

# THE STRATEGY— FINANCE CONNECTION

Q & A WITH PROFESSOR PAUL M. HEALY



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Intense competition and limited financial resources are still big problems for companies struggling to set a new course in a post-downturn world. To shift smoothly from short-term cost cutting to executing sound long-term strategy, Harvard Business School (HBS) Professor Paul M. Healy says companies must first understand how their strategy will produce the financial performance they need. In this interview, he explains how executives can uncover critical information that will yield better strategies, align company operations, and create value for stakeholders.

## **What financial challenges does today's economic climate pose for established businesses?**

First, companies have the same challenges they had before—competitors arising across the globe, technology and business models evolving, and market demand continuing to shift. But as we know, many businesses also face contracted markets and restricted credit and capital. The credit crunch has begun to ease, especially for larger firms, but many companies are still not able to borrow or attract new investment. With fewer financial options, leaders face hard decisions, whether that means putting off investments in new products and services, cutting business lines that are not strong performers, reducing or freezing compensation, or simply cutting positions across the board. Small businesses face these same challenges, but are under even greater scrutiny.

## **What strategies are companies using to attract resources as banks and investors begin to loosen their purse strings?**

Smart business leaders are rapidly shifting out of survival mode and looking ahead to define how they will create value for the future. It's tough to get the balance right, especially for smaller firms, but resources will flow toward those businesses best able to demonstrate strong performance and a sound plan for competing over the next three to five years. Unfortunately, some companies won't be able to navigate this transition.

## **Do you have specific advice for executives facing this challenge?**

They need to understand the linkage among three things: company strategy, financial performance, and company value. Decision makers need to see clearly how their strategies affect their performance and their valuation. This analysis is a critical first step for many of the choices that executives will have to make as they define company strategy. It sounds simple, but most companies could improve this process.

## **Which decisions benefit from this type of analysis?**

It boils down to this: you have to know how your company is doing, how your competitors are doing, and why. Once you understand that, you will be able to see threats and opportunities with a clear eye. Executives need to consider four key factors. First, they must be able to implement strategies that drive performance. Second, as they evaluate competitive threats, executives must be able to compare their own performance with that of their competitors—and understand the factors that drive

competitor performance. Why is your competitor outperforming you? How does their strategy differ from yours? Third, they must be able to objectively evaluate potential mergers and acquisitions—and that means assessing how those companies' strategies have produced a certain level of performance and then accurately valuing those companies. Finally, it's critically important to be able to express the results of these analyses in ways that clearly communicate the company's value and its strategy to decision makers, investors, lenders, partners—and employees.

#### **Why has it been difficult for companies to see these linkages?**

There are three major barriers. The first is organizational. Strategy formulation, company budgeting, and assessment of financial performance tend to be done by three different groups with different goals and processes. While actions taken in one of these areas can have real implications for the others, those implications are not always obvious. The second barrier is knowledge. Even long-time financial executives with sophisticated skill sets are not certain how to make these connections—it can seem like a mysterious process. The final barrier is rapid change. Competitors can arise overnight, so companies must be able to assess their markets and competition on an ongoing basis.

#### **Who drives the process?**

Alignment begins at the top of the organization, but the analysis requires financial expertise. Top decision makers need to have solid financial information at their fingertips and must be able to answer stakeholders' key questions. The basic question is: "Once we move beyond immediate challenges, how do we plan to create value over the next few years?" While the senior financial executives and analysts within the organization have the skills and responsibility to put the information together, they have to work as a team to assess how value gets created inside the organization. For most companies, this involves not only the CFO and people at the corporate office, but also executives throughout the business units. The linkage among finance, planning, and performance can be created at every level and tied closely to the organization's overall budgeting process.

#### **How does HBS enable companies to forge these links?**

In our research, consulting, and Executive Education programs, we aim to identify best practices and then help demystify the process. We want executives to be able to create better information so they don't miss opportunities. Many times, we have seen situations where companies can use financial information to strengthen their strategy going forward or address deficiencies in relation to the competition. But to uncover those opportunities, they first need to unlock the information that's buried in their companies.

The program **Strategic Financial Analysis for Business Evaluation** combines several interrelated topics: strategy formation, financial analysis, and the process of linking performance to value. This program is not about number crunching. Taking a holistic perspective, we look at how successful companies around the world are able to formulate strategies that drive financial performance—and how performance translates into company value. Participants are also able to take advantage of business models HBS faculty have evolved based on their experience, and then exchange ideas with other executives who are facing similar challenges in their companies.

### How does the program prepare executives to alter their approach to financial analysis?

By focusing on the alignment between business strategy and finance, we help executives to rethink their strategy and drive better financial outcomes. Executives first learn how to use financial information to refine strategy—whether that involves valuing companies, evaluating performance relative to competitors, or assessing mergers and acquisitions. Then they learn how to communicate the company’s strategy and performance to its stakeholders. While the specifics of who actually performs the analysis will vary from company to company, the program enables executives to be their own analysts—and to demonstrate a clear linkage between actions taken and results achieved.



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