THINK ACT

BEYOND MAINSTREAM

July 2016

Walk the walk – but talk the talk too!

The modern CFO – Financial communication on the rise

HHL LEIPZIG GRADUATE SCHOOL OF MANAGEMENT

Roland Berger

THE BIG 3

EXCLUSIV
Deutsche Telekom's Ulrich Lehner on personal involvement
→ P.8

86%

of CFOs describe one-on-one meetings as a highly effective channel of financial communication.

Page 5

4

out of 5 points are awarded by CFOs to secure follow-up financing as one of the main benefits of effective financial communication.

Page 6

58%

of CFOs report planning figures to their financing banks, while 100% report backward-looking parameter data.

Page 7

Modern CFOs are becoming strategists – on an equal footing with CEOs and financial backers.

Chief financial officers (CFOs) still concern themselves with financial accounting, financial planning and risk management. Yet since the global financial crisis – and all the more so in the face of growing uncertainty on the markets – their role has risen to far greater prominence. Internally, this is evident from the fact that CFOs are now much more deeply involved in strategy development. That is because of the support they provide to a company's operations, and their new-found importance elevates CFOs to the status of sparring partners and equals for their chief executive officers (CEOs). At the point where strategy and business numbers meet, modern CFOs focus on optimizing returns, managing risks and assessing the progress of strategically important projects. As a result, more and more CFOs can and do ultimately follow in the footsteps of their CEOs. It is no coincidence that more than a third of the chief executive officers currently in office at DAX-listed companies have deep roots in corporate finance. The strategic expansion of their role now makes CFOs the ideal choice as a company's figurehead from the perspective of the capital markets, and hence for communication with investors (bondholders, shareholders) and banks. Moreover, given that companies in German-speaking Europe are increasingly turning to the capital markets, this channel of communication is itself growing in importance. As in the past, CFOs continue to provide detailed answers to questions about business figures. At the same time, however, they are now well able to explain and provide a reasoned and thorough account of strategic issues and decisions in considerable depth too. There is no question that debt and equity providers – the recipients of this information – stand to benefit. Yet companies themselves are also reaping rich rewards from effective financial communication, one example being the resultant financing benefits. But what about the CFOs themselves? What importance do they attach to financial communication? What benefits and drawbacks do they see in it? In the first quarter of 2016, 45 CFOs at major corporations in Germany, Austria and German-speaking Switzerland helped us paint a clear and comprehensive picture.

PERSONAL INVOLVEMENT IS THE MEASURE OF EFFECTIVENESS

Broadly speaking, the respondent CFOs rate all the most common instruments of financial communication as effective. If we scratch beneath the surface of this finding, however, it is obvious that tools of financial communication become more effective as the individuals who wield them demonstrate greater personal involvement → A. Standard forms of written communication such as annual reports and investor relations documents posted on company websites score lower grades than personal – and hence flexible – communication channels. As far as flexibility is concerned, roadshows and one-on-one meetings are clearly held in much higher regard. Personal contact allows CFOs to address investors' individual interests and provide detailed answers to questions that annual reports can only touch upon. Profound insights help them tell capital backers a compelling equity or debt story and persuade them of the benefits if they buy into the project. Investors and banks themselves concur in this opinion: For them, face-to-face talks with the managers of the companies they invest in are an important factor – especially where they do not otherwise have access to all the information. A word of caution, however: CFOs must scrupulously avoid all conflicts with insider trading legislation. Accordingly, they should always remember that the information they disclose must never give any one conversation partner an advantage over other investors.

This kind of communication takes up a lot of CFOs' time, which again underscores the importance of financial communication as part of their mandate. Two thirds of our respondents spend more than 10 percent of their work time talking to investors → B. Bearing in mind the long list of tasks and responsibilities assigned to any CFO, that is a remarkable finding, especially for financial professionals who are traditionally obsessed with optimizing returns: They of all people are never going to invest their time unless they are sure it will benefit the bottom line.

FINANCIAL COMMUNICATION ALSO HELPS SECURE FOLLOW-UP FINANCING

Ask CFOs and they will tell you that the benefits of comprehensive financial communication – in descending order of importance – are securing follow-up financing, reducing the cost of financing and gleaning strategic insights from discussions with investors and banks → C.

The respondent CFOs see the ability to secure follow-up financing as the biggest benefit of comprehensive and intensive financial communication with the capital markets and, even more so, with the banks. Nurturing relationships with capital backers in this way thus keeps open the pipes through which more money can flow in in the future.

Only slightly less importance is attached to the chances of reducing financing costs through extensive financial communication. In this way, "good" companies can ease the information asymmetry between management and investors. Less information asymmetry also means lower risk premiums in the context of financing. In communication with banks, this benefit again weighs a little heavier than in communication with the capital markets.

At the same time, CFOs do not overlook the value of picking up strategically important information from dialog with capital backers. Our respondents rate this as a moderate benefit of effective investor communication, this time with more advantages seen from dialog with the capital markets than with banks. Since many of the respondent CFOs are involved in running companies whose equity is publicly traded, this variation can be explained as follows: Whereas equity investors have a powerful interest in companies' performance and will gladly share their views and experience to help improve it, banks do not normally participate in companies' profits. Moreover, on account of their professional secrecy obligations in dealings with customers, they are not allowed to share much of their information with third parties.

Clearly, however, financial communication is anything but one-way traffic. It can yield valuable insights not only for potential investors and lenders (banks), but also for CFOs.

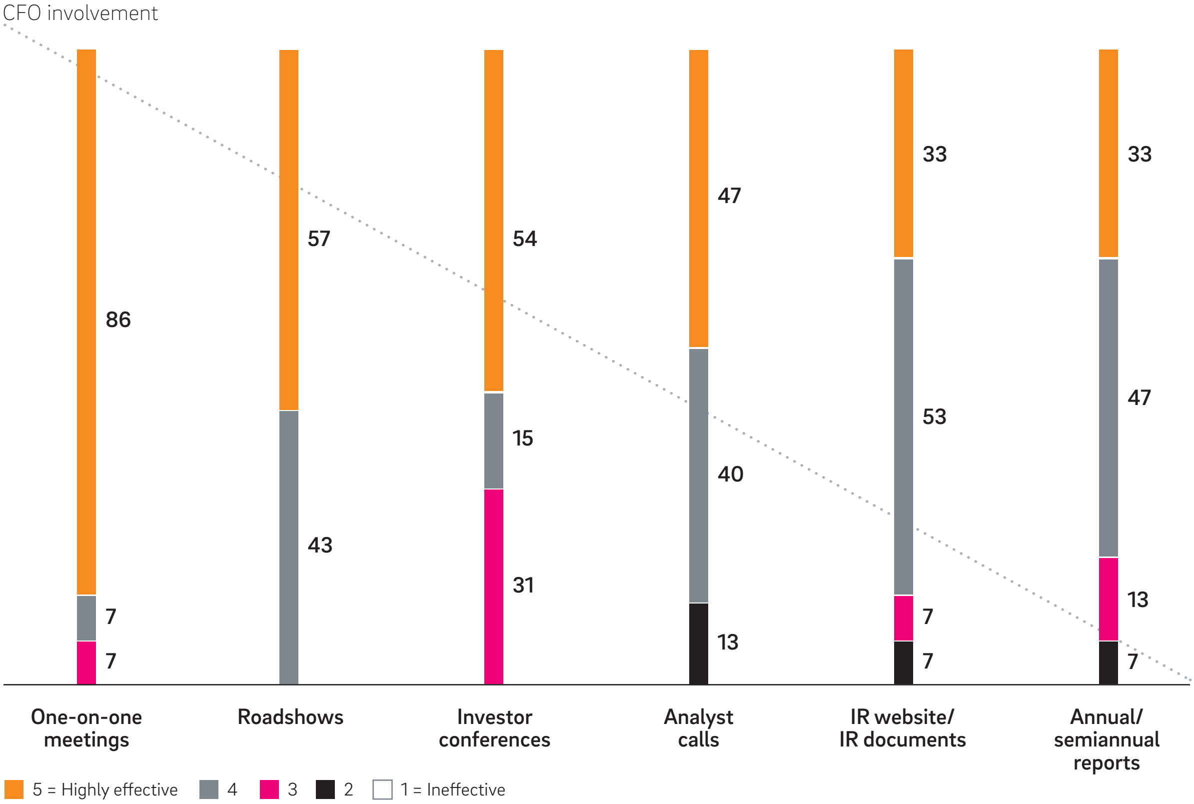
GROWING COMPLEXITY ADDS TO THE CHALLENGES FACING CFOS

Life is not getting any easier for chief financial officers. On the capital markets in particular, investors nowadays demand much more information and expect to receive it much more frequently. Stricter regulation of the capital markets is one reason for this greater need for information. Other key drivers have often been industry or company-specific events and developments that cause a given company to (re)appear on investors' radar screens. Irrespective of these factors, however, investors seem generally to demand more information these days.

A

86% OF CFOS SEE ONE-ON-ONE MEETINGS AS A VERY EFFECTIVE CHANNEL

By contrast, standard, written communication is regarded as less useful (percentage of mentions)

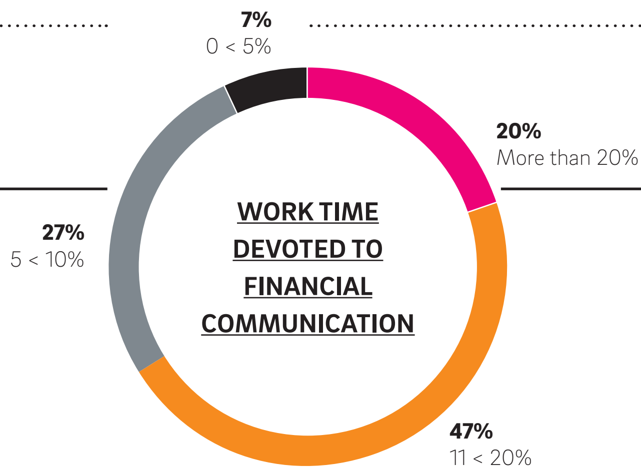


Source: Roland Berger, HHL

B

TIME IS MONEY

Two thirds of CFOs devote at least 10% of their work time to financial communication

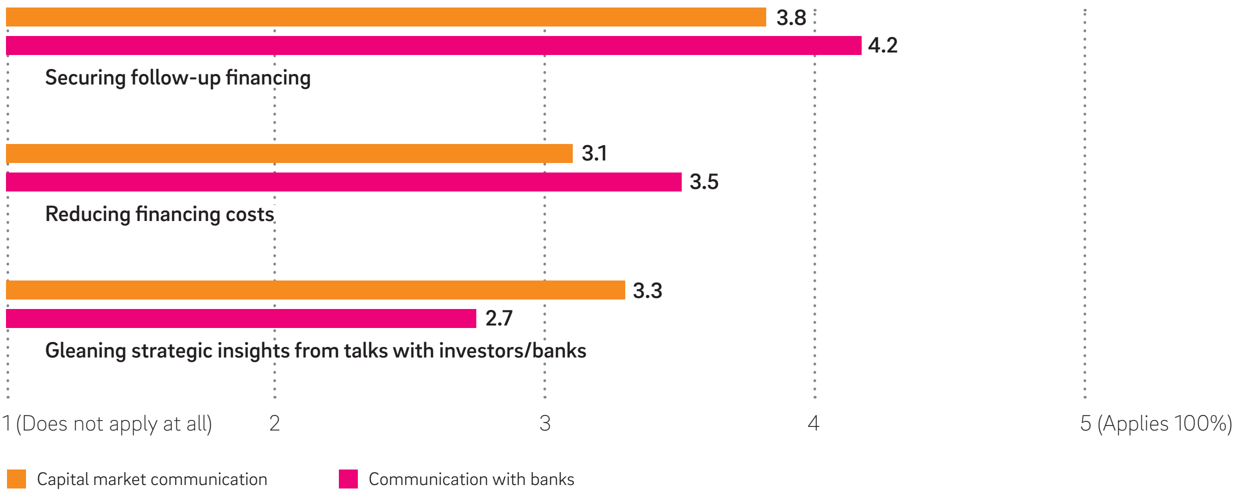


Source: Roland Berger, HHL

C

BENEFITS OF EFFECTIVE FINANCIAL COMMUNICATION

Securing follow-up financing is the main benefit of financial communication



Source: Roland Berger, HHL

On the other hand, CFOs see little change in the frequency and scope of their communication with banks, despite growing regulatory demands. This finding confirms the trend observed in an earlier study whereby credit terms are actually tending to be loosened in the form of financial covenants. In light of the current interest rate environment, banks are prepared to accept certain concessions and grant what have been termed "covenant-lite" loans in order to maintain their relationships with clients.

Trends such as the more international line-up of investors and stepped-up shareholder activism via instruments such as hedge funds have recently been the subject of animated debate, but do not appear to be affecting the complexity of financial communication at the companies we talked to.

CFOs continue to see increasing regulation as the main driver of communication with the capital markets in the future. Implementation of the Transparency Directive will essentially eliminate the need for capital market-oriented companies to publish quarterly reports, or at least significantly reduce the scope of such reports for firms listed in the Prime Standard segment of the Frankfurt Stock Exchange. Yet the impact of further directives will soon make itself felt. The Market Abuse Directive will tighten up disclosure and insider trading rules, for example, and a new CSR Directive is also due to become law (see page 12). The latter will oblige companies that source funds on the capital markets to prepare detailed reports on the subject of sustainability. Even without this directive, however, IR experts already confirm that investors – especially equity funds – are increasingly asking for information about corporate social responsibility (CSR) issues, one example being the energy consumed by IT companies' servers. It follows that non-financial indicators will come even more sharply into focus going forward.

This being the case, the respondent CFOs also expect reporting and IR departments to become more deeply integrated in order to remedy problems at the interfaces between them, and to ensure that only one face is shown to the outside world. Some respondents also predict a further increase in one-on-one meetings with investors, which will likely require CFOs to again ramp up their involvement in financial communication.

BANKS REQUEST BACKWARD-LOOKING INFORMATION

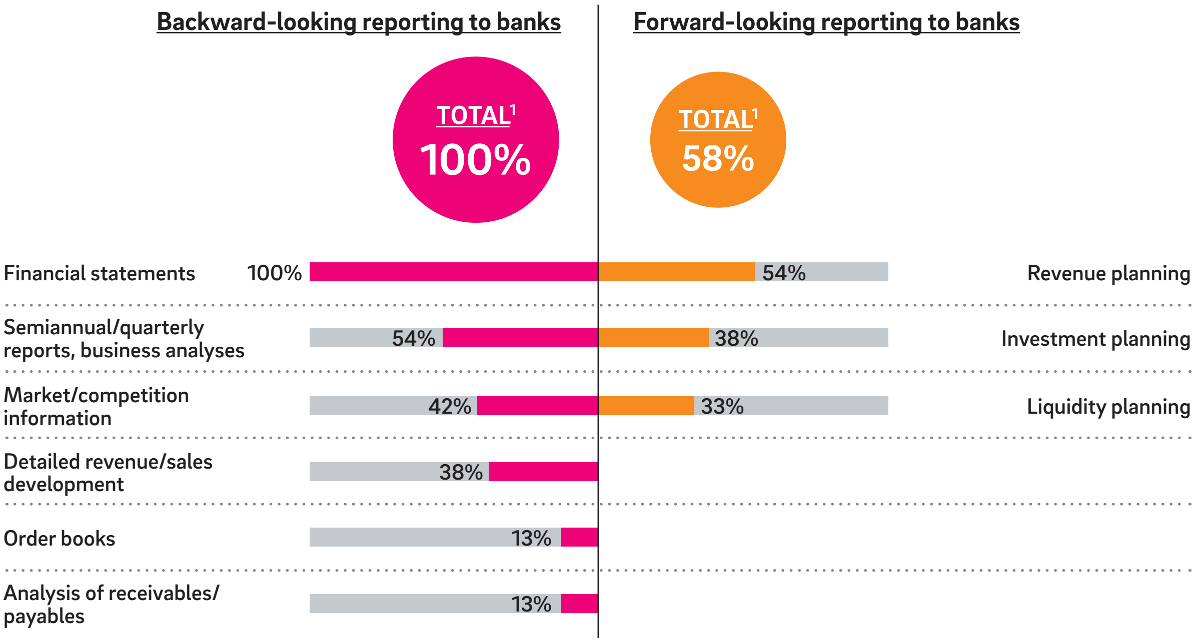
Overall, the anticipated increase in communication requirements is slightly weaker for banks than for the capital markets. Not all respondents expect the banks to add to reporting requirements. They do, however, predict that greater strategic importance will be attached to communication with banks, presumably as an ongoing side-effect of the current financing environment.

In the expectation of CFOs, creditor banks' tendency to focus primarily on backward-looking information when requesting regular updates is not about to change. →D. Fewer than 60 percent of the companies surveyed prepare forward-looking reports at all. Be that as it may, banks would be well advised to reconsider this approach. In effect, they are consciously waiving what could be fundamental insights, choosing instead to monitor their clients' business development after a "reasonable" time lag that, in reality, is anything but reasonable.

Banks in general seem to be less interested than the capital markets in their clients' numbers. Or maybe they simply lack access to the data in some cases. They receive less information across all groups of economic indicators. The only exception is their core topic of liquidity, where the information they obtain is at least on a par with that given to the capital markets, albeit on a low level. It is reasonable to ask whether it wouldn't be possible – and sensible – for corporate clients to provide more extensive but still focused KPI reporting to the banks as well. In conjunction with forward-looking report elements, this could improve banks' information position to such an extent that they are better able to assess both the financial situation and the wider future outlook for their corporate clients.

D

ONLY 58% OF CFOS REPORT PLANNING FIGURES TO THE BANKS
Banks would be wise to reconsider this approach



Source: Roland Berger, HHL Multiple answers possible 1) Percentage of CFOs who selected one of the specified reporting elements

Personal involvement is of essential importance

Effective financial communication demands personal dialog in an atmosphere of trust

PROFESSOR ULRICH LEHNER, Chairman of the Supervisory Boards of Deutsche Telekom AG and ThyssenKrupp AG (among other posts)

Financial communication – the practice of companies sharing information of relevance to decisions with investors, banks and analysts – is more than just a matter of compliance. My experience is that it is also a strategic tool to source capital cost-efficiently while, at the same time, keeping reliable, well-resourced partners onside during economically challenging times. But how do you make financial communication effective? Do you have to disclose all the information you have? Or should a company only publish that information that is most relevant? And what information is relevant in any case?

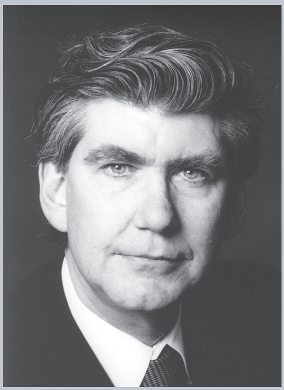
That always depends. Ultimately, whether or not information is relevant depends on the information needs of the given recipient. Some capital market investors like to see the big picture and focus primarily on the equity story. Others want to grasp even the finest details of how exchange rate risks are hedged. Conversely, a bank might be more interested in liquidity and the trend in liquidity.

In other words, effective financial communication means constantly adapting to the specific information needs of each party. The best way for a company to meet the information needs of an investor is one on one. In this setting, specific answers can provided to individual questions. At the same time, a company can nurture the capital backer's trust in the organization and its management. Trust, after all, is the fundamental prerequisite for all financial communication. Given the huge complexity of so many issues, and in not a few cases due to a simple lack of time and resources, investors often base their decisions on the degree to which they trust a company's management. In the early days, that may involve giving a business the benefit of the doubt. Over time, however, trust is the fruit that grows out of close collaboration during which promises and agreements have been kept consistently.

While building trust is a long and laborious process, losing it again can happen very quickly. Experience shows that this is the reason why the credible, personal involvement of top management is of essential importance to financial communication.

Communication as a strategic success factor

CFOs must master three dimensions of communication: performance, values and emotions



PROFESSOR TORSTEN OLTMANNS,
Partner at Roland Berger, head of the Executive Communications Practice Group

Good performance is necessary. But that alone is not enough to win the trust of investors and creditors. That is why today's CFOs must engage in much more intensive communication with target groups and stakeholders. Moreover, any strategist in the spotlight of the financial community also needs to develop good instincts for the concerns of critical stakeholders, as well as understanding the rules by which the media operate.

Communication thus has to be part of the CFO's stock in trade. That is all the more true today because, more than ever before, trust and credibility are pivotal to financial communication and communication with banks. The benefits of a positive image among stakeholders are obvious. On the other hand, the drawbacks of poor communication are equally serious. As our "Perception beats Performance" study shows, more than 70% of job losses among top managers are attributable to a negative image held by the most important stakeholders – in some cases despite excellent performance.

Having looked in the rearview mirror to study past successes, stakeholders also expect credible information about the goals, attitudes and values of the people they are dealing with. All of these issues are pointers to the future that allow them to assess how an organization and a manager will act, whether they have what it takes to genuinely realize their plans, and whether you can trust them to succeed even in difficult circumstances and follow through with their strategy even in the face of resistance.

To achieve such credibility and cultivate such trust, CFOs must master three dimensions of communication:

- Performance in all corporate categories, from current KPIs to strategic goals and projects
- The attitudes and values of the organization and the individual: What drives them to perform? What makes them tick? What do they believe in?
- Emotions and personal relationships that create a climate in which commitment, respect and mutual affinity can take root.

Many of the companies we talked to fall at the very first hurdle, that of performance parameters. They place too much trust in the power of indicators, but neglect to create a context in which their KPIs can be interpreted. Yet companies and CFOs show even more glaring weaknesses when it comes to fostering transparency about themselves, their attitudes and values, and when the need is to nurture commitment.

Communication, then, is a management skill that CFOs must possess. Or, to quote star investor Warren Buffet: "Bad news flies; good news has to be stage-managed."

Photos: Caro / Zensen; Roland Berger

TAKING FINANCIAL COMMUNICATION TO THE NEXT LEVEL

Financial communication is already of huge importance to the respondent CFOs. This is shown both by the numerous benefits they ascribe to it – securing follow-up financing options, reducing the cost of financing and gathering useful feedback for strategic decisions – and by their considerable personal involvement in it.

The potential strategic benefits are many and varied, and the entire corporate organization should be aware of them. They would then no longer only be a matter for CFOs, but could influence core decisions. CFOs and financial communication are the primary touchpoints with sources of capital. They have their finger on the pulse and can channel their perspective into the decision process at the right time. The associated neutralization of factional interests within the group would also improve the quality of decisions for the whole company. This process should be driven by modern CFOs. Communication with capital backers should continue to rectify information asymmetries. That fosters trust and gives the company advantages with a view to existing and future financing arrangements. Although slightly less importance is currently attached to communication with banks, it should not be neglected as interest rates will surely rebound at some point. When that happens, it is reassuring to have a stable financing partner by your side. For their part, banks should increasingly ask to see planning figures in order to preempt looming crisis situations for their clients – instead of sifting through damage reports after disaster has struck.

If you want to become a good financial communicator, get started now! Looking ahead, growing regulatory demands will only make such communication more complex and thus add to its importance over time.

TIGHTER RULES IN SEVERAL AREAS

Non-financial indicators will come even more sharply into focus.

	MARKET ABUSE DIRECTIVE **Tough sanctions for violations of disclosure obligations and insider trading, for example**	CSR DIRECTIVE **Extensive provisions governing sustainability reporting in management's analysis**
Valid:	From July 3, 2016	For fiscal years beginning after December 31, 2016
Concerns:	All issuers, including those whose securities have hitherto been traded over the counter	Capital market-oriented companies with more than 500 employees
Selected content:	Stricter ad-hoc reporting duties for insider information, irrespective of OTC listings; heavier fines for non-compliance Compulsory maintenance of project and event-specific insider lists by security issuers Broader catalog of proprietary trading transactions that must be reported. Even attempts at insider trading or market manipulation are now criminal offenses, for example	Compulsory addition of "non-financial" explanations to management's analysis of: • Environmental, employee-related and social welfare topics • Respect for human rights • Anti-corruption measures Inclusion of information about relevant concepts, control mechanisms, risks and KPIs Explanation of the diversity concept in the make-up of administrative, management and supervisory bodies in the corporate governance declaration

ABOUT US

Roland Berger, founded in 1967, is the only leading global consultancy of German heritage and European origin. With 2,400 employees working from 34 countries, we have successful operations in all major international markets. Our 50 offices are located in the key global business hubs. The consultancy is an independent partnership owned exclusively by 220 Partners.

HHL Leipzig Graduate School of Management is a university and one of the leading international Business Schools. The goal of HHL as the oldest institute for higher education in business in the German-speaking world is to educate effective, responsible and entrepreneurial leaders. Aside from the international focus, the fruitful combination of theory and practice is of particular importance. HHL excels in the quality of teaching, clear research orientation and close transfer of research to practice as well as in the exceptional service for students. As of 2011, HHL has been pursuing the innovate125 growth strategy.

FURTHER READING

CHIEF RESTRUCTURING OFFICER – COACH OR COMMANDER? (2016)

The demands on Chief Restructuring Officers (CROs) are rising. For one thing, their role is ever more international, as almost all major companies today have activities outside the domestic market. For another, change management is now an increasingly significant element in restructuring projects. Communication and leadership skills for companies' chief restructurers are thus more important than ever.

A MATTER OF PERCEPTION (2015)

Success is first and foremost a matter of perception. Today, more than twice as many managerial careers run aground due to negative perceptions of their actions than careers that objectively reflect poor performance. Managers need to understand that their image, the way they are perceived, is an asset that must be managed proactively.

Links & Likes

ORDER AND DOWNLOAD
www.rolandberger.com

STAY TUNED
www.twitter.com/RolandBerger

LIKE AND SHARE
www.facebook.com/RolandBergerStrategyConsultants

UP-TO-DATE FINANCIAL COMMUNICATION AND CAPITAL MARKETS
www.kapitalmarkt-forschung.de

Publisher

ROLAND BERGER GMBH
Sederanger 1
80538 Munich
Germany
+49 89 9230-0
www.rolandberger.com

**HHL LEIPZIG GRADUATE
SCHOOL OF MANAGEMENT**
Jahnallee 59
04109 Leipzig
Germany
+49 341 9851-0
www.hhl.de

WE WELCOME YOUR QUESTIONS, COMMENTS AND SUGGESTIONS

DR. MATTHIAS HOLZAMER
Partner
matthias.holzamer@rolandberger.com

DR. SASCHA HAGHANI
Managing Partner Germany,
Member of the Global Executive Committee
sascha.haghani@rolandberger.com

PHILIP KETTELHODT
Senior Consultant
philip.kettelhodt@rolandberger.com

PROFESSOR HENNING ZÜLCH
Chairholder, Chair of Accounting and Auditing,
HHL Leipzig Graduate School of Management
henning.zuelch@hhl.de

DR. CHRISTIAN KRETZMANN
Research Affiliate,
HHL Leipzig Graduate School of Management
christian.kretzmann@hhl.de

JOHANNES HOTTMANN
Research Associate,
HHL Leipzig Graduate School of Management
johannes.hottmann@hhl.de

TA_16_034