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**Steering a Secure Course
To a Prosperous Future**
*A Memo to the
Chief Financial Officer*

CFOs face three critical challenges in this recession. They must ensure that their companies have the liquidity needed to fund operations and investment; prepare their companies for oncoming icebergs; and position their companies for a better future. Those who can simultaneously manage chaos, mitigate risks, and identify and capitalize on opportunities will lead their companies to tremendous gains.

STEERING A SECURE COURSE TO A PROSPEROUS FUTURE

No one anticipated that this recession would unfold in the way and with the speed that it did. Unlike the downturns of recent memory, which stemmed from demand declines, overcapacity, or inflation, the locus of this unprecedented recession was, initially, excesses in consumer credit and, ultimately, collapsing global financial markets. This has positioned the CFO front and center in the corporate effort to respond to it.

While the financial conditions of companies vary widely, all CFOs face three important challenges in this recession and beyond. They must ensure that their companies have the liquidity necessary to fund current business needs and allow future investment. They must prepare their companies for any unpleasant surprises that have yet to appear. And they must cope with the day-to-day chaos roiling their markets, while they identify and exploit hidden opportunities to better position their companies for the future.

Lead the quest for strategic liquidity. The first priority of CFOs in responding to this recession is liquidity and debt management. Many have already addressed this issue, but in some companies, it remains an urgent challenge.

In the short term, the recession responses of CFOs are dictated by their companies' cash and debt positions. Companies that are cash-strapped or laden with debt are in a fight for survival. They should be taking immediate and aggressive actions to improve cash flow, optimize working capital, and refinance debt on more affordable terms. These tasks require CFOs to initiate immediate efforts to identify potential cost reductions, defer and delay investments where feasible, and work with functional and business leaders to capture savings.

CFOs in companies with liquidity positions that are sound can afford to take a more proactive and long-term stance. But all companies can benefit from reexamining their strategic liquidity, especially in light of a recent Booz & Company analysis. That study revealed that in North America alone, in public companies outside financial services and with more than US\$1 billion in revenues, as much as \$950 billion in untapped working capital resides on balance sheets. Now is the right time to tap that capital by asking fundamental

questions regarding the sacred cows and to determine whether they can be restructured in ways that release significant cash in an enduring way. Core capabilities need to be carefully appraised because they are expensive to maintain. However, eliminating unnecessary capabilities can create large savings.

Look ahead for new icebergs. Although the CFO's role is often focused on reporting past performance and, in the wake of financial scandals associated with the 2000–2001 recession, on improving accounting systems and complying with Sarbanes-Oxley and a host of other new regulations, this recession has placed a renewed emphasis on looking ahead.

To help identify new icebergs that may be looming in the near and long terms, CFOs should be overseeing the development of forward plans. But these should not be the grand, five-year plans of the past. Nor should they be traditional exercises in risk management, such as value-at-risk adoption or enterprise risk management implementations. Bank failures underscore the shortcomings of these internally focused initiatives.

Instead, CFOs can lead the charge, using stress testing and scenario analysis, to understand and anticipate the impact of a wider range of changes on customer and product portfolios. They can also challenge

the underlying assumptions used by business units in the development of their strategies and plans. This entails looking at the possible and probable range of potential business and cash flow outcomes, as well as identifying and monitoring a set of leading indicators that will signal trouble ahead and enable the planning of potential mitigating actions.

For example, consider Fujitsu, Japan's largest server vendor. In March 2009, IBM attempted to acquire Sun Microsystems, Fujitsu's partner in high-end server sales. IBM withdrew its offer, but if Sun is eventually sold to either IBM or another competitor in the server market, such a deal could jeopardize hundreds of millions of dollars in annual sales in the only business unit at Fujitsu that is expected to turn a profit this year. The proactive identification of such icebergs enables CFOs to focus management attention on the danger ahead and prepare interventions.

Unmanaged or improperly managed commodity, currency, and interest rate risks can also be deadly icebergs. Hedging is a good example. Many companies do not have a good understanding of their exposures, believing they may already be naturally hedged or that hedging

is too arcane or expensive. When hedging is undertaken, it can be executed inappropriately—using horizons that are too short or an overreliance on forward transactions that run a high risk of going underwater, especially in today's volatile world. For instance, airlines such as Air France lost hundreds of millions of dollars by hedging jet fuel prices for volumes that were well beyond their true exposure to changing oil prices, in part due to declining travel.

Instead, CFOs should define and quantify their largest net economic exposures and sensitivities, as well as the underlying risk drivers. They should also evaluate which risks they are strategically advantaged to own, and which ones can best be managed by the host of available alternatives.

Capitalize on the recession's opportunities. Once CFOs have addressed their immediate challenges and strengthened their balance sheets, they can turn their attention to the opportunities created by this recession. Healthy companies can capture market share by competing more creatively and aggressively for today's price-conscious customers, and building positional assets and

new capabilities (such as upgrading their talent base in a buyer's job market). For strong companies, hard times present a compelling opportunity to enhance business portfolios. Their CFOs can position them to emerge from the recession stronger and in a better position to lead in the recovery.

For example, now is the time to be thinking about how M&A can build capabilities that support corporate goals. The economic climate has created motivated sellers and very attractive valuations. The string of large deals announced by Roche, Pfizer, and Merck in early 2009 illustrates just such a transformative opportunity, which is already under way in the life sciences sector.

This recession is far from over, and the current indicators suggest that recovery may be weak and extended. But CFOs who can manage chaos, mitigate risks, and identify and capitalize on opportunities have entered an exciting, once-in-a-lifetime period to make tremendous gains in the marketplace.

For additional insight into the challenges of the current recession and practical advice for leading your function and company through it, please visit www.booz.com/recession.

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Contact Information

Düsseldorf

Klaus Mattern
Senior Partner
+49-211-3890-120
klaus.mattern@booz.com

New York

Justin Pettit
Partner
+1-212-551-6309
justin.pettit@booz.com

London/Paris

Viren Doshi
Senior Partner
+44-20-7393-3572
viren.doshi@booz.com

Tokyo

Chieko Matsuda
Partner
+81-3-3436-8573
chieko.matsuda@booz.com