EXPLORE OUTSOURCING YOUR CFO FUNCTION

KEITH MILLER, PARTNER AT **EISNERAMPER**, EXPLAINS TO *HFMWEEK* ABOUT THE IMPORTANCE OF HAVING A CFO IN PLACE IN THE BUSINESS AND THE POSSIBLE BENEFITS OF OUTSOURCING THE ROLE

Keith Miller is a partner in EisnerAmper's San Francisco office. Miller specialises in audit, accounting and outsourced CFO services to hedge funds and private equity funds (both US domestic and offshore domiciled) along with their management companies.

I asked the headline question "Does your organisation have a CFO?" in an article *HFMWeek* published last year. If you replied with anything less than an emphatic "yes," to the questions that article posed, should you pursue obtaining a CFO who possesses all the skills and expertise you need?

Your business would be harmed if the audits for funds you manage are not completed timely, your firm's tax returns significantly underreport taxable income or a routine SEC examination finds the firm to have deficient books and records. The CFO is the key defence against these and other financial management risks. Further, most institutional grade investors now demand that a manager has a CFO (separate from the CEO, CIO, and COO roles) before they will open their check book. Firms that do not have this separation of duties are viewed as failing the operational due diligence process. Not having a competent CFO could affect your ability to win and retain clients – suddenly, having a CFO from the early part of the firm's life cycle just got serious.

The traditional response to seeking a new CFO is to hire somebody. A strong employee candidate (if even available) in a major financial services location will expect at least $200K per year before bonus and benefits (not to mention the headhunter's fee) – all for someone you don't yet know.

> "CAN I KEEP A COMPETENT CFO BUSY ON ACTIVITIES JUSTIFYING THEIR SALARY AND UTILISING THEIR FULL SKILL SET?" IS THE IMMEDIATE QUESTION TO ASK

The advantage of a traditional employee hire is that the person will be at your beck and call to work on anything you choose including financial planning and making sure accounting, tax returns and audits are completed on time.

"Can I keep a competent CFO busy on activities justifying their salary and utilising their full skill set?" is the immediate question to ask. If not, then hiring a full-time employee could create a morale issue and guarantee you'll be paying someone to frequently check Facebook updates. This comment may make an employee CFO sound like a luxury, but a manager with assets under management (AUM) of $300-500m or more will still want to seriously consider this route, especially as it can normally generate sufficient management fee income to cover the cost of having a full-time person available and occupying this important role. The firm can hire and then seek to keep its CFO busy, knowing this is an investment in helping grow the business.

ANOTHER WAY

For everybody else who cannot afford this luxury, including smaller and emerging or start-up managers, is there another way?

Outsourcing is an alternative. Outsourcing the CFO function should be thought of as time-sharing. It allows a manager, irrespective of AUM, to retain a CFO but maintain flexibility through buying just the right amount of hours per month (no more, no less) from the CFO to fit their needs, while avoiding the commitment and possible ceiling on the skills and/or experience of a single employee.

An employee will (rightly) be protected by employment laws, making it difficult to remove him if the firm's circumstances change, the firm raises significantly more in AUM than expected, suffers a mass exodus of investor capital, or the CFO's skill set fails to keep pace with the firm's requirements. Terminations are expensive, including the cost of legal counsel and severance payments. But, since an outsourced CFO is a service provider, if you need to change direction, he can be terminated guilt-free based on the terms of the original service agreement.

Engaging an outsourced CFO from a firm experienced in servicing financial services clients will grant access to its considerable knowledge of the industry, including what your peers are doing and the challenges they are overcoming. It avoids the trade-off when hiring a full-time employee between whether she has sufficient (or too much) previous experience (including working with a certain level of AUM or securities/asset classes), whether your shop's circumstances will keep her satisfied professionally, whether she will be able to grow with the firm, and what her salary will be. Finally, how can you be sure a candidate's understanding of current industry best practices and regulations is not stale even if her résumé shows a large accounting firm or asset management shop background?

To the small and mid-sized AUM adviser, outsourcing gives immediate ability to delegate the financial steward-

ship role to an expert who would almost certainly be unobtainable if incurring his full cost as an employee. Through his other clients, the outsourced CFO will have experience assisting in organising fund and management company structures, and so could be particularly useful for an emerging manager in "cutting to the chase" when creating its own entities, choosing service providers and building internal controls/processes.

There is a large opportunity cost to the founders (especially for a smaller firm) in performing financial management activities. Outsourcing allows you to immediately re-focus on activities impacting your enterprise value and get back to managing the portfolio and winning new advisory clients.

One person can only retain a finite amount of knowledge. Outsourcing the CFO role to a specialist financial services firm provides a gateway to its other financial experts specialising in areas like compliance and international tax. An employee CFO would have to spend time locating suitable experts to assist in these matters and negotiating fees.

Outsourcing the CFO function to a brand-name service provider can enhance your performance during the investor operational due diligence process: It adds another marquee name to the stable of service providers you have engaged and creates a greater level of transparency over your operations. This gives peace of mind to clients that your firm is a professionally run, legitimate business and is implementing financial services industry best practices.

NUTS AND BOLTS

Outsourcing only needs to be as difficult as paying the CFO's monthly invoice.

Let's examine the actual 'nuts and bolts' of the outsourced relationship more closely. From the beginning, the firm must identify the duties and activities the CFO will handle and which functions you will retain in-house. This will also determine how much to expect to be billed each month. An open-ended relationship is not advised as this can lead to the outsourced CFO billing anything and everything by the hour or incurring significant unbillable time (which will dampen their enthusiasm for the role). An outsourced relationship can begin with the manager clearly stating his objectives from outsourcing and providing a detailed tour of the business, its clients and products offered and its investment strategies. From here, the manager and CFO can build a detailed list together of the core functions the CFO will perform and the fees he will charge. It is often said that one of the strongest relationships within any successful business is that between the CEO and the CFO, and this remains true even within the outsourced model. The optimal relationship will see the CFO's duties include the key specific activities the firm needs assistance with, but also a role in the firm's strategic vision and business plan, incorporating activities that will assist the business in growing to its desired enterprise value.

Whatever tasks are assigned to the outsourced CFO, this relationship is unique among all the shop's relationships with its service providers. The outsourced CFO must be empowered by the firm, and be viewed as a full member of the executive board, having a fluid and continuous relationship with the firm. He must also act, think and be treated like an employee rather than a service provider who performs only discrete monthly or annual services and waits to receive a call for help before acting. The outsourced CFO must be dynamic and proactive in order to provide the most value.

Nothing lasts forever, and this is also true for the outsourced CFO relationship. As you grow and allocate more and larger activities to the outsourced CFO, his monthly invoice will increase. Eventually an inflection point will be reached where the financial and time costs of having an in-house CFO, together with the flexibility this arrangement brings through owning all of the CFO's available time, will cause you to consider switching back to the traditional employee model. The inflection point can be around an AUM of $300-500m, although this may differ depending on the firm's circumstances. Terminating the arrangement is no harder than giving notice. The new in-house successor will inherit the role in a strong state, benefiting from the systems and controls already in place. ■