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# *The CFO as strategist*

# Leading value creation in the MENA region

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This report was originally published by Booz & Company in 2009.

# EXECUTIVE SUMMARY

*In the Middle East and North Africa (MENA) region, as elsewhere, the economic crisis is changing the way that companies do business. For the CFOs of MENA-based organizations, the current circumstances have a number of implications. CFOs will need to manage the uncertainty caused by turbulent capital markets and pressured cash flows while taking advantage of the region's fundamentally sound economies. They must prepare for competition from multinational corporations attracted by the MENA region's continuing growth, and simultaneously seek out the global opportunities for M&A afforded them by their strong cash positions.*

To better understand the evolution in MENA CFOs' priorities, and the impact it is having on their agendas, we conducted a set of interviews with the CFOs of operating companies and groups in the telecom, real estate and construction, energy, consumer packaged goods, transportation, and retail sectors. We discovered that they believe they are still spending most of their time on operational roles, such as accounting and collections, when they should be focusing on strategic tasks such as financial planning, financial performance management, funding, investor relations, and M&A. They also believe they should have more interactions with the board of directors and CEO, and increase their collaboration with business units to better manage expectations.

The major priorities for CFOs involve leading their organizations through the economic crisis while capturing potential growth. In this regard, they should actively manage the balance sheet, while providing input regarding the development and implementation of corporate strategy. To accomplish their goals, CFOs must swiftly develop their agenda, focusing on four key themes: extracting value from current operations; regularly assessing and assuring the enterprise's financial health; managing the corporate portfolio; and securing optimal funding sources.

KEY FINDINGS

- CFOs should lead the way in creating value for their organizations, rather than simply maximizing revenues or minimizing costs.
- If CFOs default to standard downturn defenses such as across-the-board cost cutting and layoffs, they might see short-term results—but these measures could limit the enterprise's ability to grow in the long term.
- CFOs are best positioned to help their companies succeed by actively providing input about the development of corporate strategy, steering the business based on quantitative analysis, and making the organization's vision and strategies measurable and accountable.
- CFOs should define performance metrics that tie management behavior and actions more closely to shareholder value creation, while actively managing the balance sheet.

# LEADERS IN A TIME OF CRISIS AND GROWTH

Few of the CFOs in the MENA region who are struggling with the current economic crisis have ever experienced anything like it. Not many of them were in their jobs during the collapse of the dot-com bubble at the start of this decade. Moreover, despite some similarities to the last economic downturn, this crisis is significantly different in terms of its global nature and scope.

In the MENA region, as elsewhere, the economic crisis is generating numerous challenges: Lower business-to-business spending, and lower consumer spending in some industries, has brought about declines in revenue. Restricted bank lending could lead to cash flow shortages—which could further limit growth, increase risk perception among investors, and ultimately have a negative impact on shareholder value.

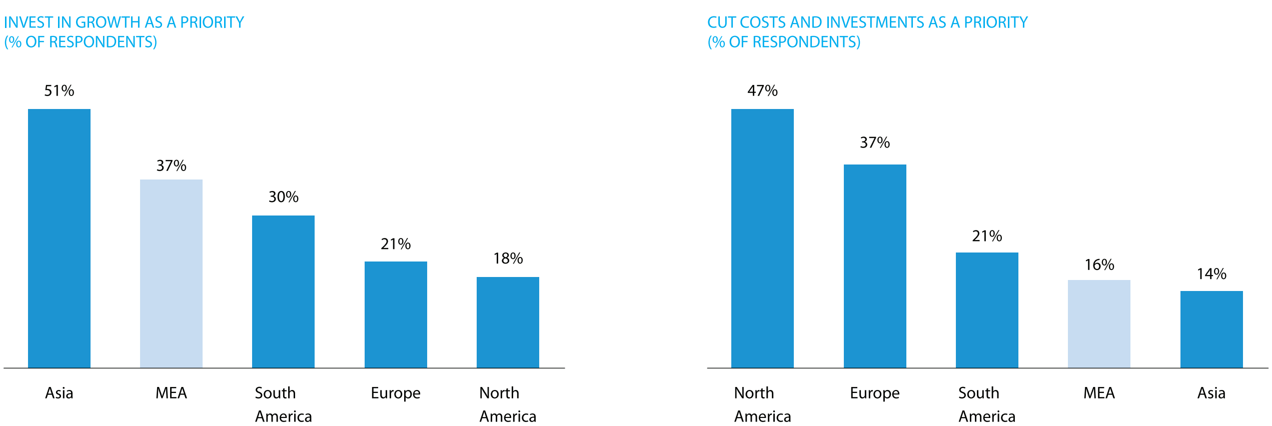
These conditions are showing their effects: MENA capital markets, like markets elsewhere, declined sharply in 2008. The Tadawul in Saudi Arabia and the Cairo & Alexandria Stock Exchange (CASE) in Egypt, for example, showed a decrease in market capitalization of approximately 54 percent and 50 percent, respectively, since the beginning of 2008[1]—comparable to the 51 percent drop in the value of the New York Stock Exchange (NYSE) and 59 percent drop in the German Bourse over the same period.

Nevertheless, the MENA region's economies continue to grow through the crisis, though at a slower pace than previously, while economies of developed nations, such as those of the U.S. and U.K., are still struggling in a recession.[2] The region's strength is based on growing sectors, such as telecommunications and construction; the increasing role of private consumption in growing and stimulating economic activity; relatively little exposure to international markets and subprime assets; financial institutions' focus on core banking activities and prudent credit standards; and continuing government spending, particularly in Gulf Cooperation Council (GCC)[3] nations that have high liquidity, thanks to their oil-fueled cash surpluses.

***CFOs should lead the way in value creation to position their organizations for growth during the inevitable upturn.***

The MENA region's strong economic fundamentals are attracting global companies' investments. U.S. companies earmark the majority of their new investment dollars for Asia, Africa, and the Middle East, according to our research. In a recent Booz & Company survey of Fortune 500 multinational corporations with a presence in the MENA region, 37 percent of respondents said that investing in growth was their highest priority in the MENA region, while only 16 percent said the same about cutting costs. However, they are taking a very different approach to their North American and European operations, where cost cutting is a high priority and growth is less so *(see Exhibit 1)*. This difference demonstrates global enterprises' strong belief in the growth potential of emerging markets, which should bolster MENA enterprises' confidence in their own prospects.

***Exhibit 1***
***Multinationals Are Investing in Growth in Emerging Markets While Cutting Costs Elsewhere***




Note: An anonymous survey in January 2009 consisted of 86 senior executives of Fortune 500 multinational corporations with a presence in the MEA region; the survey addressed Middle East and Africa as a whole rather than North Africa exclusively.
Source: Booz & Company

Global corporations' investments in the region are paralleled by the ongoing globalization of regional enterprises. In the last few years, companies in the region have been increasingly interested in expanding into international markets. One example is Saudi Basic Industries Corporation's US$11.6 billion purchase of General Electric Company's plastics unit in May 2007. Others include Saudi Telecom's investments in Binariang GSM in Asia (2007) and Oger Telecom in the Middle East, Turkey, and South Africa (2008); Lebanese M1 Group's acquisition of the Façonnable apparel line in the U.S. (2007); and Saudi bank Al Rajhi's 16-branch operations in Malaysia, with the first branch launched in 2007.

The globalization of regional enterprises continues despite the crisis. For example, in 2009, the UAE's Etisalat acquired the third mobile license in Iran, Batelco acquired a 49 percent stake in India's S Tel, and Al Rajhi received its second international Islamic banking license in Malaysia, with plans to expand to Singapore and Indonesia. Some companies in the region are in a better position than their counterparts in developed markets to pursue M&A and investments in growth opportunities, thanks to their strong cash flows and relatively low debt levels. These MENA companies will have the flexibility to take on more debt or could use their excess cash to opportunistically and selectively finance investments. The telecom sector offers a case in point: The debt level of operators in the MENA region is, on average, less than half that of operators in Europe.

These changing circumstances for MENA companies should be reflected in the evolving role of CFOs. For the last seven years, since the end of the last downturn, successful CFOs have positioned themselves at the forefront of corporate strategy development, driving financial performance across all business entities. During this economic crisis, more than ever before, CFOs must be more than accountants or referees: They must actively manage the balance sheet, finding cash to sustain the company through the downturn, and seek out the growth opportunities that remain. Although the region's capital markets have experienced turbulence, its economies are fundamentally sound. CFOs should lead the way in value creation to position their organizations for growth during the inevitable upturn.

# THE MENA CFO'S CHALLENGES

Although CFOs cannot control the economy, they have significant influence over their corporation's response to it. If they go into panic mode, defaulting to standard downturn defenses such as across-the-board cost cutting and layoffs, they might see short-term results—but these measures could limit the enterprise's ability to grow in the long term.

During this turbulent time, cash is king. The CFO's challenges will vary according to the financial strength of the company. In organizations with liquidity constraints, CFOs will have to cope with declining EBITDA margins and difficulties in raising capital. Debt is more costly, if it is available at all; floating more shares could prove ineffective in the current turmoil and would further send negative signals to stock markets. At companies that have more cash on the balance sheet, CFOs will still have to contend with threats to revenue, while sustaining organic growth and keeping an eye out for potential low-premium acquisitions.

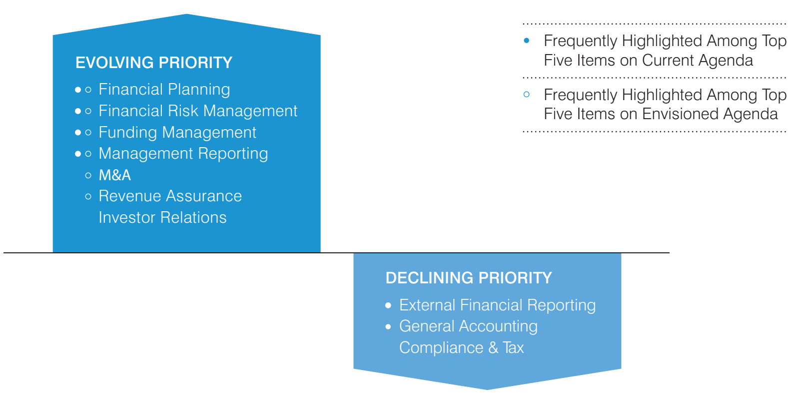
To better understand the evolution in MENA CFOs' priorities, and the impact it is having on their agendas, we conducted a set of interviews with the CFOs of publicly listed and private operating companies and groups in competitive markets in telecom, real estate and construction, energy, transportation, consumer packaged goods, and retail. Generally, CFOs noted that reducing costs and working capital and protecting revenues are among their current top challenges. They believe they are still spending most of their time on operational roles, such as accounting and collections, which they consider candidates for outsourcing or centralizing in a shared services function. The respondents think they should be spending more time on strategic tasks such as financial planning, financial performance management, funding, investor relations, and M&A *(see Exhibit 2)*.

In particular, CFOs believe they should play lead roles in managing financial risks, designing the capital structure, optimizing working capital, and managing investor relations. They also think they should more frequently play lead roles in managing capital investments and revising the dividend policy *(see Exhibit 3)*. In M&A, they should play lead roles in the business case, due diligence, and financing stages, and should provide their input in the origination, negotiation, and post-merger integration stages. Moreover, CFOs believe they should have input into the development of the corporate strategy.

Finally, CFOs recognize the need to work more closely with business units—collaborating on areas such as performance management, financial planning, business development, cost optimization, capital investments, and even product pricing *(see Exhibit 4)*. By doing so, CFOs can tie management actions and behavior more closely to value creation.

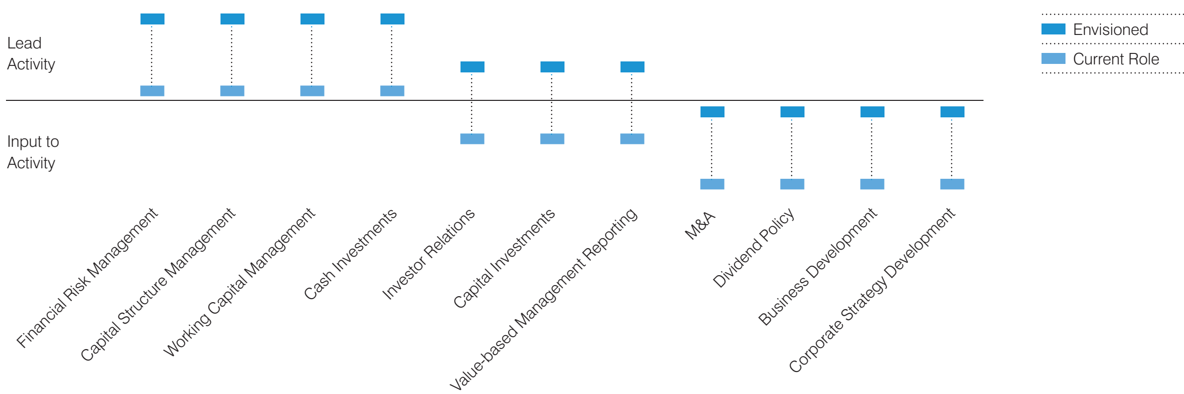
*Exhibit 2*
*CFOs Believe They Should Devote More Time to Strategic Activities*

MENA CFOS' EVOLVING & DECLINING PRIORITIES
(ITEMS HIGHLIGHTED BY CFOS AMONG TOP PRIORITIES ON THEIR AGENDA)




Note: The qualitative interviews of 20 CFOs in several industry sectors in the MENA region were conducted between December 2008 and May 2009.
Source: Booz & Company MENA CFO Questionnaire Interviews

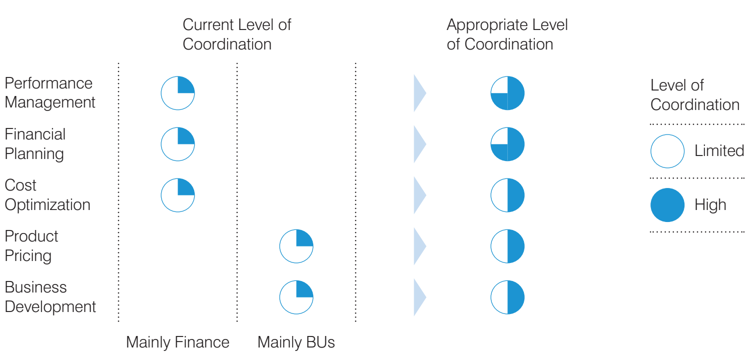
### *Exhibit 3*
### *MENA CFOs Believe They Should Have Leading Roles in Several Strategic Areas*




Note: The qualitative interviews of 20 CFOs in several industry sectors in the MENA region were conducted between December 2008 and May 2009.
Source: Booz & Company MENA CFO Questionnaire Interviews

### *Exhibit 4*
### *CFOs Seek Greater Collaboration with Business Units on Various Activities*

LEVEL OF COLLABORATION BETWEEN FINANCE AND BUSINESS UNITS




Note: The qualitative interviews of 20 CFOs in several industry sectors in the MENA region were conducted between December 2008 and May 2009.
Source: Booz & Company MENA CFO Questionnaire Interviews

## THE EMERGING CFO AGENDA

The major priorities for CFOs involve leading their organizations through the economic crisis while capturing any potential growth that will ready their enterprises to cruise through the post-downturn period. In this regard, they should actively manage the balance sheet, while providing input regarding the development and implementation of corporate strategy. To accomplish their goals, CFOs must swiftly develop their agenda, structuring it according to four key themes.

1. ***Extract value from current operations:*** CFOs must look across the organization for ways to improve operating margins and generate cash flow. This may include optimizing operating expenditures and rationalizing capital expenditures against value-based business cases, reevaluating fixed-asset utilization against opportunity cost to maximize return on assets, investing excess cash, and integrating or consolidating across global operations to capture synergies.

***CFOs must look across the organization for ways to improve operating margins and generate cash flow.***

At the same time, they will have to ensure effective management of company resources to maximize value generation. In short, MENA CFOs should entrench a culture of value-based management across the organization. Management should be fully aware that their ultimate financial objective is maximizing value rather than simply maximizing revenues or minimizing costs. CFOs should identify and define the value driver levers to guide cost cutting in ways that do not jeopardize value. They should push to institute metrics that measure economic profit rather than revenue or costs in order to align management behavior and actions with the creation of shareholder value *(see Exhibit 5)*.

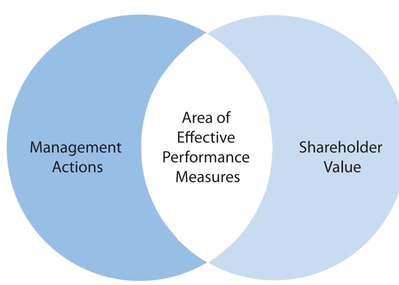
2. ***Regularly assess and assure the enterprise's financial health:*** Conduct dynamic financial planning and risk management to detect financial time bombs before they explode, and provide the CEO and board of directors with early warnings of any threats to the enterprise's financial health. Timely value-based financial management reporting, cash flow forecasts, short-term liquidity requirements, and scenario planning are essential in this regard. Management perspectives and strategies should be based on awareness of the relationship between actions and the enterprise's financial results. Moreover, MENA CFOs should consider revising customer credit policies to limit risk. They could consider hedging international investments across various financial risks, such as currency fluctuations. Finally, CFOs should revise dividend policy and capital structure as necessary to maintain their debt-to-equity ratio at controllable levels.

***Exhibit 5***
***CFOs Should Define Performance Measures That Link Management Actions to Shareholder Value***

VALUE-BASED MANAGEMENT

MANAGEMENT ACTIONS

- Management actions are influenced by incentives
- Incentives should be tied to key value-based performance indicators




SHAREHOLDER VALUE

- The generation of shareholder value involves stock price appreciation and dividend payments

AREA OF EFFECTIVE PERFORMANCE MEASURES

- Effective performance measures align management behavior with shareholder value
- Effective performance measures should correlate with shareholder value while being controllable, simple, and understandable by management
- Effective performance measures are organization-specific

Source: Booz & Company

3. ***Manage the corporate portfolio:*** Reassess the business's portfolio, based on what assets create value and how they fit together strategically; consider carving out assets with opportunity costs that are higher than the asset's current market value, as well as pursuing mergers when new entities could leverage synergies and scale. CFOs of financially strong corporations should continue to actively seek regional or international investments that are a good fit with the organization's capabilities and strategies to emerge stronger out of the downturn. The decision to invest doesn't depend on the market cycle, but rather on whether the investment will drive the operational strategy and whether there is access to necessary financing. It's possible that the economic crisis will generate undervalued opportunities for corporations that can afford to secure the required cash flow. CFOs should define the metrics and establish the goals necessary to justify a deal's purchase price. The investment cycle comprises four key stages that the CFO should be actively involved in: originating opportunities, conducting business case analysis and due diligence, performing post-merger integration to capture synergies, and developing the diversification and divestiture strategies that define the portfolio.

4. ***Secure optimal funding sources:*** CFOs must manage liquidity and ensure optimal funding sources for OpEx, CapEx, and M&A activities. The region has recently witnessed significant M&A activity that has consumed excess cash resources; the current credit crunch further exacerbated the situation. Nevertheless, cash might be still on the balance sheet in the form of working capital. Although some enterprises fund their operations with a negative working capital (e.g., Amazon.com and some other consumer businesses), many

***CFOs of financially strong corporations should actively seek investments that are a good fit with the organization's capabilities and strategies.***

enterprises suffer a highly positive value compared to their industry peers. Smarter management of receivables, payables, and inventory could release the cash needed to recover liquidity. Furthermore, CFOs should leverage any potentially slower deal-making period to negotiate and secure financing alternatives, revise the pecking order, and optimize their credit rating. This will speed the company's ability to act when a target emerges.

Finally, CFOs should also manage investor relations—meet with fund managers, increase their participation in conferences and announcements in the financial press, and organize workshops with equity analysts—to optimize equity funding and contain the turmoil around share prices. Successful investor relations would help manage market expectations and reduce the impact of speculation on the enterprise's stock price by providing the financial community with reliable information. It could also help generate more analyst coverage of the company, which could increase demand for the company's stock, increasing its value. In fact, CFOs are best positioned to rebuild confidence among the community of investors in the MENA region, via proper communication of their enterprise growth story based on business fundamentals.

# CONCLUSION

CFOs should swiftly restructure their agendas to cope with the current conditions, if they haven't done so already. They need to quickly build capabilities, free themselves from daily operational tasks, and focus their efforts on value-based management with an outward perspective on contemporary business issues, increasing collaboration and interactions with the board of directors, CEO, and business and functional units to effectively manage expectations.

Within this uncertainty and mix of challenges and opportunities in MENA economies, the winners will be enterprises that manage for value creation—and CFOs are critical to making this happen. CFOs are best positioned to help their organizations emerge from the crisis ready to capture the potential for growth. They can do so by steering the business based on quantitative analysis rather than mere qualitative evidence, as well as making the company's vision and strategy measurable and accountable.

## Endnotes

[1] Measured up to Q1 2009.

[2] Nominal GDP (purchasing power parity) growth forecasts, Economist Intelligence Unit 2009.

[3] The GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

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This report was originally published by Booz & Company in 2009.

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