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No longer on autopilot: Lessons for CFOs from COVID-19

The CFO must ensure that the financial-management approaches and tools being used to guide their companies through the pandemic stick in the next normal.

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We're now months past the first reports of global infections and deaths from the novel coronavirus, and CFOs and finance teams have done the hard work of leading their organizations through the immediate crisis—for instance, helping to ensure the safety and protection of employees, suppliers, and other key stakeholders; collaborating across functions; assessing liquidity and conserving cash; and reaching out early and often to investors to reset performance expectations.

To borrow a flight analogy, they've steered the plane through an extended wave of turbulence—but there is every indication that many more dips and dives lie ahead. There is no apparent return to business or finance as usual. Market conditions are changing, and so must companies' traditional day-to-day planning and budgeting activities—and quickly.

The CFO must regain control of and reimagine financial plans and processes that, many would argue, have been on autopilot in the lead-up to the COVID-19 crisis. A hands-on approach is needed not just to steady business operations in the near term but also to create conditions for the company's value-creation efforts in the next normal—and to act on key scenarios and strategies generated by the plan-ahead team.[1]

Drawing lessons from these unsettled months, the CFO must permanently build speed and flexibility into forecasting, planning, and resource-allocation processes and incorporate new tools and rapid decision-making protocols into the finance team's day-to-day work. Taken together, these actions will comprise the CFO's new operating manual for the finance function, with detailed instruction in six critical areas:

— setting multiple flight paths (or business scenarios)

— building flexibility into planning and forecasting cycles

— adopting contingency-based resource reallocation (or "contigent resourcing")

— improving performance reporting

— accelerating decision making

— securing senior leadership's commitment to bold, strategic moves

The CFO cannot steer this plane alone, of course. The finance leader will continue to need support from other C-suite executives and the board of directors, as well as an agile financial-planning and -analysis team (FP&A). The members of this crew must come together in new ways to steer analytical and strategic resources and capabilities to the priorities that matter.

Finance's new flight plan

For most CFOs, the established flight plan is out the window; their standard routines for generating forecasts and scenarios, reviewing performance reports, and making critical resource-allocation decisions no longer make sense in a world where the global health and economic situation has changed so profoundly. These routines have largely been driven by inertia—simply doing things the way they've always been done. By contrast, the new flight plan must address the rapidly changing context, focusing on several best practices.

Set multiple flight paths

Most companies already use some form of scenario planning, but in the next normal, finance teams must embed them into existing core planning processes. The CFO and the finance team should continue to rely on the three or four independent scenarios built during the acute phase of the crisis that reflect short-term and long-term revenue and cost outlooks. Each scenario should have a perspective on the length of potential economic decline, the depth of the decline, and the ramp up to the next normal. Among them should be a momentum

[1] Yuval Atsmon, Chris Bradley, Martin Hirt, Mihir Mysore, Nicholas Northcote, Sven Smit, and Robert Uhlaner, "Getting ahead of the next stage of the coronavirus crisis," April 2020, McKinsey.com.

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case—or a do-nothing scenario—that accounts for country-specific macroeconomic outcomes and sector-specific implications but excludes the execution of any strategic initiatives or the allocation of resources toward those initiatives. Having a varied range of scenarios can allow for more agility and flexibility in both the planning process itself and the company's eventual responses as pandemic-related events unfold—if a U-shaped recovery turns into an L-shaped or "swoosh"-shaped recovery instead, for instance.

The CFO and finance team at a consumer-goods company, for instance, might identify two likely scenarios (alongside the momentum case): one in which a rapid rate of recovery allows it to gain greater market share given the strength of its e-commerce channel; and the other in which a more muted rate of recovery prevents the company from growing at a rate much more than that of the economy, with much less opportunity to gain market share and differentiate itself from competitors.

The finance team can then use one or two of senior leadership's chosen scenarios as the anchor for an operating plan that will be used to "run" the business. The operating plan should have clear key performance indicators (KPIs) and triggers that reveal when the shift from one scenario to another is required. For instance, in an initial scenario, a retailer had initially planned for only a modest shift in sales to its online channel. Based on the increased click-throughs it was seeing, however, the company boosted its sales targets under what the company had deemed a higher-demand scenario.

Build flexibility into planning cycles

Companies that are determining how to address changes in the market as a result of the novel coronavirus obviously cannot rely on financial plans that were generated at the beginning of the calendar year; the circumstances have changed dramatically since then. Even beyond the effects of the current pandemic, CFOs and finance teams are finding that annual scenario-based planning cycles are no longer responsive enough to the pace of change in business today.

Planning and review cycles at the peak of the crisis were sped up out of necessity; that pace must now become habit within the finance function. The CFO and finance team must continue the shift toward quarterly (or more often, if needed) planning and review cycles. The financial plan should continue to include detailed breakdowns of the ten or 15 highest-value business units, geographies, or strategic initiatives—for instance, those that account for 80 percent of the value of the business. It should also continue to incorporate multiple scenarios focused on the five or six potential pain points for the company in the wake of the pandemic—those geographies, products, and business units, for instance, where the company expects to see significant value leakage.

If the company isn't already using dynamic forecasting, now is the time to start. Dynamic forecasts, common in retail and software settings where churn is rapid and data are plentiful, are updated in real-time, and the FP&A team adjusts inputs in a predictable way as conditions change.

Most companies use them to manage the top line or to limit discretionary spending if forecasts are falling behind annual targets. In a world in which pandemic scenarios will drive business decisions for the foreseeable future, the CFO and finance team should take a similar approach—with the understanding that the rolling COVID-19 forecast must be modified at least twice each quarter, as various business scenarios unfold, and the company is managed to the forecast instead of the budget.

Some finance teams are even using advanced analytics to stress-test their forecasts and scenarios. For instance, one consumer-packaged-goods company is using a combination of precrisis data, postcrisis assumptions about business drivers, and consumer-behavior research to model demand for its product categories under various recession scenarios. One early finding showed that the one-year compound annual growth rate in the canned-goods category changed from –2.7 percent in a business-as-usual setting to 4.2 percent under a deep-recession scenario.

Adopt contingent resourcing

To avoid any sudden, steep dives in performance, the CFO and finance team should build more agility and flexibility into their resource-reallocation processes. They should consider implementing contingent resourcing, in which funding and resources kick in as certain scenario-based triggers do. For instance, during this crisis period, a business unit may receive a base minimum to spend that covers only fixed costs. Any additional funding would be contingent on increases in, say, demand, delivery rates, or customer-retention rates—the business unit would have to meet predetermined thresholds, set jointly by the finance team and the business. This stage-gate approach gives the CFO and senior management options: they can quickly put a hold on initiatives or cancel them altogether if the financial plan is off track or if indicators of success are not there.

Similarly, the CFO may want to take a more dynamic approach to resource reallocation—perhaps creating a separate pool of funds that is allocated throughout the year based on risk–return expectations across businesses and geographies. The CFO at one dental-services organization, for instance, has set aside funding for office renovations and renewed marketing to consumers; these discretionary dollars are held centrally and allocated based on which regions open up first and the levels of customer demand for dental hygiene after quarantine. The organization intends to make this a permanent approach to allocating discretionary funds.

The finance leader will need to ensure that performance-management dialogues reflect this change in budgeting strategy. Any reviews should be based on real-world data, and conversations should be focused on costs and tradeoffs rather than on budgets and variances. Make no mistake, building flexibility into resource allocation can introduce challenges: some investments may get delayed; some companies may end up paying more for indirect spending contracts with fewer up-front commitments and uncertain future allocations. On balance, however, having more flexibility is better than not: it allows companies to manage to the actual outcomes of various business scenarios rather than being forced to adhere to a target that no longer makes sense.

Finance’s new navigation system

The CFO will need to refine various elements of the finance function’s navigation system—that is, the tools, KPIs, and protocols that will support changes in forecasting, planning, and budgeting. By institutionalizing the best practices adopted during the crisis, the CFO and finance team can help ensure the company’s success in the next normal.

Keep eyes on the control panel—always

Companies today are likely in one of three categories: still in a severe liquidity crunch, experiencing some decline in performance but still airborne, or experiencing some tailwinds from increased consumption and demand. The CFO must be ever cognizant of where the company is on its journey and, with help from the FP&A team, closely monitor and manage resource deployment and consumption accordingly.

Most organizations, at this point in the life cycle of the pandemic, have likely set up spending control towers, cash war rooms, dashboards, and nerve centers—all of which should be maintained to help fuel the recovery. The CFO and FP&A team can use these tools to keep constant watch on capital investments and may even want to revisit assumptions about various business cases as conditions evolve. The finance team in one industrial company has established new stage gates for capital investments across all businesses. The new hurdle rate is linked to the percentage of top-line-revenue attainment over the next two years. The team has created a user-friendly finance dashboard where everyone can see (in the form of dynamic graphs and charts) the progress of the top three initiatives they are managing. Business leaders' performance evaluations are explicitly linked to the completion of these initiatives versus top-line goals alone.

Fire up the GPS early and often

Even after the company's recovery strategy has been established, the CFO will need to ensure that it remains constant or, if it needs to change, that all are in agreement on a new direction. That is why the finance function's new navigation system should include a robust global positioning mechanism—namely, frequent (weekly or monthly), detailed check-ins with senior management about strategic direction and the outcomes from the company's biggest moves and initiatives.

These performance-related dialogues, powered by the FP&A team, should focus on the top five to ten initiatives and the real-time data being generated about them—for instance, the status and utilization of crucial production plants or the order-intake and -delivery rates from an e-commerce platform. A laser focus on the top initiatives and triggers associated with them can give senior-management teams visibility into how resources are being deployed currently, how conditions are changing (in terms of, say, an increase in customer demand for certain types of products), and how budgets may need to be altered over the longer term. Traditional reviews of aggregated financials and analyses of budgets versus variances can provide some indication of the extent of the financial impact from the pandemic. But they probably will not accurately reflect the impact of the actions the company has taken in response to the crisis.

Digital tools like robotic process automation (RPA), advanced analytics, and machine learning can further enable these dialogues. One forward-thinking electronics company has consolidated its analytics resources within the FP&A team and created a digital-boardroom capability that allows for deeper, more engaged performance dialogues and quicker decision making.

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Even without all the digital bells and whistles, some FP&A teams are enabling deeper discussions and quicker decision making simply by organizing themselves differently. For instance, a consumer-goods company has created dedicated subteams (with no more than seven members) within the FP&A team that support analyses and decision making on critical topics, such as customer response, vendor management, and product pricing. Some FP&A teams are scheduling daily, weekly, or monthly stand-up meetings to identify urgent and immediate tasks and match them to team members' schedules (who is free?) and expertise (who can lead, who can support, and who can teach?).

Be prepared

Most companies have likely already undertaken some version of a financial stress test that indicates their ability to survive this or any other crisis. That's only the first step, however. The companies that are fortunate enough (liquid enough) to begin thinking about recovery and that are considering which bold bets to place will need a reliable financial fact base to draw from. It is incumbent upon the CFO and the finance team to continually refine their perspective on liquidity and cash flows, taking into account industry-specific factors and any changes in senior management's and the board's appetite for risk. The CFO will need to continually monitor the fuel gauge—that is, the driver-based models they have built, from revenue to cash. Armed with this information, the CFO can evaluate liquidity and solvency risks, determine how much fuel is left in the tank to allocate to new initiatives or prop up existing ones, and evaluate how many more miles are left to cover before the company begins to emerge from dark clouds.

Understanding the business's safety profile also means understanding what to do if the worst-case scenarios unfold and a "controlled crash" is in order: What moves make the most sense, and when do we make them? These will be critical questions for the CFO to consider in the next normal and points on which the finance leader will need to gain clear commitment from the management team. Most organizations have run simulations and constructed what-if options. Others have built decision frameworks with contingencies that note when, say, the divestment (or acquisition) of assets would most be in order. Taking it a step further, the CFO, often viewed across the C-suite as an objective arbiter, should be working with the plan-ahead team to establish a set of plan-B and even plan-C actions so the business can act as various business scenarios take hold.

Once all is stable, the CFO and senior management should conduct a thorough and honest review of how finance teams, systems, and processes carried the business through the storm—not just to prepare for the next rocky flight but also to ensure that the company has the new operating manual it needs to thrive in the next normal.

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