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CFO leadership in the COVID-19 crisis

How finance leaders are prioritizing their activities to maximize their roles on the executive team.

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As companies craft their responses to the COVID-19 crisis, CFOs are in the thick of the action. They need to make sure that their organizations weather the immediate business shocks while preparing them to emerge from the crisis in the best possible shape. In this episode of the *Inside the Strategy Room* podcast, Strategy and Corporate Finance communications director Sean Brown talks with three of McKinsey's corporate-finance experts about the top imperatives for CFOs today. Ishaan Seth is the leader of the Strategy and Corporate Finance Practice in the Americas and heads McKinsey's Financial Services Practice. Ankur Agrawal leads the CFO Finance service line in North America, working primarily in healthcare, and Kapil Chandra heads up our work in Europe on financial transformation in banking. This is an edited transcript. For more conversations on the strategy issues that matter, subscribe to the series on Apple Podcasts or Google Play.

Sean Brown: Ishaan, I think it's fair to say that this crisis is putting new pressures and responsibilities on the CFO. How do you see your clients responding?

Ishaan Seth: CFOs are playing critical roles—really, first-among-equals roles on the executive team—in helping their organizations navigate through this crisis along multiple dimensions: helping stabilize the company in the near term, creating the right conditions for growth as we emerge from the crisis, and building the resilience the company will need to get through the next several cycles. We must be prepared for a significant economic shock, which we think will have an impact on global GDP in the range of 8 to 13 percent. To put that in context, the last financial crisis delivered a roughly 4 percent GDP hit. So, from an economic standpoint, this is catastrophic. It harkens back to the Second World War and the Great Depression in its intensity.

We see three sets of actions that CFOs ought to be thinking about over different horizons (Exhibit 1). The first horizon is what we call Resolve. This is all about leadership in stabilizing the organization. It includes stakeholder management, in particular the board and investors, and ensuring liquidity. Preservation of cash is at a premium in many industries and setting up a cash war room, we think, is a critical element. The third element of Resolve is having a point of view on different potential scenarios. We believe the wait-and-see approach is not the right one, and we would encourage people to think about at least four real scenarios, because when you go with three you typically end up picking the middle one. Then you need real debate about these scenarios and their business implications for your organization.

The second horizon we are calling Resilience and Return. The focus here is steadying the business as we enter the new normal, or the "next normal." A lot of our thinking here is based on empirical

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–Ishaan Seth

research we did coming out of the last crisis, looking at the actions that about 1,500 public companies in the US and Europe took going into, during, and emerging from the downturn. I would highlight in particular the importance of taking a through-cycle view of operational moves to support performance, doubling down on productivity, and thinking about the balance sheet and bold moves around M&A as you go through the crisis.

The next element of Resilience and Return is about reevaluating the investment portfolio. Many companies have major capital ex and technology or platform investments—big-ticket items that were made in a different time and different context. We are seeing companies beginning to triage that book of work, figuring out things that are mission-critical and should continue, those that are more discretionary, and others where the ROI has to be reevaluated given the current environment. A lot can be done in the near term to bring some science to the investment portfolio. Then there is the upskilling and turbo-charging financial planning and analysis, or FP&A. This is in many ways the decision cockpit of the company, not just finance, and this is a unique time for FP&A to provide visibility around a handful of key metrics that can orient the senior team and the board.

The third horizon, what we're calling Reimagination and Reform, has to do with positioning the company for emergence from the crisis. Every organization is in a different place, but there are three elements in this reimagined phase that we urge CFOs to think about. The first is launching a plan-ahead team. The era of single-time-horizon planning is gone, at least for the next several years. A plan-ahead team focuses on the two-day, two-month, two-quarter, and two-year view, and ensures the company has the portfolio of moves and the trigger points in place for each scenario. Getting that plan-ahead team in place is important to do now.

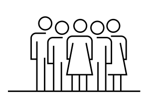
The second action in this category is around M&A. We anticipate a wave of consolidation and portfolio moves will occur across most industries. In the last crisis, we saw those who outperformed their peers were very active in M&A. Finally, accelerating digital is an important move. Most of us could not have imagined the level of remote capability and digital interaction that we are experiencing today. This crisis provides an unparalleled catalyst for finance to take on the digitization of the function.

Sean Brown: Many companies are still managing the immediate fallout from the crisis. Kapil, how can the CFO pivot the organization's thinking toward Resilience and Return?

Exhibit 1

CFOs should take three types of actions to emerge from the crisis strongly.

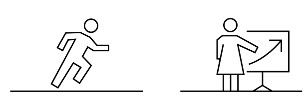
Lead from the front



Resolve

- Reformulate the stakeholder-communications strategy
- Size the company's liquidity position and set up a cash war room
- Model multiple COVID-19 scenarios

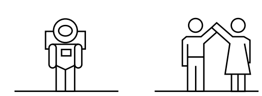
Steady the business in the next normal



Resilience | Return

- Take a through-cycle view of operational moves to support performance
- Reevaluate the investment portfolio and strengthen the balance sheet
- Turbocharge the financial-planning and -analysis role and upskill finance talent

Make bold moves



Reimagination | Reform

- Launch a plan-ahead team
- Go on offense with portfolio moves (eg, M&A, divestitures)
- Accelerate digital transformation to support the next normal

Kapil Chandra: Some of the research we did on models of success during the last crisis is quite central to what the CFO could emphasize now. There are a handful of companies that do very well during a crisis period, and those companies' outperformance continues beyond the crisis, with growth at almost double the average of the S&P 500. And the resilient companies outperformed both on the top line and on margin.

We tried to discern empirically what actions drove this outperformance and resilience and found many took through-cycle actions—moves that helped in the short term but also enable an organization's long-term strategy. It was a mindset of "we are not cutting costs but spending wisely." During the downturn, management looked at what they could do, from the top-line revenue perspective, to build customer loyalty, such as providing mortgage holidays. This helped improve retention in the short term but also built the customer lifetime value in the long term. In this crisis, such measures are needed even more. I serve insurance companies, and some are thinking about returning portions of customers' auto-insurance premiums given that people are not driving as much, which will help build loyalty. There is also an opportunity to zero-base the organization. The outperformers during the last crisis took the opportunity to do a clean-sheet rethink of how they conduct business, their cost structure, and their organization.

Sean Brown: What moves did these companies make on costs to position themselves to emerge strongly from the crisis?

Kapil Chandra: The resilient companies took immediate action to reduce operating costs. The nonresilient ones got there in the end, but the resilients were ahead of the curve and were able, in fact, to sustain and increase the delta over time. The other important subtlety is that resilient companies focused on cost reduction through operational effectiveness but protected growth and sales capacity. Another lesson was that the speed they showed on the cost side was matched by actions on balance-sheet improvement (Exhibit 2). They moved much faster to manage leverage and that gave them firepower as the recovery set in to conduct M&A while others were struggling.

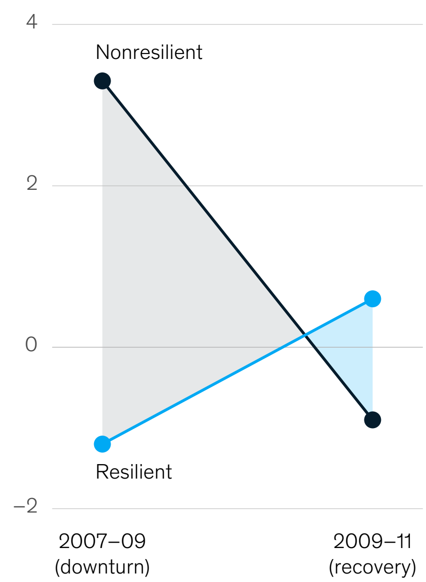
Sean Brown: Ishaan mentioned that CFOs have the opportunity now to raise the role of their FP&A groups. How can finance teams help the overall organization embed some of this type of instantaneous monitoring?

Kapil Chandra: One of the themes that comes out of our research is that speed and boldness in making the various operating shifts really matter. FP&A, with the CFO's support, should turbo-charge these operational improvements. Budgeting, performance management, forecasting—these all need to be done in a fundamentally different way, with a fundamentally different metabolic rate. You need a decision cockpit where you monitor key metrics and course-correct incredibly rapidly. That is a very different rhythm from many typical FP&A processes, which are more structured and usually conducted quarterly or monthly.

Exhibit 2

Take the opportunity to strengthen the balance sheet.

Impact of financial crisis on resilient vs nonresilient companies, leverage ratio[1]



[1] Calculated as an average of different subsector medians for resilient and nonresilient companies. Excludes financial companies and real-estate investment trusts. Total debt divided by total capital. Total debt (book value) calculated as short-term borrowings plus current portion of long-term debt plus current portion of capital lease plus long-term debt plus long-term capital lease plus current finance-division debt plus noncurrent finance-division debt. Total capital calculated as total common equity plus total preferred equity plus minority interest plus total debt.

The point is, how can you quickly repurpose existing technology and capabilities to allow you to monitor the key metrics on a real-time digital basis? You need about seven to ten high-impact variables and you want to create an electronic dashboard that is available for your top teams and can be drilled down. This may not be the elegant long-term solution, but it's vital to find ways to respond rapidly. The CFOs I have interacted with have found that this crisis has forced extreme prioritization, extreme demand management. Finance teams are at the eye of the storm and are ruthlessly prioritizing what is important and what is not. Many are using this crisis as a sort of great experiment.

Sean Brown: What about communications with investors? Ishaan, what do you find CFOs are sharing with stakeholders these days?

Ishaan Seth: There is an internal piece and an external piece. The early days have been occupied with taking charge of the situation and setting up nerve centers that serve as decision cockpits, and CFOs are often in the middle of that. Board interest, obviously, has picked up significantly. In general, more communication, not less, is important. I would encourage upping the rhythm of interactions with the board chair, the audit committee chairs, and other board members. Avoiding surprises with the board is always at a premium but now more so than ever, so having a clear plan with the CEO on the cadence of board communications is important.

In terms of messaging to the rest of the organization, CFOs play important roles as change leaders in both helping manage the understandable fear and anxiety many are feeling and balancing that with a pragmatic view on what is achievable in terms of financial performance. That is a delicate balance.

Sean Brown: What about the external messaging to investors and analysts? This must be a difficult area for the CFO to navigate right now.

Ishaan Seth: The SEC has provided some explicit outs, saying they will not penalize companies for being wrong on forward-looking statements as long as they were given in good faith. But there is clear encouragement to provide views on different scenarios. I think there are several questions companies need to answer. First, how is the coronavirus crisis affecting your business? We are seeing people beginning to do interesting things around transparency, slicing and dicing EBITDA impact by business and by regions affected by COVID-19 and those that are not affected. Some are showing results based on scenarios or forward projections, providing indicators on operational, not just financial, indicators. They are talking about the remote workforce and availability of platforms, the degree of employee disruption by region and how that has cascaded over the weeks. Some talk about restructuring charges and things they could take hits on now in the context of broader transformation. It stops short of saying, "Here is what the actual

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numbers will be." In general, we are seeing people moving away from providing earnings-per-share guidance—certainly for the second quarter but also as the direction of travel through the end of the year.

In our recent discussions with investors and companies, there has been much interest in how organizations are mobilizing, how senior teams are communicating, what are the employee protocols and the governance mechanisms. How are you managing liquidity? The focus is on providing operational indicators of how the organization is thinking about working through the crisis.

Sean Brown: Looking toward a time when business and life start to normalize, Ankur, what role do you see CFOs playing in preparing their organizations for that?

Ankur Agrawal: Continuing on the theme of leveraging this crisis, there is an element of thinking about how the strategic plan will evolve, and related to that, what kinds of bold moves you can make. As in the military, it's valuable to have a plan-ahead team, as Ishaan had mentioned, that is cross-functional and enabled by a couple of senior executives, which is thinking about how plans will unfold under different scenarios. How will your sector and your direct competitors respond, and based on that, what are the three or four actions you want to take in the near and middle terms? Companies have been mobilizing an infrastructure for crisis management, but it is equally important to think about the plan-ahead team and having a perspective on the triggers which will help you move from one scenario to another.

Sean Brown: Both Ishaan and Kapil mentioned that M&A can be an important lever in positioning the company strongly for the postcrisis period. What are some of the lessons that CFOs should be applying now?

Ankur Agrawal: The research clearly suggests that in the last recession and even in the dot-com bubble earlier, the companies that came out stronger were those that worked hard on their mergers and acquisitions but also divestitures, divesting assets that did not fit the strategy. Interestingly, the mergers and acquisitions they did tended to be close to their core businesses, suggesting there was some hesitance, and rightly so, about making step-out moves at crisis times. Half of the transactions in these recession times were around core businesses. As valuations drop, there is a temptation to be opportunistic, but being deliberate about the moves you make and using the crisis to accelerate your existing strategy may be the best way to think about acquisitions.

Each sector will have a different situation. In some cases, cross-border acquisitions may not be relevant. In healthcare, where I work a lot, companies are thinking hard about digital acquisitions, because digital enablement of delivery of care has become common and the adoption of technology is changing how organizations are reaching patients.

Sean Brown: McKinsey published research showing that programmatic M&A yields the best results. Does that hold true in crisis times like today?

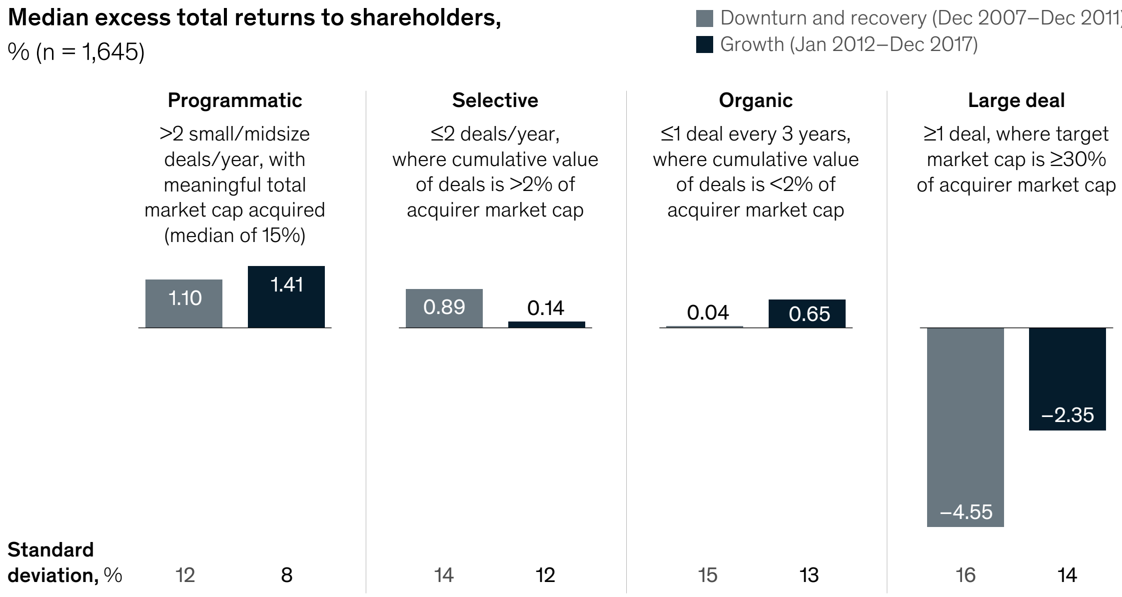
Ankur Agrawal: Programmatic acquisition strategies, even during downturns, yield significant excess total returns to shareholders (TRS) (Exhibit 3). These companies have significant M&A programs, making more than two acquisitions per year, amounting to about 15 percent of market cap. They make small bets that make a meaningful contribution in aggregate. With large acquisitions, average TRS is actually negative, with a lower probability of success at beating the market.

Sean Brown: As you noted earlier, technology and connectivity have played huge roles in helping us weather this crisis. How can CFOs capture the opportunity this presents for their function and broader organizations?

Ankur Agrawal: These are times when digital technologies, considerations around redundancy, the business cases for digital acquisitions, and the channels companies are using to reach customers are all at the forefront of management

Exhibit 3

Programmatic M&A outperforms in good times and downturns.



discussions. In the last recession, many companies who leveraged digital technologies, whether through cloud infrastructure, Internet of Things, or digital ways to approach customers, leapfrogged the competition. This crisis will have similar implications—not only for finance, as Kapil mentioned, but also for the overall enterprise.

In the past three or four years, we have seen lots of investments in digital technologies, but many companies have been stuck on pilots and experiments. I would encourage management teams to think hard about areas where the business model itself would be transformed by digital technologies.

Sean Brown: Obviously, CFOs have enormous pressure on them these days. To close, maybe you could talk about how finance leaders should approach leadership today?

Ankur Agrawal: Finance leaders have a big role to play in this crisis. It is an opportunity for them to not only drive crisis management but help build a plan for coming out of the downturn and find talented individuals to put in charge of initiatives. The softer sides of personal leadership are more important than ever, such as leading teams empathetically and showing your passion. Lastly, CFOs should communicate frequently and transparently with the board and investors as well as with their own teams. I was talking to one CFO recently who has been sending blogs and emails to his team every two days reflecting on how he is personally dealing with the crisis. Those kinds of actions allow CFOs to exhibit their ability to lead.

Ankur Agrawal is a partner in McKinsey's New York office, where **Ishaan Seth** is a senior partner. **Kapil Chandra** is a senior partner in the London office. **Sean Brown**, global director of communications for the Strategy and Corporate Finance Practice, is based in Boston.

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