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What to do when the well runs dry?

Rebuilding the finance function
within the Financial Services industry

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Finance talent – slow turnover meeting heightened demand

In 2009, during the depth of the recession, only 15 Chief Financial Officer (CFO) positions turned over among Fortune 1000 financial services companies, compared to 26 in 2008 and 30 in 2007. The numbers for 2010 fell even more dramatically, with only 12 CFO turnovers in this group of financial firms. This slowdown mirrors numbers across other industries as well, with only 105 CFOs turning over across the Fortune 1000 as a whole in 2010, continuing a downward trend of 191 turnovers in 2008, then 126 in 2009. What is even more interesting is that all 2009 CFO moves within a Fortune 500 financial company were lateral hires from a direct competitor as compared with 55% in 2008 and 33% in 2007. 2010 paints a very similar picture with 33% of CFO hires made from within the industry.

Why the lull? Faced with a credit crisis and limited access to capital, CEOs needed their CFOs more than ever and were cautious about making unnecessary changes to their finance teams. Concurrently, we have seen through our experience working with financial officers and firms that many seasoned CFOs delayed retirement because they felt an obligation to lead their companies through difficult times. CFOs, too, made their own risk calculations: with a greater sensitivity to risk in the market, many executives thought twice about leaving a 'known risk' situation for a company with an 'unknown risk' environment.

Looking ahead, there are several factors that have come to bear at the same time that will substantially change the dynamics for finance over the next several years. As the recovery continues to take hold, CEOs are beginning to make changes to their leadership teams and are competing for game-changing financial talent. Hiring by private equity firms is also fueling the demand for CFO talent, as these firms are successfully competing with publicly traded companies for exceptional CFOs, either for their existing portfolio companies or for new deals in the pipeline. Moreover, with increased regulatory reform, almost all financial services companies will be shoring up their finance function to meet new risk management, financial disclosure, and compliance requirements.

On the talent side, there is an opposing set of forces at work. We expect to see many CFOs retire or leave the industry, exacerbating the shortage that already exists. Many loyal CFOs who delayed retirement until the worst of the recession was over are now eyeing the exit door, hoping to be able to leave while preserving their legacy.

'Fatigue' and the talent gap

Many financial services companies tell us that they already feel the pressure in trying to bring in CFO talent, finding that when it comes to outstanding finance candidates – whether promoted internally or hired externally – the 'talent well is dry.' Exacerbating the problem has been the demand on the CFO throughout the financial crisis, especially in such a highly regulated industry. This has caused enormous 'fatigue' in many public-company CFOs, and, as a result, the role is viewed by many as

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increasingly unattractive. With fewer willing players, the talent gap will widen. CEOs and boards will be forced to think differently about the finance function in order to ensure that they not only have the right CFO in place, but also greatly strengthen the bench to ensure a succession pipeline. Companies that do not address succession will inevitably find themselves scrambling for talent when the need arises – and oftentimes with only a temporary or sub-optimal solution available. And, a talent shortage at the top in finance not only affects the viability of the company’s financial function but also has reputation and business continuity implications, particularly in the current regulatory environment.

The dynamics of the talent shortage – and why it will get worse

Due to the global economic turmoil of the past two years, a significant number of talented finance professionals have already left the financial services industry, either voluntarily or involuntarily. Those remaining are concerned about the future, irrespective of what dynamics led to the current state of their institutions. With a smaller talent pool from which to choose, when a position does become available companies are challenged more than ever to recruit from a much narrower pool of sitting CFOs and other finance professionals.

The origins of the shortage lie in the first wave of regulation earlier in this decade. With the advent of Sarbanes-Oxley and related governance measures, life for CFOs generally became much harder. It has been estimated that Sarbanes-Oxley increased the workload of finance by as much as 25%¹. CFOs faced more regulation, more responsibility, and more liability than ever. They

found themselves prioritizing technical accounting, reporting, and compliance matters ahead of larger strategic challenges that had originally attracted them to the finance discipline. That unwelcome change, in combination with onerous personal liability, led to an early wave of departures and retirements of a number of CFOs and other top financial talent in many industries, including financial services.

Now, a second wave of regulatory pressure in the form of the Dodd-Frank Act is washing specifically over the financial services industry. Because the industry was the epicenter of the global economic meltdown, it now finds itself facing another round of regulatory oversight and new regulations from governments around the world. For financial services CFOs, this will mean more time spent interfacing with regulatory bodies that are placing even greater demands on the role. With changing regulation comes a higher degree of risk and ambiguity, and we see that CFOs are becoming more concerned about the impact this will have on their careers. We predict that many more CFOs will leave the industry, creating an even greater shortage of ready-and-willing finance chiefs. When combined with the first wave of post Sarbanes-Oxley retirements and the retirements of baby boomers in the coming years, the talent gap will inevitably widen.

As the financial services CFO role is likely to evolve over the next several years, fewer talented up and comers – who are viewed as natural successors to the current crop of CFOs – will have an interest in taking on the parent company role. Others to include CEOs, CHROs and industry analysts worry that boards will gravitate more toward accounting-oriented successors rather than strategic thinkers and decision-makers – the kind of game-changing talent that will be much in demand in other industries. As a result, financial services companies will find themselves facing more CFO departures and a depleted pool of possible successors.

¹ “Why is CFO Turnover So High?”, David McCann, *CFO.com*, February 29, 2008

What can be done?

These developments – early retirements, flight to private companies, reluctant up-and-comers – add up to more than an isolated problem. They point to a wider challenge across financial services that must be addressed strategically and comprehensively to ensure a viable and sustainable financial infrastructure. Institutions seeking to attract and retain the best talent should consider the following in order to address this challenge:

Making the CFO role less “harrowing”

Today’s financial services CFO role entails five significant – and delicate – responsibilities: satisfying shareholders, managing relationships with regulators, working with the board, helping business unit leaders run the company, and, for public firms, working with and positively influencing the analyst community. These are inescapable, but companies must do what they can to make the role less harrowing. Many internal succession candidates, who have witnessed the uncomfortable visibility, risk, and fatigue that their CFOs have suffered over the past several years, will stay only if those issues are addressed. One solution may be for companies to bring the finance and corporate strategy functions closer together in order to create better alignment with the design, not just the execution, of corporate strategy. Another solution for some firms may be to invite the CFO onto the board of directors. Additionally, to supplement the CFO in his or her day-to-day responsibilities, the CEO and CFO can together work to determine what talent can be added underneath the CFO to handle some of the less mission-critical priorities.

Simplifying the role

We are also seeing some companies move to simplify the CFO role. At public companies, the internal audit function is now required to be separated from the CFO’s office (meaning the audit head cannot report into the CFO). Other functions that used to be in the CFO’s domain – such as procurement, real estate, and certain financial

operations – are often being grouped under another C-suite executive’s mandate. These kinds of changes are creating (at least in theory) a ‘time dividend’ for the CFO – one that the CEO and CFO together should determine how to re-invest.

Make expectations clear

In such an uncertain market and regulatory environment, boards and CEOs should be careful not to send mixed signals to the CFO. What many boards, more cognizant than ever of their liability, want in a CFO is a ‘safe’ pair of hands, someone who can serve the company and the larger financial community and deal with the new regulatory situation. By contrast, CEOs may want a strategic partner to help take advantage of growth opportunities that may emerge in the economic recovery. If such differences exist, the CEO should ideally take the lead in ironing out the CFO role and clarifying it with the board, especially with the head of the board’s audit/risk committee. At that point, the CEO can outline consistent expectations encompassing both his and the board’s point of view. However the CFO role is ultimately defined, companies must also realize that there are few CFOs out there who can come in on ‘day one’ and perform all the required functions to perfection. CEOs and boards would do well to prioritize which functions matter most along certain timelines (e.g. certain compliance-related implementations may take greater priority in the short run) and clarify how the CFO’s performance will be measured against these specific objectives.

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Analyzing the bench

With a clear redefinition in hand, the organization can assess its existing talent for their ability to fulfill and to support the CFO role. A clear understanding of gaps in competencies and skills can guide both recruiting and development, and at the same time help in the identification of high-potential individuals. Conducting a rigorous analysis of the 'bench' of candidates just below the CFO (as well as those feeding into that level) through a succession-planning mindset will allow talent development to proceed in a strategic, thoughtful way that will be better for the business than a series of one-off, ad hoc promotions. Retention efforts will also be made easier by clear – and clearly communicated – expectations of the CFO role, as companies can better address potential concerns from up-and-comers.

Creating a succession plan

Understanding the strength of the bench will help the board, the CEO, and the incumbent CFO to develop an appropriate and comprehensive succession plan, including building contingency arrangements in the event of an unexpected departure. It should combine in-depth assessment of internal candidates with benchmarking of external candidates. This exercise should be part of the annual review process and must be well designed and rigorous. Best-in-class companies regularly conduct talent reviews that involve the CEO and their executive leadership teams and work to build experiences that will prepare the next generation of CFO leaders. By seeing to it that succession needs and risks in finance are being systematically managed, the CEO and the incumbent CFO can ensure the company's continued success and protect their legacies as leaders.

Grooming internal talent

Talent development is an area that, unfortunately, has been put on the back burner in many companies amid the more urgent concerns around the financial crisis. As companies have come to rely more on the depth and expertise of their financial specialists – such as their treasurers or controllers or tax experts – many have

moved away from planned development rotations that were the hallmark of great finance organizations for many years. This has stunted the growth and readiness of up-and-coming finance talent who could step into the more general CFO role. The fact is that best practice for succession planning is to create wide-ranging developmental opportunities for high potential talent, which sends a clear signal that a path has been marked for their success. These developmental assignments, which stretch an individual in new ways by including rotational roles across the company, will help up-and-coming talent develop experiences that can carry them to the top finance job. Mentoring, by strategically pairing an executive with an experienced colleague, can help accelerate development toward higher levels of responsibility. Executive coaching can help individuals achieve necessary behavior changes to meet the demands of new roles and responsibilities. And, finally, corporate training – including traditional leadership development activities such as executive communication skills training, executive education, and other training to impart technical or functional skills – can also be invaluable throughout the executive's progress toward the top.

Looking more broadly for external talent

A potentially rich pool of talent for the top seat may be found among the CFOs who sought early retirement and are now teaching, working in government, and/or serving on boards. A decade ago, financial services companies would rarely consider as viable candidates CFOs who were not currently employed. Today, the question is not whether companies should consider such candidates but whether such candidates will want to return to the industry.

Financial services companies should also consider looking for talent outside the industry. While top CFOs from other industry sectors may lack specific financial services domain knowledge, they bring other capabilities combined with a fresh perspective that will offset specific industry experience. The 'secret sauce' for success lies in identifying the core issues that need to be addressed and then seeking talent who have effectively addressed them, irrespective of the industry in which they currently

work. The only open issue to be tested is whether the current state of financial services combined with the heavy regulatory component to the CFO function might deter other industry CFOs from making the switch. This, however, may be mitigated if the CFO role is properly redefined, making it more forward-looking and combining other functions to include corporate strategy. In addition, an important component to hiring outside the industry is ensuring that there is a comprehensive “on-boarding” process for the incoming executive that will bring him or her up to speed on the industry and the regulatory environment in which the firm operates. If there is no opportunity for a deep and substantive learning experience for the new CFO, bringing someone in from the outside will likely prove too risky for a firm to take on.

When it comes to replacing their CFOs, financial services companies have largely tended to look within the industry. Considering the skills a CFO brings, it is at times worth trading industry expertise for other, more fungible capabilities. Numerous organizations known for best-in-class grooming of CFO talent are more often than not found in consumer, industrial, technology, and life sciences companies. While there may be some risk in importing talent from outside of the industry, the bigger risk is not grooming the next generation of CFO talent within financial services.

Given the talent shortage the industry will increasingly face in the coming months, CEOs and boards must rethink the way they build their finance teams and consider a broad array of solutions for attracting, retaining, and developing finance talent. In recruiting for the top job, corporate leaders should consider the core issues they are trying to solve and then consider where that talent may come from as it may not always be the lateral hire from their nearest competitor. The impacts of the supply and demand imbalance will manifest itself in numerous ways, but most importantly in the transition costs, an organization will have to absorb to attract a top flight CFO from a direct competitor. ■

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Financial Services & Financial Officers practices

Heidrick & Struggles' view is simple: In today's global economy companies must recruit, retain and develop financial services executives possessing a mastery of products and services, as well as technical and operating expertise. At the same time, the demands of global business coupled with more complex and rigorous financial reporting requirements and regulations make finding chief financial officers and senior financial executives a challenge.

We are committed to helping our clients build winning leadership teams in all finance-related functions. The global Financial Services Practice – our largest practice – incorporates our leadership advisory and leadership search capabilities using a consultative approach to providing tailor-made human capital solutions. We have a high-caliber team of professionals in every major international financial center.

Our global Financial Officers Practice leverages the right mix of expertise to meet our clients' industry and functional needs as well as their local and international business requirements. We have more than 30 consultants, half of whom previously were financial executives, who are adept at working across all finance-related functions.

Heidrick & Struggles serves as a true strategic partner to our clients. We have the reach, resources and first-hand understanding to help them build top-notch senior finance teams.

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