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Finance dream team

Strategic finance in action

How dynamic Silicon Valley companies seize opportunities (and avoid flameouts)

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Our nearly 20 years in the trenches with Valley companies have taught us that a flexible, business-savvy finance organization is a fast-moving business's best friend. For this report we reached into our collection of real-life examples to show how strategic finance thinking in key areas such as capital efficiency, business information systems, people and culture, and process optimization can make the difference between struggling and thriving.

Reports from the trenches: strategic finance in action

Ever faced problems like these?

You're a life sciences company with a promising drug nearing the payoff end of the pipeline (you think). You've also got a business IT "system" that is barely hanging together with Band-Aids and chewing gum, making day-to-day operations a frustrating slogfest. What's your next move?

Your hot social media start-up is taking off, but your staff, while brimming with smarts and enthusiasm, lacks the business chops to keep up with rapid growth. You've sprung a cash leak. How can you plug it? And what could you have done to prevent it?

Your technology is game-changing—but market demands mean you need more money to scale quickly and your usual capital well is dry. How do you stay afloat now without compromising the future?

These scenarios are all real-life situations we've helped clients work through. Silicon Valley is no place for bean counters—the businesses that thrive here rely on strategic finance teams to be sure they can wheel on a dime when conditions change, are positioned to jump on emerging opportunities, and have a true picture of every major decision's potential risks and rewards.

Our nearly 20 years in the trenches with Valley companies have taught us that a nose-in-the-books, here's-your-report-and-forecast approach falls short of what it takes to ride a wave and stay ahead of it. That's true now more than ever, as industry leaders drive toward ever leaner operations and the world economy remains tumultuous. Entrepreneurs and established companies alike are increasingly relying on the design prototyping approach: get a concept to market fast (and cheaply!), find the failures as quickly as possible, and move on to the next iteration.

Finance teams with strategic skills offer insights that help a company move forward with confidence, taking the optimal approach.

The Department of Yes: a flexible, business-savvy finance organization

Some executives still think of their finance organization as gatekeepers (aka the Department of No). We see finance teams with strategic skills as the Department of Yes: they are enablers whose insights can help a company move forward with confidence, taking the optimal approach. And the finance organization is in a unique position to help assess business risk, identify points of potential failure (single-source vendors, geographic concentration, and so on) and hedge against them, and determine measures of success (not always by profitability or revenue metrics).

Strategic finance teams help a company:

- See trends before anyone else.
- Ensure that various departments interact efficiently and effectively.
- Draw insights from past performance.
- Design an infrastructure that will support future business operations.
- Ask hard questions about strategic initiatives and associated risks.

Finance pros play key roles in assuring capital efficiency, determining the right business systems infrastructure, getting the right people balance, and optimizing processes so that the company can take fast action and doesn't get bogged down. Read on for examples, including solutions to our opening challenges.

Capital efficiency: the difference between success and flameout

Capital efficiency isn't as simple as cost control. Depending on your industry, the difference between success and flameout may be gaining market share quickly or it may be stretching every dollar to the breaking point. But every company needs judicious management of its cash position and careful balancing of costs versus investment in new opportunities—especially venture-funded start-ups.

When a cash crunch does come, the companies that emerge as the strongest tend to be those that look beyond cost control and know the opportunity costs as well as the dollar costs. What are the long-term costs of pulling money from sales or research? What's the best place to continue investing? How long can you afford to wait for current initiatives to pay off? These are hard decisions.

The game-changing technology company that was growing crazy fast and needed to make capital investments illustrates how to thread this needle. The company faced exponentially increasing hardware expenses and needed to expand their workforce. They had already been through several rounds of equity financing, and early investors were concerned about ownership dilution. After considering all these factors, the CFO used a mix of debt instruments and equity to finance the needed hardware and HR investments while carefully tending the expansion. The interest on debt financing raised costs in the short term, but the strategy gave the company the flexibility to meet the demands of both competition and investors while navigating a choppy market. The investments paid off and the company emerged with excellent market traction and a solid financial position. Had they merely hung on, the company might have missed the market opportunity or been unable to meet investor demands.

Managing money for the future as well as the present can pay off in all sorts of ways. We helped one company manage an initial VC funding round in a way that positioned the company to secure more than $12 million in debt financing over two years. At the same time, we created a revenue recognition model that worked with the company's complex and highly seasonal sales process. This focus on careful cash stewardship (but not miserliness) and attention to technical accounting issues, combined with the CEO's growth vision, enabled sixfold revenue growth in just two years and put the company in position to go public or get acquired.

Business information systems: solving the riddle of when to scale up

The most cost-effective and efficient business systems pass the Goldilocks test: they're just the right size for your business. Implement an ERP system too soon and you can get bogged down in overhead and upkeep. Wait too long and you can't keep up with the growth of your business—your lack of infrastructure will cripple you.

Deciding what to move up to can be just as confounding. Large ERP systems are typically expensive in terms of both initial licenses and hardware requirements, have long implementation time frames, and are costly to maintain. Cloud-based systems are typically quicker to implement and have lower up-front costs, but they are not without risk: handing over your sensitive data to a third party raises questions about data protection, privacy, and security. How well do the various cloud applications integrate with each other (and with your on-site applications)? How reliable is the cloud service provider—for system uptime, technical support, and disaster recovery? What happens if the provider goes out of business? Choosing a cloud-based system isn't as easy as just clicking a button.

What did our life sciences company with the promising drug do? The CFO made a conscious choice to make do with his ailing system until the company was confident of drug approval. But the finance team didn't just ignore the issue until then; they investigated options and did due diligence on their top choices so they'd be ready to implement as soon as the coast was clear. The company did get FDA approval—and because of that advance work, the new system will be up well before the company is recording revenue from the new drug.

It's hard to find that sweet spot—you can wait too long as well. We worked with a consumer products company that was running on Intuit QuickBooks well after the sales volume exceeded that small-business tool's capacity. The company faced a genuinely difficult situation: Tight access to capital meant that product development and customer acquisition had to take priority. Sales growth was seasonal and difficult to predict.

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So they waited themselves into a crisis. They were getting more orders than they could process and ship. That led to a lot of manual work outside the system that didn't adequately capture the data, which meant they weren't sure their financial statements would be accurate, or that they were paying commissions correctly. And in all this scrambling to avoid total breakdown, they certainly didn't have time to research new systems and plan a system implementation.

The company could have avoided at least part of this mess by investing early on in the right people. Their first IT staffers were from large companies where they maintained systems; people with experience in fast-growth environments would have been a better fit. The company also lacked the personnel needed in other departments to take on a cross-functional implementation. Sometimes situations like these come from "good soldier" syndrome: someone who wants to squeeze everything out of what they have thinks they're being smart. But an accounting director who's lived this scenario will fight for the necessary tools. When you miss your sales projections because you can't ship on a timely basis, that's not being a good soldier.

Another life sciences client implemented a large ERP system too soon. They took on a major expense and faced a difficult implementation with scant resources, and then the FDA did not approve their drug. They don't need a big system anymore and wish they still had that money to spend on additional clinical trials. Not only that, they're stuck with the ongoing increased overhead required to maintain a complex ERP system that's hard to use. The problem? Overoptimism. It's great to have confidence in your company's product, but major infrastructure decisions are better made based on hard facts.

In fact, unrealistic forecasting is the top culprit in premature upgrades. If your sales team tells you business will triple in the next six months, you have to ask: is that credible? When a business has waited too long to upgrade, however, we typically see these signs:

- Time-consuming work-arounds outside the system are necessary.
- Topside adjustments developed on spreadsheets become more common.
- Missing functionality becomes apparent—the system can't handle foreign currency transactions or consolidations of foreign subsidiaries, for example.
- The system can't capture the detail needed to analyze business activities; for example, it can't generate margins by product.
- The system doesn't play well with others, requiring custom interfaces or manual inputs and topside entries.

Understanding the timing of business activities is key to being prepared. If your organizational complexity increases, requiring analysis of varied aspects of the business or incorporation of multiple business units, or if you know that a business combination is likely in the near term, that's a heads-up that it's time to analyze your system's capabilities.

People and culture: getting the right talent and reaping the benefits

HR heads are increasingly reporting to CFOs, and that makes sense to us: hiring and staff development should be aligned with finance operations, and having the right people in place can be the difference between triumphing over a challenge and getting mired in an impossible situation (see above). And this is definitely an area where broad business insights and beyond-the-numbers skills are essential—starting with the finance department.

The challenge that the hot social media start-up faced is Exhibit A. This company had a finance department stocked with young, enthusiastic employees without much business experience—they hadn't "been there, done that" and weren't able to develop the processes and infrastructure required to keep up with business growth. RoseRyan gurus were able to step in and get the situation under control (naturally!), but it was a big job: we helped them improve billing processes, designed custom processes to handle direct wire payments, helped them reconcile to third-party systems, developed reporting to help them understand daily operating results, and established a revenue recognition policy. All is well now. But the lesson is: know that when you hire an inexperienced staff, they won't be able to figure out increasingly complex financial transactions on their own. Plan for expert help and mentoring.

One advantage this company had was a culture of honest communication. This is important throughout a company, and perhaps in finance most of all. RoseRyan has been a sponsor of the Ernst & Young Entrepreneur of the Year program for many years, and one thing that stands out year after year is that the finalists routinely mention culture as a differentiator in their success—empowering people to do what's right, eliminating delays in decisions, and ensuring that everyone is headed in the same direction.

Respecting the chain of command has its place, but it often gets in the way. In a culture where people fear speaking up or making a mistake, problems never surface, people don't feel empowered to try new approaches, and innovation gets stifled. The consequences can range from missed opportunities to business disaster (remember Enron?).

Process optimization: preparing for the business you want to be

Your business evolves, requirements change, regulations change, and the tools to manage workflow change. What worked in the past may not be the best solution going forward.

Here's a not uncommon situation: One of our clients grew from a mom-and-pop shop pretty rapidly and then received a major investment. The company then had the money to reach the next level, but the organization wasn't positioned to grow. Finance processes weren't documented or rigorously followed, and revenue wasn't properly accounted for. After process efficiency exercises, documentation, and risk analysis, the client is on the path toward ensuring they can scale fast and efficiently in the future.

What worked in the past may not be the best solution going forward.

A strategic finance team heads off such troubles by ensuring that the company's processes are up to speed for the business's next phase (or three), rather than making do with processes established at the beginning. For example, many private companies track stock option activity with Microsoft Excel spreadsheets. That's fine when employees are few and stock option volume is low, but as head count and activity grow, so does complexity. Computing stock-based compensation quickly gets tricky, especially if there are stock option modifications, which are not uncommon in private companies.

We've seen many a company let this slide because they didn't always have monthly activity and weren't concerned about the P&L impact. What's the big deal? When IPO filing time rolled around, equity became very important, and these companies found their records didn't match the transfer agent's records. They then faced time- and money-draining reconciliation and other equity accounting issues—and wished they'd had the foresight of companies that invested early on in a stock administration application and sailed through that common IPO roadblock.

You're not alone

Your finance team should be composed of experienced, business-savvy guides who can help manage the business through its evolutionary journey. But the fact is, sometimes businesses grow in unanticipated ways and even the smartest leaders end up in a jam. Sometimes it doesn't make sense to keep high-level experts on staff when you just need them once in a while. And sometimes it makes sense to keep your staffing highly flexible—for example, one of our clients outsources their entire finance function, except for the CFO, so that they can stay nimble and focus their resources on drug discovery and clinical trials.

Contact Maureen Ryan at mryan@roseryan.com to find out more.

About Pat Voll: Pat Voll heads RoseRyan's compliance and risk management services, in addition to mentoring and supporting RoseRyan consultants and finding perfect matches for gurus and clients. A finance veteran, she has expertise in revenue recognition, SEC and management reporting, mergers and acquisitions, and plain old nuts-and-bolts accounting.

About Chris Vane: Chris Vane has a true knack for building relationships—including strategic alliances and partnerships. He's been kicking around Silicon Valley for more than 20 years and leads the development of RoseRyan's cleantech and high tech practices. Before joining RoseRyan in January 2008, Chris was a partner at Computer Sciences Corp., where he focused on providing strategy and technology consulting for Fortune 1000 clients.