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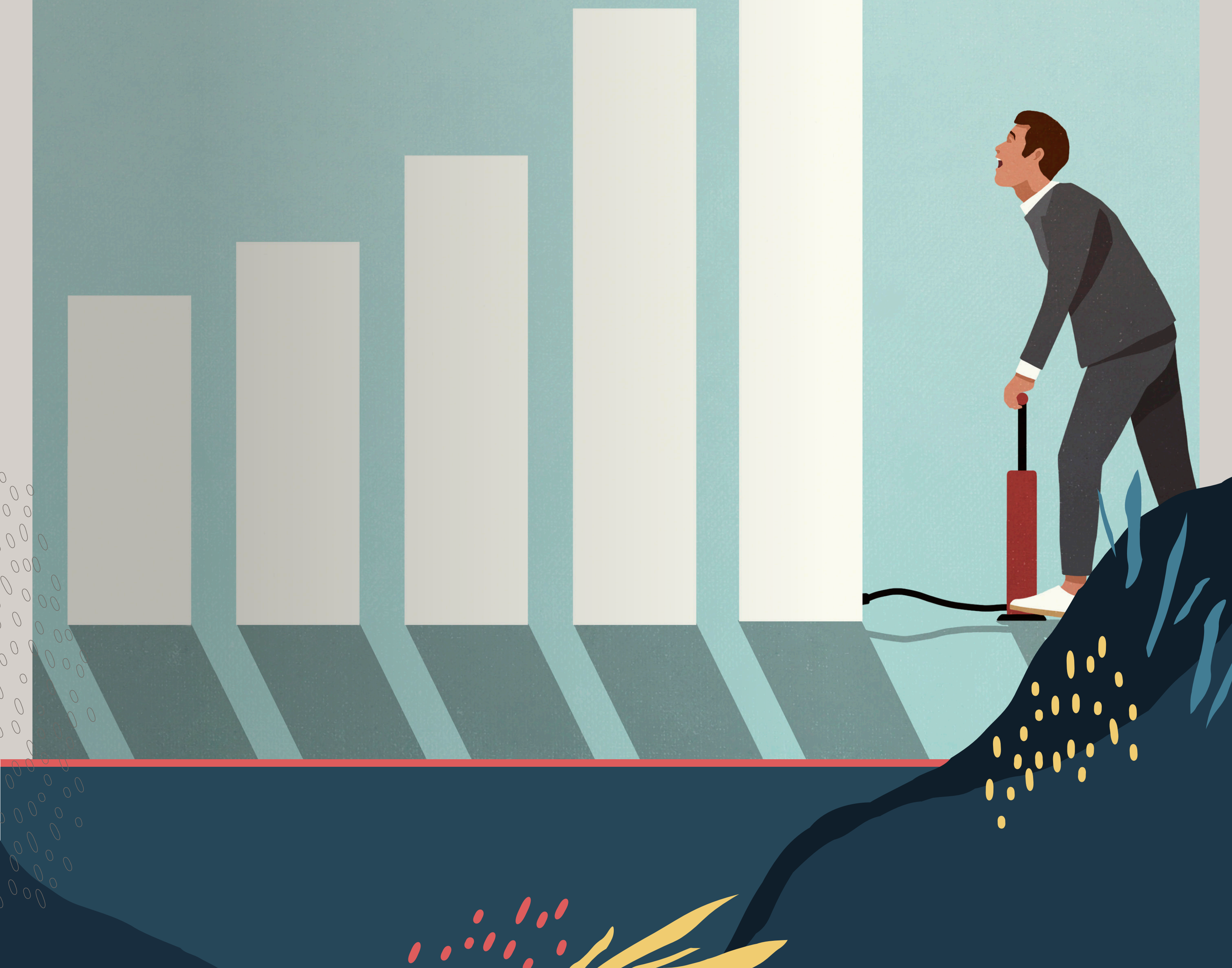
BUSINESS GUIDE

7 Steps CFOs Can Take for Efficient Growth



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7 Steps CFOs Can Take for Efficient Growth

For the past several planning cycles, business leaders across industries have been waiting for a recession that seemed imminent. But recession predictions have been continuously delayed as a steady stream of better-than-expected data on jobs, inflation, and consumer sentiment brightens the immediate picture. Some Fed leaders and economists now see a viable path for a soft landing. In fact, just 8% of CFOs expect a recession in the next six months, per a mid-2023 PwC Pulse survey.[1]

That shift in expectations means more CFOs are not as narrowly focused on cash preservation and cost cutting. CEOs and boards have given the green light to pursue the right opportunities to grow their businesses. A McKinsey survey showed 57% of finance chiefs expect to increase internal investment in the next year,[2] and 67% remain bullish on the future success of their own businesses, per The CFO Survey from Duke University.

This cautious interest in growth is still a far cry from the grow-at-all-costs mindset of the boomtimes, but it does signal that more companies are no longer hunkering down and waiting for a storm to pass. Capital is still expensive as interest rates have soared to a 22-year high, meaning finance leaders are eschewing expensive and risky projects for ones that are safer bets and that may require less capital. Leaders still are taking a hard look at their operations in search of ways to increase profit margins and boost the balance sheet. Put simply, CFOs and their teams are in search of efficient, profitable growth.

> Companies look to their finance leaders and teams to illuminate and build the path to profitable growth, so this is a chance for finance to make a real and lasting impact on the business.

They have a uniquely broad and numbers-centric perspective on their companies' operations and performance that makes them a natural fit for the job. As CFOs look for smart, measured ways to increase profit while also finding revenue growth, we have seven recommendations for them.

7 Strategies to Grow Efficiently

1. Fine-tune your forecast

Forecasts affect so many other key decisions—purchase orders, hiring plans, yearly sales goals—that increased accuracy can create a positive domino effect. They can prevent a software services business from overhiring or a retailer from ordering too much of a product with highly seasonal demand. In the latter example, getting inventory right can speed up your cash conversion cycle because inventory will turn faster if you have the right items in stock.

Better forecasts start with accurate, up-to-date, and comprehensive historical data. If you're pulling data from multiple systems, they must be tightly integrated with the planning system so decisions are always based on timely information. The right system will then use that information to automatically update forecasts, which makes it more feasible to reassess forecasts frequently. Leading software can also pull in external economic data such as employment and inflation numbers from government sources like the U.S. Department of Labor.

Some systems can also project cash flow, which is always top of mind for CFOs. Anticipating potential cash shortfalls before they happen is invaluable in a time when loans are historically expensive. On the other hand, if the projections show a future cash surplus, you can use metrics such as the capital asset pricing model (CAPM) to determine where to invest that money for the best returns.

Connecting these more accurate forecasts to scenario planning can help CFOs and their teams understand how different outcomes or moves could affect their financial position. For example, what is the expected impact of investing free cash in stocks and bonds compared to using it to buy certain fixed assets? How much more cash would you have available in two months if you could reduce days sales outstanding by two days and extend days payable outstanding by four days? Scenario planning helps you better understand and weigh your options to maximize efficient growth.

What Qualifies as Efficient Growth?

Efficient growth means different things to different leaders and businesses, and your definition will shape your strategy. First, what growth measures are most important to your business? Increasingly, it's profitability rather than purely revenue or market share, but it will likely be a combination of these.

Gartner, for example, defines efficient growth in a very specific way: a business must rank among the top 25% across compound annual revenue growth, median total costs, and number of years with simultaneous revenue and profit growth.[3] Unsurprisingly, just 5% of companies in the S&P 1200 met those criteria, but this could serve as a good aspirational target for CFOs as they set their own goals.

Second, what level of growth would qualify as a success? An efficient growth plan will look very different for a business targeting 8% growth versus one aiming for a 25% jump. Company maturity, industry, near-term projections, and strategic goals will influence this. Third, how central is cost cutting to achieving efficient growth? If profitability tops your list, lowering or stabilizing costs is obviously a big part of the equation.

The measures of success have changed dramatically and quickly, making efficient growth a top priority for many. But it doesn't come easily: 83% of executives in the Pulse survey said finding the right balance between short-term cost cuts and investments that drive growth is a challenge to their overall transformation. Those that solve this formula, trimming the right costs in the right places and injecting that money back into the business, are set up to grow and scale efficiently.

2. Double down on top performers

Given the focus on profitability, it only makes sense to concentrate time and resources on the services or products that have the ideal mix of high profit margin and healthy sales volume. For product companies, keeping an eye out for slow-moving products is especially important as warehousing costs keep rising—they were up 8% year-over-year in mid-2023, according to WarehouseQuote.

Review recent and forecasted sales and profitability trends to group products or services into three or four tiers based on total gross profit margin, net profit margin, or another metric that's critical for your organization. You may also categorize these offerings by location and seasonality to account for natural fluctuations in demand.

There are other considerations to weigh in decisions to increase or trim investment in any products and services. For example, product lifecycle stage—is the product or service still on the steep upward part of the curve, or has the curve crested? Also, factor operational requirements and complexity into these decisions as well. For example, does the product require unique raw materials, components, or labor inputs? How do potential supply chain disruptions and labor shortages affect the cost and difficulty of acquiring these resources for products businesses?

Close coordination across the finance, marketing, sales, and operations teams is essential during product rationalization. Marketing teams need to push those goods or services that have an ideal profile using targeted promotions, and operations needs to order or produce more of them. Sales must know about your plan so they don't oversell products you're scaling back or eliminating so as to not upset key customers or cause other unexpected consequences.

Cutting products or services might not be the only answer. There may be opportunities to fix some of these poor profit performers by raising prices for products or services with strong demand or packaging them with value-added services for better margins. But sometimes there's no logical path forward for a product or service, and it's time to make the tough call to cut it.

3. Increase your supply chain efficiency and resiliency

Inventory is a major cost for products companies, and one that more CFOs should dig into because there are often big savings opportunities. You can start by reviewing the journey of goods once they come into your possession and look for the most common red flags. Are carrying costs climbing and, with it, the risk of rising rates of obsolete inventory? Are order volume and frequency aligned with recent demand, or have they not been adjusted to reflect changes up or down? Core operational metrics such as inventory turnover ratio and sell-through rate can identify problems pulling down your bottom line.

Use metrics to guide questions about your warehouse and factory operations and look for inefficient steps that process improvement or technology could improve. An increasing late shipment rate, for example, might lead the ops team to conclude you have too many warehouse employees picking items and not enough prepping them for shipment, leading to backlogs. Or maybe it makes long-term financial sense to bring logistics in house as your sales and third-party logistics costs both rise.

There are bigger steps companies can take here as well. If scenario planning points to supply chain disruption as a major profit risk, you might look for new suppliers in different regions so, for instance, a hurricane in one region doesn't halt all shipments of a crucial material. Many companies are looking to nearshore with suppliers and manufacturers that are closer to home—42% of supply chain leaders took steps to nearshore in 2023, a 2.5x increase from the previous year, according to a McKinsey survey. Suppliers located closer to a product's final destination means faster shipments, allowing you to place smaller orders and hold less inventory. Shipping costs are usually much lower as well. And while it's hard to calculate an exact ROI on avoiding a supply chain disruption, the alternative is often not being able to sell something customers want because you lack backup suppliers.

Done right, this kind of supply chain planning can help you grow efficiently by improving both your cash conversion cycle, profitability, and revenue growth through fewer stockouts and potentially lower costs.

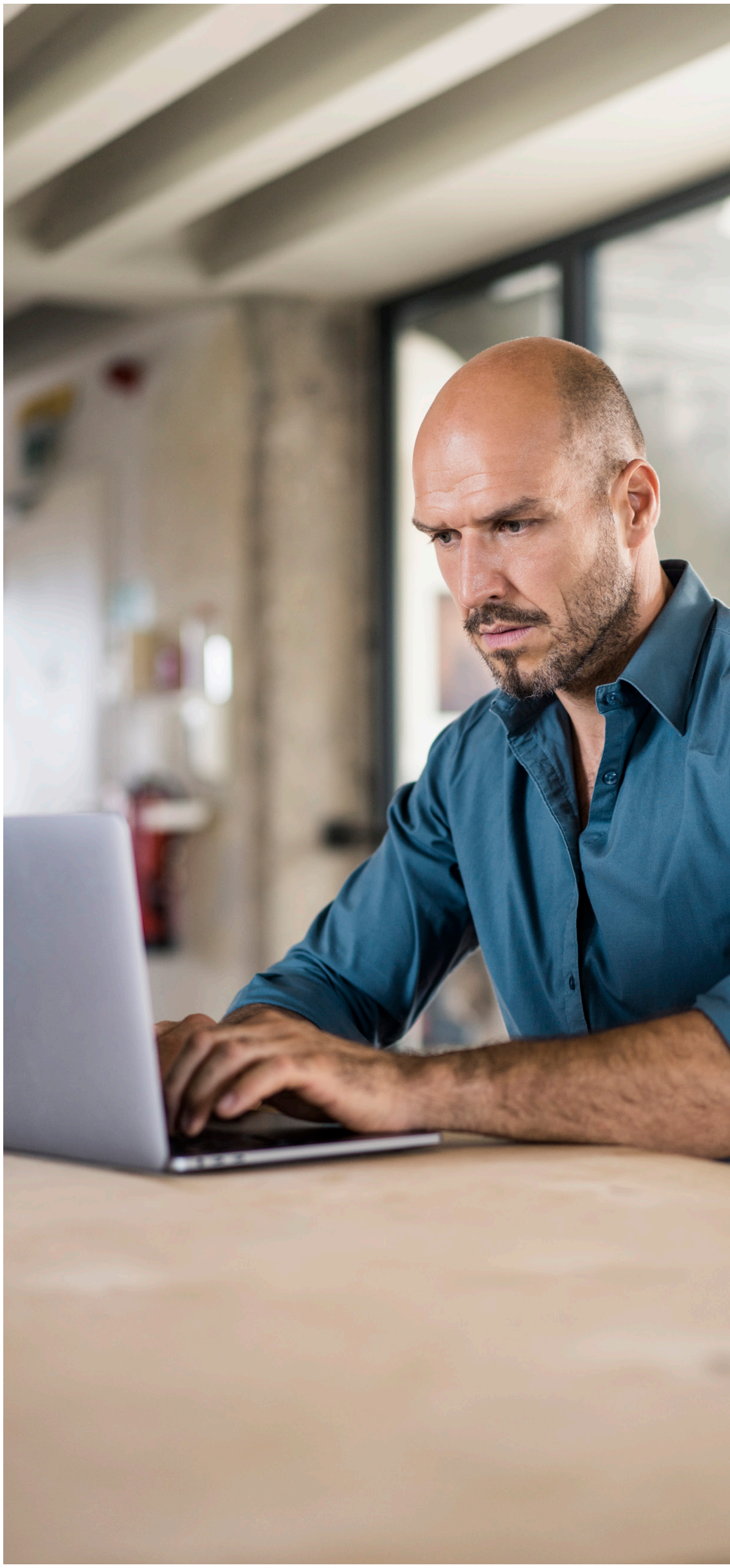
4. Evaluate divestiture opportunities

The acquisition boom of the last few years has ended. Now there's a potential knock-on effect of divestitures picking up soon. There were four acquisitions for every one divestiture in the last two years, according to PwC, and the firm predicts midmarket deals will drive activity as deal volume picks up.[4] Business units with a weak connection to the company's core business model are hard to look past with capital being much more expensive. Divesting these units provide a prime opportunity for CFOs to free up capital.

The key is to identify business units that should be sold off as soon as possible and then close the deal quickly. To make this happen, PwC recommends executives perform thorough portfolio reviews quarterly or biannually to identify potential divestiture candidates, a practice the firm says doubles the chance of delivering positive shareholder returns. PwC cites emotional factors including overconfidence, status quo bias, confirmation bias, and anticipated regret as keeping business leaders from moving on when they should. But fixing a business unit that's not a good fit is usually not worth the time and effort.

57% of senior leaders admit trying to fix a unit decreased or did not change its value.

To determine what entities should be put on the market, identify and closely monitor performance metrics specific to the company's business model and sector. And if it's clear you should move on, get the ball rolling quickly. Mitigate the negative perception of cutting ties among fellow executives and the board by explaining why it's in the business's best financial interests and laying out a clear plan for the funds from the sale.



10 Metrics to Watch for Increased Efficiency

1. **Mean absolute deviation (MAD):** Average error size in your forecasts over a certain period.

   MAD = 1 / n Σ (Forecast – Sales)

2. **Cash conversion cycle (CCC):** Number of days it takes a company to recover money spent to purchase inventory.

   CCC = Days inventory outstanding + Days sales outstanding – Days payable outstanding

3. **Inventory turnover ratio:** How often a company sells and replaces its inventory in a given period.

   Inventory turnover = COGS / Average value of inventory in that period

4. **Obsolete inventory rate:** Percentage of all inventory that's no longer sellable or usable.

   Obsolete inventory rate = (Value of obsolete inventory / Total value of inventory)

5. **Stockout cost:** Total revenue or profit lost from selling out of an item.

   Stockout cost = Number of days out of stock x Average units sold per day x Price (or profit) per unit

6. **Fixed asset turnover ratio:** Efficiency of generating sales from fixed assets.

   Fixed asset turnover ratio = Net sales / Average fixed assets

7. **Quick ratio:** Company's ability to pay its short-term financial obligations.

   Quick ratio = Quick assets / Current liabilities

8. **Return on sales (ROS):** Profit per dollar of sales, a measure of efficiency.

   ROS = Operating profit / Net sales

9. **Capital asset pricing model (CAPM):** Expected returns of an investment, accounting for risk.

   CAPM = Risk-free rate + Beta of investment x (Market return rate – Risk-free rate)

10. **Weighted average cost of capital (WACC):** Cost of funding for a project and often used as the hurdle rate.

    WACC = (Equity / Equity + Debt x Cost of equity) + [(Debt / Equity + Debt x Cost of debt) x (1 – Corporate tax rate)]

5. Rebalance your capital structure

The fast-rising cost of capital today means companies need to closely track and update their hurdle rates—the return required to pursue a certain project or initiative. Numerous metrics can determine your hurdle rate, but weighted average cost of capital (WACC) is a popular one. Finance pros know this concept well, but it looks at cost of equity and cost of debt to figure out if the rate of return is high enough to justify the cost to fund the project. Interest rates make it relatively easy to determine the cost of debt, while cost of equity is usually calculated by using the CAPM.

The Federal Reserve's frequent interest rate increases since March 2022 has made certain initiatives unviable. WACC helps businesses determine whether, for example, using $50,000 to purchase more inventory or buy a piece of warehouse automation equipment will generate a higher return, comparing the net present value of each investment. Furthermore, is the expected return higher than the hurdle rate? CFOs can also use WACC to determine what mix of debt and equity financing is the best path to raising that $50,000.

Businesses should compare their current WACC to that of industry peers. If it's high, or even near the average, you should evaluate other financing strategies you may be neglecting or underutilizing. Even minor improvements can make a big difference.

6. Reduce fixed costs

While trimming fixed costs is hardly a groundbreaking idea, it is an area where companies may be overlooking clear wins. As hybrid or remote work takes hold, can you move into a smaller, cheaper office or reduce the total number of offices? This not only lowers rent or lease costs, but also related expenses including utilities, insurance, and, if you own the space, property taxes.

Leasing equipment such as vehicles and machinery can also be a smart move. A lease boosts working capital because current assets only account for the next 12 months. That means a $250,000 machine might be leased for $2,500 per month, adding $30,000 to current liabilities (for the year) instead of removing $250,000 from current assets if you paid upfront. It's also a welcome alternative to debt financing assets in a time of still-rising interest rates.

Leasing gives you access to assets that will help your company capitalize on current opportunities and drive growth without the risk of buying an expensive asset. You can delay large investments until there is more certainty about the future of your business or the broader economy. Compared to owning, leasing can also boost your cash flow and give you a healthier quick ratio.

7. Keep looking for additional automation opportunities

An ever-increasing amount of work can be automated with technology—and yes, AI is part of that equation, but hardly the only option to consider. Finance chiefs know that automation means employees can spend more time on strategic work and thus is essential in mitigating the impact of the finance labor shortage. But if you're not sure where to start—or continue—with automation, try these:

- Financial reporting. Your financial system should be able to generate and instantly update reports with the latest data for complete and timely context about company performance. That translates to faster, better decision-making.
- Payables. Accounts payable automation software can automatically capture and verify key information from bills. Your staff can then pay these bills with a few clicks, eliminating much of the time and money spent processing invoices.
- Payroll. Time-tracking and payroll systems make it easy to remit accurate, on-time paychecks to employees, freeing accounting staff to handle work that adds more value.

- **Account reconciliation.** Software can automate many steps in your monthly close, including the reconciliations that most accountants dread. This has the added benefit of increasing the accuracy of reconciliations and, ultimately, key financial statements. It lets finance teams spend more time on assessing financial performance and collaborating with executives and business unit leaders around those results.

While AI has captured the attention of executives and promises to eventually automate more complex financial tasks, CFOs should recognize that other types of automation may provide as much or even more value. The clean data and best practices needed to set up more basic automation can also serve as the building blocks for AI projects in the future. Additionally, CFOs have had a head start in understanding the potential impact of AI thanks to their years of experience using capabilities such as robotic process automation (RPA) and machine learning (ML).

How Technology Helps Fuel Efficient Growth

Executives in PwC's Pulse survey said leveraging new technologies is their top strategic near-term priority, and it's also critical to efficient growth. Indeed, having easy access to accurate information and reports from across your business is the foundation CFOs need to make prudent cost cuts and investments. That's the kind of data that an ERP system provides.

NetSuite ERP brings together all critical data on financials, operations, sales, customers, and more, updating that information in real time. NetSuite modules for accounting and finance, supply chain, CRM, human capital management, and analytics are designed to work together, with no need for complex and unreliable integrations.

NetSuite's vast and flexible reporting capabilities assist in a number of areas that boost efficiency. NetSuite SuiteAnalytics dashboards and reports can break down the performance of products and services by your preferred metrics, highlighting key trends so you know what to promote and what to pull back on.

These reports can help you track the financial performance of different business units to show which could be candidates for divestiture and break down fixed costs to show where there are savings opportunities. The system also has all the data companies need to calculate their cost of capital and track how it changes over time. Together, NetSuite's reporting tools help decision-makers understand all of their options so they can choose the best one.

NetSuite has both the information and capabilities necessary to quickly pull together trustworthy sales forecasts. Refreshing forecasts with the latest data requires just a few clicks. NetSuite's Cash 360 tools lets leaders view projected short-term cash flow in a single, digestible dashboard so they can plan accordingly. NetSuite Planning and Budgeting builds on those capabilities with long-term cash forecasts, sales and expense projections, and budgets. You can also use NetSuite Planning and Budgeting to see the impact of different potential scenarios, such as adding new suppliers or building a new factory closer to your warehouses.

> By putting all your data in one place and connecting processes across departments, NetSuite ERP opens the door to more automation across your business.

For instance, the system can automatically place reorders when stock falls below a certain level and send bills and follow-up reminders to customers. Complementary modules including NetSuite AP Automation and NetSuite Account Reconciliation help drive additional cost and time savings by automating much of the work that comes with paying bills and closing the books, respectively.

Conclusion

CFOs will have to lean on their deep financial know-how, experience, and nuanced understanding of their businesses to determine the best path to profitable growth. Achieving it is no small feat, especially as some leaders struggle to move past the grow-at-all-costs mindset.

By taking the right steps now, businesses set themselves up for not only immediate success but long-term results that will help them stand above the competition. When purse strings loosen and interest rates finally come down, you want to be ready to capitalize, and making improvements now will put you in a position to do just that.

[1] PwC Pulse Survey: Focused on reinvention, August 2023
[2] In the face of volatility, CFOs—and their organizations—adapt, McKinsey & Company, July 2023
[3] Only 5% of companies achieve "efficient growth"; here's how they do it, CFO Brew, June 2023
[4] The power of portfolio renewal and the value in divestitures, PwC, 2022

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