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The Life & Times of a CFO in a Midsized Enterprise (MME)

How Data & Knowledge are Elementary
A Modern Fable

MME CFO

MME Team



CONFIDENTIAL

Preliminary investment materials

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“No amount of sophistication is going to allay the fact that all of your knowledge is about the past and all your decisions are about the future.”

Former GE executive



The Quest for Knowledge

Tom is the CFO of The Modern Coffee Company ('TMCC'), based in the **UK** with a subsidiary in **Brazil** and **Singapore**. The Brazilian subsidiary buys the coffee beans and then ships them to the UK and Singapore. In the UK, they mix the beans to create a light blend which they then sell to retail and wholesalers in the UK and other European countries. They also supply the light blend to Singapore for on sale to Asian customers.

In Singapore, they mix the beans to create a dark blend that they sell to Asian retailers and wholesalers, along with the light blend that they receive from the UK. They also supply the dark blend for sale to the UK for on sale to UK and European customers.

Tom is approached by his CEO, **Susan** who is concerned about how future events might impact TMCC.

"Tom, I need to know what the impact will be of our new marketing campaign that we are running in Europe. Also, I am hearing that the price of coffee is about to rise. Can you run some numbers please?"

Tom asks his assistant Sam to pull something together.



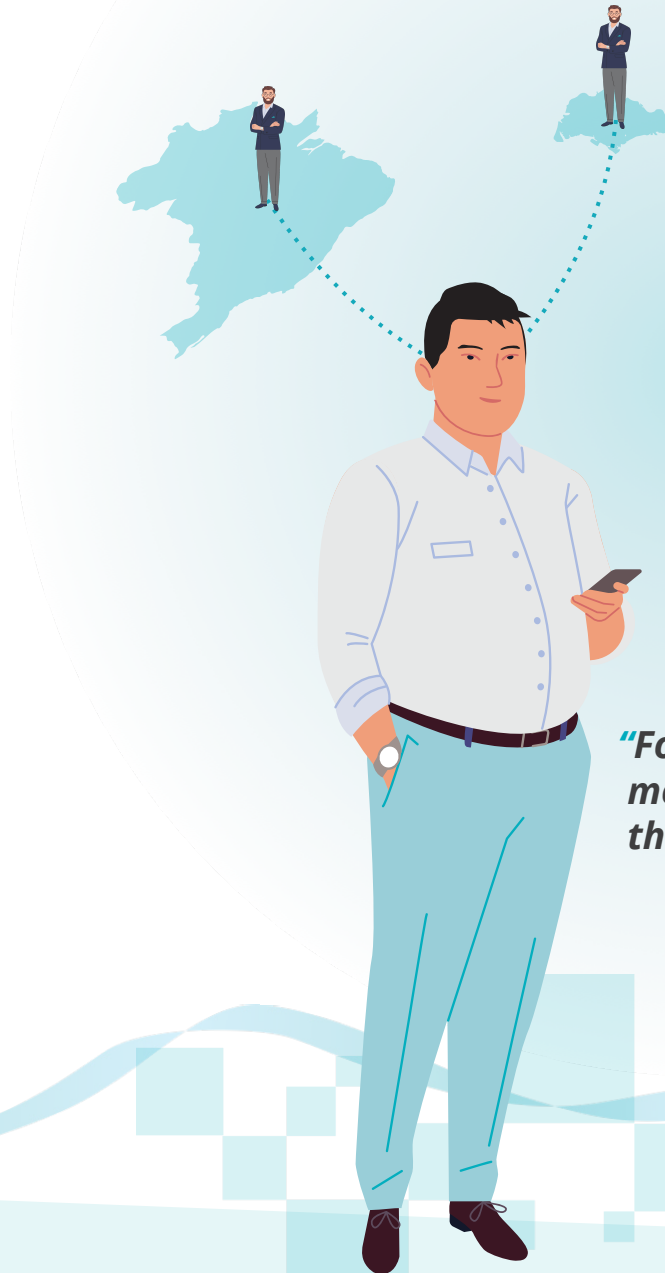
Forecasts are Dangerous

Sam's story

Sam emails the CFO in **Brazil** and **Singapore** and asks them to complete a template showing their revised Income Statement for the next 12 months, after taking account of any price increases and the impact of the proposed marketing spend.

He then gets going on trying to construct the forecast for the UK.

Two days later he receives the completed templates back from Brazil and Singapore and aggregates the data together to produce an overall forecast. Tom has indicated that he needs it by the end of the day so he can review before sending on to Susan. As he is short of time, he takes a quick look at the output and then emails it to Tom.



"Forecasts usually tell us more of the forecaster than of the forecast"

Warren Buffett

Tom's story

It is the end of a long day when **Tom** clicks on the email from **Sam**.

It is immediately obvious that Sam has put a great deal of effort into producing the forecast. Tom looks across the figures and notices that sales and profitability show a sudden decline for months 11 and 12 of the forecast.

By searching through the various sheets, he discovers **a formula has been incorrectly copied across in the UK forecast** - and corrects this. He is also concerned that the full-year forecast looks lower than he would have expected. After 30 minutes trying to figure out why, he discovers that the **full-year numbers do not agree to the sum of the 12 months** due to an adding formula error.

Relieved that he has spotted these errors before sharing with Susan, he now analyses the individual countries. He is struck by the fact that Brazil's gross margin has remained the same with increased sales and COGS.

He calls the CFO in Brazil and asks why this is.

The CFO responds that he has assumed that the increased cost of coffee beans will be passed through to the subsidiaries. Unable to contact Sam to determine what has been assumed by the UK and Singapore he sends them an email and goes home.



Susan's story

Tom came to see me this morning with the 12-month forecast.

He opened up by saying that he had just discovered that Brazil had **used different assumptions** from Singapore and the UK in terms of dealing with the raw material price increases. Singapore had assumed that they would be borne by Brazil and the UK had assumed that they would be split equally between the two.

Tom said that the numbers would need to be rerun and **couldn't estimate what the impact would be** until this was completed.

Nevertheless, we sat down to review the numbers. I **found the numbers difficult to follow** as they were in raw number form as opposed to the graphical display that I favour. When I looked at the forecast, I immediately noticed that the starting point of the actual numbers for March was lower than expected.

After retrieving my March management accounts, we ascertained that this was indeed the case and appeared to be due to Singapore having increased their costs. Tom undertook to investigate this.

Looking at the forecast, the impact of the marketing **spend seemed to be very positive with increased sales and profitability** feeding through three months later. **I was concerned about the impact on our cash position in the short-term** so asked Tom whether this was an issue. Tom said that he hadn't asked for the balance sheet forecast so couldn't comment on the cash impact. I told Tom that I wanted to present the propositions to the Board so we needed to get our ducks in a row.



Tom...

Just had a horrendous meeting with Susan in which she was **less than impressed with my efforts**. In order to get on top of things I have sent fresh instructions out to **Brazil** and **Singapore** including a request for a full balance sheet forecast.

Sam is now on holiday so his assistant **Claire** has taken over the management of the forecasting process. With a fair wind we should be able to produce a much more comprehensive **forecast in five days' time**.

Claire...

I have taken over Sam's spreadsheet and responsibility for the production of the UK forecast. **Sam** appears to have used some **macros in the forecast which I cannot figure out** so I have decided to rebuild the forecast with the balance sheet added in.

I called Sam and asked where he had obtained the Income Statement numbers from? He said that the **head of sales** had given them to him over the phone. I called the head of sales and asked to discuss the numbers in the light of the revised assumptions. I also asked whether we could agree on the balance sheet forecasts. The **head of sales said that he didn't really understand balance sheets** but would do what he could to help.

...Tom

Well, I've spent most of my waking hours over the last 3 days working with **Claire** on this revised forecast and it looks like we are getting there. **We have included some quite cool features like using a formula to calculate interest** and then update the cash balance in the balance sheet. Unfortunately, this appears to have created a **circular reference which neither Sam nor I know how to fix** other than by amending the final output. Let's hope my meeting with Susan goes better than last time.



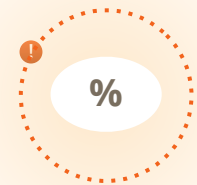
Sales



Looks like I have **some tricky days ahead**.



Claire



Susan's story

I had my follow-up meeting with an **exhausted looking Tom** today. He seemed to have **corrected the actual numbers** so that they now agreed to the March management accounts – Apparently **Singapore** had under-accrued for costs in March and had attempted to fix this by back posting – He also said that the assumptions were now consistent between **Brazil**, **UK** and **Singapore**.

When we reviewed the numbers, the **forecast was nowhere near as positive** as the previous version. When I asked Tom why this was, he said that he'd need to complete a lengthy reconciliation to explain that.

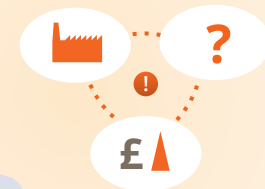
Tom then proudly showed me the balance sheet forecast. When I questioned whether he was sure that these were consistent with the Income Statement forecasts he said that he **hadn't fully checked** that but felt that they were '**directionally correct**'. When we looked at the cash position it showed that, whilst we would need to borrow more, it could be accommodated within our overdraft facility.

Clearly this was good news. However, when I looked at the stock levels it was apparent that the UK had **insufficient warehousing capability** to house the required inventory ahead of the marketing push.

Tom commented that we'd **need to take on more space** for which there would be an extra costs and time to arrange. Conscious that time was up, we made some high-level adjustments to estimate the impact.

I also asked to see the numbers split by product. Tom commented that whilst this was available in the actual numbers this detail hadn't been requested as part of the forecasting process and would take extra time to produce.

As no more time was available, I fed the numbers into my Board presentation.



Susan's story continued...

Well, I arrived at the Board meeting feeling somewhat trepidatious.

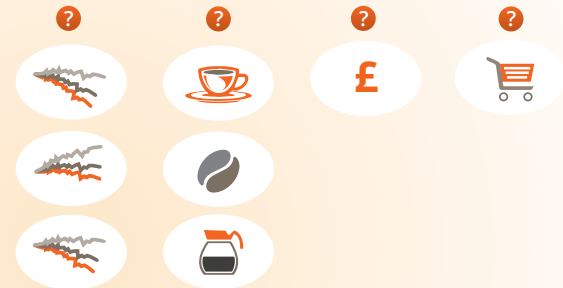
As it transpired, I was right to feel this way. When I presented the forecast, I was questioned as to the robustness of the numbers. I said that it was inevitable that a forecast would contain an element of estimation. The Board understood that but **asked why I hadn't presented a range of outcomes**. I was actioned to revert with a best, medium and worst case. I was also questioned as to the key assumptions that were used in the forecast.

As I suspected, they also **asked to see the forecast split by product**. As these weren't available it was agreed that there was **insufficient information** to make an informed decision and that the forecast should be put on the agenda for the next meeting.

The Board then **questioned the impact of the forecast on cash**.

I reassured them that our **overdraft facility was sufficient** to deal with the forecast requirements. However, the question was asked as to why we weren't considering a long-term loan or alternative funding option given the predicted extended use of the overdraft facility.

It was agreed that I should take this away as an action.



Tom's story

I had a post-board meeting wash-up with Susan. We agreed that **the forecasting process had not gone well** and that we would have a retrospective review of what had happened and, more importantly **what we needed to change** going forward.

Sam and Claire would be invited so that we could consider all aspects of the process.



Minutes of retrospective meeting into forecasting for Board session

It was agreed that:

A forecast represented a vital tool for senior management decision-making as it was looking at events that could be influenced rather than past events that could not.

Too much time had been invested in the forecasting process at the expense of identifying “what do the numbers mean”

Issues identified

- ❗ Process was too lengthy
- ❗ Numbers were not robust
- ❗ No ability to impose checks and controls
- ❗ Absence of clarity over assumptions
- ❗ Lack of consistency in application of assumptions
- ❗ Insufficient audit trails
- ❗ Struggle to undertake scenario analysis on a timely basis
- ❗ Handover issues with the model
- ❗ Inability to process changes and yet maintain audit trail

It was agreed that whilst spreadsheets were fine for quick calculations and analysis, they were not the ideal tool for a forecasting model. Sam felt that the extent of the requirements for the forecast had not been clear up-front and this had resulted in a ‘mushrooming effect’

The solution

There is a need for a forecasting system that;

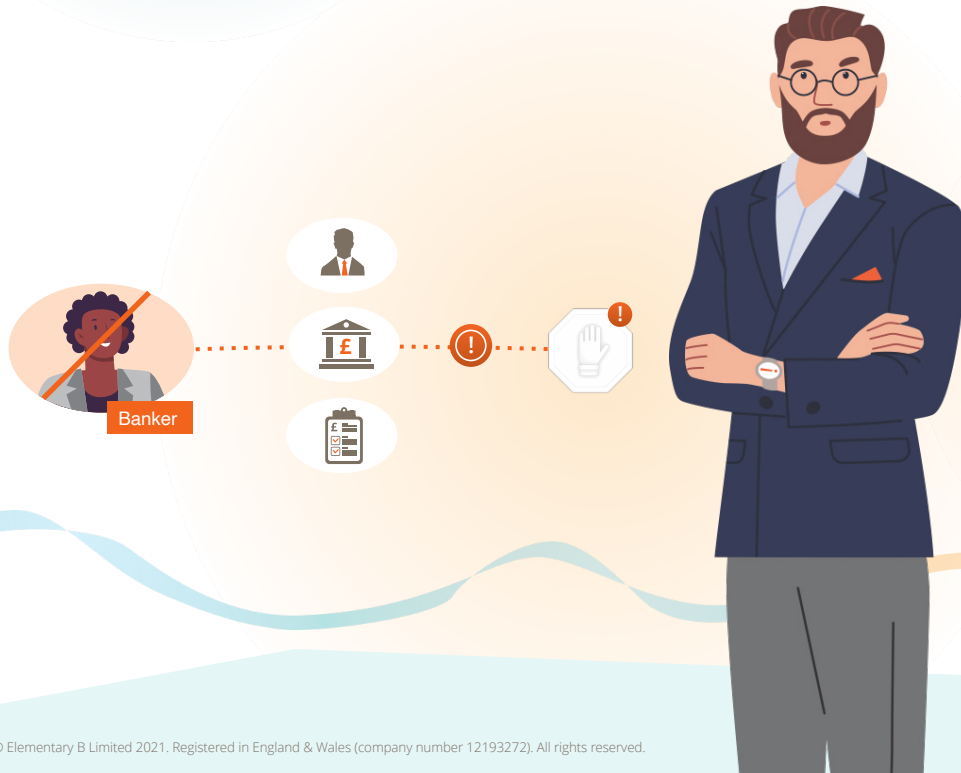
- ✓ Was complementary to the accounting systems
- ✓ Was highly intuitive to use
- ✓ Could not be ‘broken’ by a user
- ✓ Contained control checks to ensure consistency of numbers
- ✓ Used prompts to identify the constraints on the business e.g., warehousing, credit facilities
- ✓ Maintained a robust audit trail



The Product Search

Susan's story

As requested by the Board I asked Tom to investigate the best funding strategy for TMCC.



"A bank is a place that will lend you money if you can prove that you don't need it"

Bob Hope

Tom's story

Susan called and asked me to investigate the best funding strategy based on our forecast. I rang our bankers and asked to speak to our relationship banker. I was told that **due to our size, we no longer had a relationship banker** and we would be directed to the customer service centre. After clearing security, I asked the customer service centre what the alternatives were to the overdraft facility that we currently had in place. They said that they couldn't advise on that but connected me with the lending department. The lending department said that they would email me the relevant forms that I would need to complete. When the forms arrived, it was clear that

- ! They already possessed a great deal of the standing data
- ! They were requesting forecast data and this was available in our model

Consequently, I emailed them our model and advised them accordingly.

Tom's story continued...

Two days later I received the response that unless our data was submitted in the approved manner, they would be unable to proceed with our loan application.

I called **Sam** in and asked him to stop working on the forecast and asked him to complete the **loan application forms**.

Duly completed we submitted the forms to our banks.

One week later we received an email stating...

"Dear Sir/Madam,

I am afraid that we are unable to proceed with your loan at this time"

After numerous calls to the bank to try and discover why this might be, I was informed that *"I really cannot say but it might be that you don't meet our profitability targets"*

I am really not looking forward to my next conversation with **Susan**.



If I Had Only Known...

Tom's story

After the sort of week I've had, I'm relieved to be able to have some down time. It's a Wednesday evening and I am relaxing in front of the TV when a text comes through. I keep forgetting that I'd set up a **daily text alert** so I can track what is going on in the main UK bank account. Even if I **couldn't get this set up** on our **Brazil** and **Singapore** bank accounts it gives me some feeling of control. As usual it is multiple lines of incoherent code with lots of ins and outs but the net effect is that the balance is roughly where I'd expect it to be.

In **further good news** our biggest customer, **Multibean**, have placed a big order and I have been emailed to approve it. I click yes and settle down for a comfortable night in.

The following Monday, refreshed from the weekend I meet **Sam** in the office who says,

"It's great news that our tax credit got paid early isn't it. Apparently, it reached our account last Wednesday – which is three weeks earlier than we thought"

"Without knowledge and understanding, one tends to become a passive spectator rather than an active participant in the the great decisions of our time"

Diane Ravitch

I wasn't aware of this so am also very pleased. Or am I?

"Hey Sam – if that arrived last Wednesday why is our bank balance only showing £30k? We needed that to meet the planned marketing spend in three weeks time"

Sam looks puzzled. *"I'll check he says"*

Three hours later Sam emails to say – *"our forecasts said that Multibean would settle their bill on Tuesday but their payment didn't arrive"*

"Has anyone contacted Multibean?" I ask. Sam says that he doesn't believe that anyone has. As I walk to my desk my phone rings. It is the chief buyer from Multibean. He informs me that I have had probably seen the news that **Multibean is suffering "trading difficulties" and consequently is looking to change its supplier payment terms.** I ask when we can expect the payment due on Tuesday and also with respect to the shipment made on Wednesday. He responds that it is too early to say and he will be in touch with more information in due course. He hangs up.

Unknown unknowns

Tom's story

I am looking at the news today. I chance upon a story about an **increase in duty for exports to Singapore**. I was unaware of any duty. I call our tax advisors, **Kim** and ask for reassurance that this does not apply to TMCC. Kim tells me that she only deals with corporation tax and will need to speak to the indirect tax department. An hour later a member of the indirect tax department, **Phil** calls us and asks me some questions. I tell him that the **UK** has been supplying light beans to Singapore for the last two years. In that case he says that **we have an unpaid tax bill** for which we will be liable to a fine and interest.

I ring Kim and demand to know why her firm hadn't made us aware of this duty given that they have been our tax advisers for five years. She says that firstly we only engage her firm for corporation tax advice and secondly, she had **no idea that the UK was supplying product to Singapore**. This latter point hits me hard – surely, we had told them? Isn't it obvious from our numbers? Phil explains that the numbers he receives from us show total sales and not the location of the end customer, or whether it is an inter-company sale.

“There are known knowns. These are the things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know”

Donald Rumsfeld

Sam's story

Tom looks like he has the weight of the world upon him. He has just told me to stop working on documentation for a loan application or the forecast but to extract details of all sales of light beans to Singapore over the last two months.



The End Game

Susan's story

Tom has just emailed me to say that he needs to see me urgently on the following matters

- ❗ The forecast
- ❗ Our loan application
- ❗ Multibeane account
- ❗ An issue surrounding export levies

This **does not look good** and I desperately hope it is not going to impact upon our ability to undertake the marketing push.



"I wish life had a rewind button."

Sayings Point

I have been worried about Tom. I felt that he was a competent CFO when we were smaller and simpler but he seems to struggle now we have grown and become more complex. I am not sure whether he has the right systems in place to cope with the demands of the business. The last Board meeting was a disaster and he seems to have an increasing tendency to provide surprises just when I don't need them. I'm afraid that if I don't act then the Board will take matters into their own hands.

I send a message to the Head of HR requesting a meeting for this afternoon.



New beginnings

Tom's Story

Well, **being fired by TMCC really wasn't a pleasant experience** but in hindsight I can't say that I blame them.

I've spent time with a personal coach who has helped me reflect on my learnings from my time at TMCC. As painful as this was it was very helpful in preparing me for my **new role as CFO at We Love Tea** ('WLT'). The company has been on a similar growth path to TMCC and has a turnover of £25m with operations in four countries.



"It's fine to celebrate success but it is more important to heed the lessons of failure."

Bill Gates

As one of my first tasks I will be installing a system that:

1. Provides easily developed forecasts

- ✓ That can be undertaken at a high, medium or low level of detail
- ✓ Where the assumptions are very visible
- ✓ Where interlinkages between line items can be established
- ✓ With a robust audit trail
- ✓ Capable of comparing multiple scenarios

2. Alerts me when my transactions deviate from my expected cash forecast

3. Identifies cost effective potential products to fulfil our needs with WLT and helps populate the application.

4. Protects me against what I should know and the unknown unknowns.

I think I've found that product – it's called **Elementary^b**



The Eb Platform

Tom loves that Elementary^b is a **highly flexible forecasting and planning tool** that generates timely and accurate information to support decision making.

Using the latest technology, it provides feedback on a forecast **identifying potential issues and optimal solutions.**

Forecasting and
Corporate Planning

Business
Insights

Identification of Product
Solutions and Providers

Rapid Product
Fulfilment

Ecosystem
Model



A dashboard to live for, with topical industry alerts to make sure **Tom looks and feels like a financial super hero.**



E^b brings together a support community for MMEs



in @ELEMENTARYb
 @elementaryb4MME
 f @elementaryb
 @elementaryb4MME

transforming financial decision making, it's elementary



ELEMENTARY^b is committed to being the change in the world by baking sustainability into its *modus operandi* and measuring impact where possible. This includes a commitment to the above to support sustainable development goals.

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