behind the numbers."

Seek out independent guidance. "You don't want to go to battle alone against a group of people who are all from one school of thought."

Build support for your point of view. "Engage with your colleagues on an individual or group basis. Don't allow professional disagreements to devolve into personal ones."

HOW TO INFLUENCE CHANGE

ADVICE FROM THREE SUBJECT MATTER EXPERTS

While many CPAs advise their colleagues to rely on numbers to break free of the strategy straitjacket, they also acknowledge the importance of finding or influencing colleagues to support them in their struggle. We reached out to three CPAs in academia and professional services to ask for their advice on how to influence a change in strategic direction.

Build credibility by understanding how the business works. Chartered Professional Accountant Laurence (Larry) Ginsberg is the founder of GinsOrg International, which provides strategic management and business advisory services to high-growth clients. An author and media spokesperson on governance and strategy, Ginsberg says "many executives — not just CFOs — have never talked to a customer or supplier, worked in a plant or met with marketing agencies.

"They have the theory but no practical experience. Good CFOs have done all that. They have earned the respect of their team and are viewed as a partner.

"If you know first-hand how things work then you are in a better position to have the appropriate evidence of why something is a problem."

Make the audit committee your champion. Chartered Professional Accountant John Gordon is the Canadian Managing Partner, Audit, at KPMG. "Building a strong relationship with the audit committee will take time but it's well worth the effort," says Gordon.

"Talk to audit committee members about challenges. Use them as a sounding board. The audit committee can help the CFO gain respect and influence within the organization. It doesn't mean you'll always win but you will have the opportunity to make your case."

Make your case for change by focusing on the customer. Chartered Professional Accountant Rick Robertson is an Associate Professor of Managerial Accounting and Control at Ivey Business School. He urges CPAs to "Befriend the head of marketing. They are the ones going through all the data to understand what the customer wants and how they want to receive it. Argue your case from the point of view of the customer and the organization's ability to satisfy their needs and wants.

IBM focused on the shareholder. But if you focus on the customer first, things will be OK for the shareholder." D&A

Mary Teresa Bitti is a freelance writer based in Oakville, Ontario.

D&A thanks: Laurence Ginsberg, FCPA, FCA; John Gordon CPA, CA; Kevin O'Neil, CPA, CA; Rick Robertson, FCPA, FCA; Timothy Zahavich, CPA, CA; and "Janet Chang" and "Rajiv Singh," Chartered Professional Accountants.



Many executives — not just CFOs ... have the theory but no practical experience.

Laurence (Larry) Ginsberg, FCPA, FCA

Founder, GinsOrg International

Chartered Professional Accountant Larry Ginsberg facilitates CPA Ontario's *CFO Leadership Program* and the *CFO as Strategist Program*. As a part-time Professor of Entrepreneurial Studies at the Schulich School of Business at York University, he lectures on strategic management, family business, entrepreneurship and mergers and acquisitions.

CFO's Role to the Board of Directors

Wednesday, June 24, 2015

The CFO's role continues to grow and expand far beyond the basic custodianship of the books and records. Today's CFOs are responsible for ensuring the overall direction of the business is consistent with the direction provided by the board of directors — and managing the politics that come with this responsibility.

This interactive workshop will provide you with a clear understanding of the concerns of board members and your role and responsibilities. The content will provide you with a perspective on how to align your role with the objectives and needs of your fellow management team members and the board of directors. You will learn how all organizations are different, whether public, private, large or small. You will learn from other participants, and a leading facilitator, how to manage and successfully accomplish your role as it relates to the board.

CFO's Role to the Board of Directors
Status: Registration Open
Date: Wednesday, June 24, 2015 9 a.m. - 4:30 p.m.
Location: CPA Ontario, 69 Bloor Street East, Toronto

DISCUSSION

1. True or False: Senior finance personnel rarely disagree with a company's strategic direction, as they most likely would have influenced its creation.

2. Is it more advantageous to be an incoming CFO when one must influence a change in strategic direction?

ANALYSIS

1. In 2009, IBM's annual report did not use the phrase "non-GAAP" at all. The 2013 annual report used it 125 times. Source: Bloomberg Businessweek.

2. Former IBM CEO Sam Palmisano introduced IBM's "2010 Earnings Per Share Roadmap" in 2007. He continued the practice with Roadmap 2015 and announced his departure in 2012.

RECOMMENDED READING

Dergel, Samuel. *Guide to CFO Success: Leadership Strategies for Corporate Financial Professionals.* Wiley & Sons, March 2014.

Schroeter, Martin. "IBM Investor Briefing: Financial Overview." International Business Machines Corporation, 2015. Online at IBM.com.

Summers, Nick. "The Trouble With IBM." Bloomberg Businessweek, May 2014. Online at Bloomberg.com.

Tim Hortons Annual Report. "Winning in the New Era: Tim Hortons Strategic Plan 2014-2018." Tim Hortons 2013 Annual Report.