

## The Top Spot

### Why more companies are tapping their finance chiefs for CEO.

Don Durfee, CFO Magazine

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This is not an easy time to be running California's largest investor-owned utility. PG&E Corp. has only recently begun to recover from the biggest calamity of its corporate history: the 2000–2001 California energy crisis. That event, which featured soaring wholesale and retail energy prices, swiftly brought the company to its knees, forcing its two major subsidiaries into Chapter 11 and causing the parent to default on its loans and commercial paper.

The \$11 billion company is regaining its health — its utility subsidiary, Pacific Gas and Electric, emerged from bankruptcy in 2004 and its share price is showing new life — but it still faces big challenges. These include fixing relationships with regulators, revamping company operations, and, crucially, figuring out how to avoid a similar disaster in the future.

To lead the company through this transition, PG&E's board turned not to a star CEO from another company or to an operational specialist, but to its own CFO, Peter Darbee. In many ways, Darbee is a natural choice. The company's current woes stem from a financial crisis, and Darbee understands the company's finances as well as anyone. His career in finance — which includes stints at Goldman Sachs, AT&T, and Pacific Bell — has given him deep operational experience. Most important, he helped steer the company out of bankruptcy. "The issues I dealt with as CFO were among the top issues confronting the board," he says. "They've seen me tested in battle."

Darbee, who became president and CEO in January, is only one of many former CFOs who have landed in the corner suite in recent years. The list includes Lawrence W. Kellner of Continental Airlines, Robert Niblock of Lowe's, and James Ziemer of Harley-Davidson. In fact, a *CFO* magazine review of CEO backgrounds found that 20 percent of *Fortune* 100 CEOs were once CFOs, up from 12 percent 10 years ago.

To be sure, not many finance chiefs step straight into the top job. According to the CFO Executive Board, only 12 percent of CFOs get promoted to CEO. Instead, finance executives often pass through operational roles before getting there (see "Where Do CFOs Go?" at the end of this article). Sometimes the reverse happens: an operational executive spends a couple of years as CFO on the way to CEO, as was the case for International Paper Co.'s John V. Faraci.

Either way, the change reflects a shift in what boards look for in a CEO: they are less interested in the swashbuckling executive of the 1990s and more apt to choose a trusted manager who shows the right blend of operational and financial expertise. With more CFOs gaining hands-on experience managing businesses, they have become contenders.

"We've seen a significant trend of CFOs becoming CEOs," says Peter Crist, chairman of Crist Associates, a Chicago-based executive search firm. "Increasingly, boards look at a potential CEO and require real financial acumen. Ten years ago, board members looking at a succession sequence wouldn't have even given the CFO a nod, but today they are definitely looking at him."

### Why Now?

The idea that a CFO could be a good chief executive isn't new. As far back as 1990, *CFO* wrote about finance executives taking on the top job at such companies as PepsiCo, American Airlines, and Gillette. Many of these executives rose on the flood of takeovers during the 1980s: boards believed that someone with balance-sheet discipline and Wall Street experience could guide a company through its own takeovers and deal with the aftermath.

Other trends have also contributed to the increase in CEOs with a past in finance.

**Increased emphasis on finance.** In the 1990s, the financial CEO fell out of fashion in favor of executives with engineering, marketing, and sales in their backgrounds. Things are different today. Recession, the dot-com and telecom meltdowns, and a rash of corporate scandals have led board members to view a strong finance background as essential to the CEO. "You see an ebb and flow over the years as different functions step into the limelight," says Jeffrey Sonnenfeld, senior associate dean at the Yale School of Management and a director of Gevity Inc. and TheStreet.com Inc. "Today, boards want CEOs who can help them understand the puffed-up proposals coming in from the company's bankers, consultants, and attorneys."

**Shifting senior management.** But this is only part of the story. More important is the evolution of senior management roles. First, finance has become a bigger part of the CEO's job as companies have grown more global and thus trickier to manage.

The CFO's role has changed, too. As finance executives find themselves more involved in strategy and operations, they are gaining at least some of the experience a CEO needs. Take, for example, David Hoover, CEO of \$5.4 billion Ball Corp., based in Broomfield, Colorado. Hoover, who became CEO in 2001, joined the company's treasury operation in 1970. Over three decades he moved through a variety of financial positions, including jobs with Ball's agricultural-irrigation division (which sent him to the Middle East and Venezuela) and its aerospace business. He became senior vice president and CFO in 1992, and eventually took on responsibility for the aerospace unit as well. "I was fortunate to get outside the finance area," says

Hoover. "If I'd stayed in the accounting department, that's probably where I'd be today."

Operational experience not only teaches finance executives to think broadly about business, it also puts them in front of those who will choose the next CEO. "People don't often notice this," says Crist, "but CFOs at big companies are now present at every significant strategic discussion the board has. And when you are in the room, you are being observed." That is how Bob Bowman, the president and CEO of Major League Baseball's online unit, MLB Advanced Media, got his first operational job as president and chief operating officer of ITT Corp. He had worked closely with chairman and CEO Rand V. Araskog on a variety of projects, including the three-way split of the company in 1995. "Rand and I had a good working relationship," says Bowman. "We worked closely in the gnarliest of circumstances, and that was valuable to both him and the board."

For once, Sarbanes-Oxley is not driving the trend. "[Given the need to comply,] having a former CFO in charge would certainly be helpful, but it's not a prerequisite," says Charles Elson, a professor of corporate governance at the University of Delaware who sits on several boards. But like operational duties, Sarbox offers finance executives a chance to prove they can handle more than numbers. "The law has turned out to be a great opportunity for CFOs to really get into the guts of a company's processes and show they can be operational experts," says Gary Moran, a managing director with Alvarez & Marsal in New York.

**Decline of the COO.** There's another reason why more CFOs are becoming CEOs: less competition from COOs. Between 1999 and 2005, the number of companies in the *Fortune* 500 and S&P 500 with a COO dropped from 249 to 204 (see "The Vanishing COO," at the end of this article). CFOs are picking up those duties. "The board expects the CFO to be involved in line activity," says Crist. "So, increasingly, CEOs who move up from COO aren't bothering to backfill the position."

### Where Are They?

Ex-CFOs now run companies of every type, but they are nearly ubiquitous in certain places.

**Deregulated industries.** Former finance executives are most common in once heavily regulated industries such as utilities, airlines, and financial services (see "Where to Find Financial CEOs," at the end of this article). "These companies are operating in the aftermath of wrenching deregulation," says Sonnenfeld. "Now they need somebody who understands how to operate in a completely different financial environment from their predecessors'."

Such businesses also share a particular need for financial expertise at the helm. Utilities, for example, are cash machines, generating more cash flow than they need to reinvest in the business. "Even before deregulation, utilities had financially oriented CEOs because you need people with the discipline to invest that cash," says Paul Fremont, a utilities analyst with Jefferies & Co. Airlines put financial expertise high on the list for the opposite reason — their focus on pricing, cost cutting, and restructuring.

**Desperate circumstances.** Turnaround situations offer the classic showcase for a former CFO. Recent examples include Delphi, where, in 2005, Robert Stevens "Steve" Miller (former CFO of Chrysler) was brought in to repair the company and help find a buyer; TXU, where C. John Wilder joined from Entergy to guide a successful overhaul of the business; and BearingPoint, where the former CFO of Oracle, Harry L. You, has taken the helm after an accounting scandal that led to the departure of both the CEO and the CFO.

**Complex companies.** Global businesses also run to financially oriented CEOs, with former financial executives heading some of the largest global enterprises, including General Motors, Altria Group, Archer Daniels Midland, and Lockheed Martin. "Global businesses have become extraordinarily complex," comments E. Peter McLean, vice chairman of executive search firm Spencer Stuart. "Boards of those companies want financially literate people who understand issues of capital allocation, but also understand how to use financial products such as hedging and derivatives."

Not every company favors the finance executive for CEO, however. Technology companies often have a decided prejudice against putting them in operational roles, says Crist. Similarly, consumer-products companies like Kraft Foods and Procter & Gamble rarely promote executives who didn't come up through product management and brand marketing. "If you go to P&G and you aren't a product manager, you just aren't going to rise to the top," says Crist.

### The Advantages

Do former CFOs make better CEOs? In some cases the answer may be no. An overly financial view of the organization might lead to a bias for acquisition rather than organic growth, for instance. "Whatever advantages one function brings [to the CEO's job], there are also blind spots to watch out for," says Sonnenfeld. "For a financially oriented person, that might be whether they truly understand how a decision will cascade down to interpretation and final execution in the organization."

There is no evidence that companies with finance executives in charge are any better at avoiding financial scandal; Entergy Corp., which was investigated in 2003 for illegal "round trip" trades, and Harley-Davidson Inc., which is currently being examined for alleged channel stuffing, are two that have run into trouble despite being headed by onetime CFOs.

In several other ways, though, the CFO background is an asset.

**Focus on shareholder value.** "Your background shapes your biases when it comes to a value-creation strategy," says Eric Olsen, a senior vice president of The Boston Consulting Group (BCG). "Sometimes a former marketing guy will think that growth is the answer, or an operations guy will see cost as the answer. But often a former CFO will look at all the levers."

The numbers seem to bear this out. Data provided by Capital IQ, a unit of Standard & Poor's, shows that over the past three

years, large companies run continuously by ex-CFOs have outperformed the S&P 500, returning 41 percent compared with 29 percent for the market index. (These stocks are also more volatile — they have done worse when the market has fallen and better when it has risen, as it has over the past year.)

"When you are a CFO, you come to see that this is all about shareholder value, even at a private company," says Bowman of MLB Advanced Media. "And operationally, you understand the things that drive value. For example, it's second nature for me to know that an online cash flow will be worth more to the public than an offline cash flow [because an online income source is presumed to be able to grow faster than one offline]." As a result, Bowman focuses on the parts of the business that are valued more highly — subscriptions to the Website's videos of baseball games, for instance, rather than merchandise. "It's part of your DNA, for better or worse. Of course, it does mean that you aren't the first person people want to invite to a dinner party."

**Attention to metrics.** At Ball, where the share price has appreciated strongly in recent years, Hoover attributes at least some of his success to his determination to produce a return that exceeds the company's cost of capital. "Our focus on EVA [economic value added] has led us to make decisions — such as the decision to divest the glass business — that have really improved the performance of this business," says Hoover. "Today, you could go into any of our beverage-can plants and the people on the line could explain EVA to you." This has earned praise from analysts and investors alike. "You would be surprised how many companies don't think about their cost of capital," comments Christopher Manuel, an analyst with KeyBanc Capital Markets. "Hoover has done all the right things to make it work."

**Investor-friendly.** Former CFOs have another edge: experience talking to Wall Street. "You often see CFOs step into the investor-relations role naturally because they've been dealing with investors and analysts for years," says Jeff Kotzen, a BCG vice president.

The lessons haven't always come easily. Bowman recalls an experience from his days at ITT. "Back in 1994, we didn't know how to signal to the market whether we had a good quarter or a bad quarter," he recalls. "There was a lot of whispering going on among investors. We missed our EPS by a penny, and stock fell \$3. I thought, 'Why did we do that?' It made me learn that you tell your stakeholders what you expect to do, remind them of that, and make sure you do it. And at the first sign that you can't do it, tell them."

Olsen argues that CFOs may also be better at keeping their investors happy — not a surprise given their focus on shareholder value. For instance, a company with a low P/E multiple may have value-oriented investors who doubt management can come up with good investment ideas and would rather see high dividends. "You sometimes see CEOs fighting an uphill battle," says Olsen. "They want to improve their P/E ratio, but then their value investors start asking why they are trying to grow their way out of their problems. You need an investor strategy that recognizes the boundaries of what you can do in the short term. A CEO with a CFO background may be more sensitive to those issues."

**An eye for risk.** An ability to see the risks that might wreck the business is another valuable CFO trait. For instance, PG&E's Peter Darbee became adept at classifying risks and quantifying their likely impact on financial performance. "When I learned that I was to be appointed CEO, I started thinking about the major threats and opportunities facing the company," he says. He soon focused on the possibility of another energy crisis in California. "What I realized was that the state, the energy commission, and our company were all so burned by the California energy crisis that if we saw the same situation again, we wouldn't make the same mistake. But what if we faced a close cousin that was camouflaged so people wouldn't recognize it?"

Darbee decided that the issue might be natural-gas supplies: demand for clean-burning natural gas is expected to rise in coming years as new plants come online. If supplies prove inadequate, the price could jump. (The spike in natural-gas prices following Hurricane Katrina shows that this isn't far-fetched.) This realization led Darbee to contact the chairmen of the state's other main utilities, Edison and Sempra, as well as California's energy regulators. "We are working as a group to come up with a common view on natural-gas supplies," says Darbee. "If we decide they are inadequate, we'll work to address the problem."

### Are You Ready?

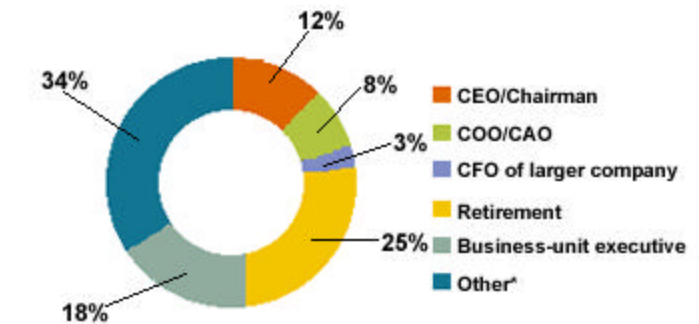
More CFOs may be taking charge, but no one claims that finance executives are a shoo-in for chief executive. Peter Crist contends that only 10 percent are qualified. "It's a pretty rarefied atmosphere," he says. "Was there a potential CEO among the last 10 CFOs I met with? There was one."

To run a major company, an executive needs several traits in addition to financial acumen, according to Crist. These include international experience, strong leadership and communication skills, and strategic sense. "Lots of CFOs are very reactive people," he says. "But the really good ones are forward-looking and able to create energy around a strategy."

In any case, demand for financially experienced CEOs at public companies will only rise. The reason: according to most experts, stocks are entering a period of slow growth — between 5 and 8 percent annually, rather than 16 percent. That has already made investors pushier about value creation, says Olsen. "There will be a lot of emphasis on the guy at the top knowing how to pull all the financial-, investor-, and business-strategy levers," he contends. "Companies will need a strong CFO. And chances are, a strong CFO is going to be a competitor for the top job."

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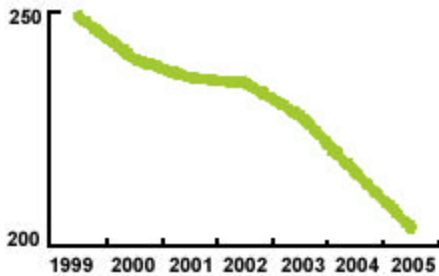
## Where Do CFOs Go? Next steps, by percent



\*CFO of smaller company, fired, or resigned.  
 Note: Based on largest global 162 companies by market cap, 1995-2003.  
 Source: CFO Executive Board

### The Vanishing COO

The number of companies with COOs has been falling since 1999.



Note: Based on 2005 *Fortune* 500 and S&P 500 companies.  
 Includes only the 578 companies continuously operating since 1995.  
 Source: Crist Associates

## Experience Required

What is the best background for a CFO angling to become CEO? Historically, the finance executives most likely to get tapped for the CEO position haven't come up through the controller's organization. Instead, they have tended to come up through treasury or — more likely — to be ex-bankers. This is true for the three CEOs discussed in this story: David Hoover started in the treasury function of Ball Corp.; Peter Darbee got his start at Citibank; and Bob Bowman began his career at Goldman Sachs before becoming treasurer for the state of Michigan.

The reason: companies sometimes recruit banker-CFOs to oversee their mergers and acquisitions, and that kind of work is a good training ground for future CEOs. "M&A really stretches a CFO to be more than an accountant," says Eric Olsen, a senior vice president at The Boston Consulting Group. "You have to negotiate deals, interact with people, face off with investors, and argue the rationale for why the deal makes sense."

But the past few years have brought a change in CFO recruitment. Because of Sarbanes-Oxley, a growing number of companies now want CPAs running finance. According to executive search firm Spencer Stuart, the number of CFOs-CPAs in the *Fortune* 1,000 has jumped from 26 percent to 45 percent since 2003. "We're seeing a real shift to CFOs with a technical accounting background," says Spencer Stuart vice chairman E. Peter McLean.

Does this mean that fewer CFOs will make it to the top, or does it mean one day more of those at the top will be accountants? One other shift in CFO recruitment may shed some light: in addition to wanting CPAs, large companies are also demanding that their CFOs have operational experience. "For every CFO search we are running, we have a request for someone who's done more than finance," says Peter Crist, chairman of executive search firm Crist Associates. Ten years from now, the result may be a truly exotic breed: the charming, operationally expert accountant-CEO. — D.D.

## Where to Find Financial CEOs

Ex-CFOs in the *Fortune* 500

Rank in <i>Fortune</i> 500	Company	CEO

## Airlines/Transportation

119	AMR	Gerard J. Arpey
232	Continental Airlines	Lawrence Kellner
318	Southwest Airlines	Gary Kelly
419	Laidlaw International	Kevin Benson

## Business Services

95	Electronic Data Systems	Michael H. Jordan
219	Aramark	Joseph Neubauer
277	Automatic Data Processing	Arthur F. Weinbach

## Construction

444	NVR	Paul Saville
469	The Ryland Group	R. Chad Dreier

## Consumer Products

17	Altria Group	Louis Camilleri
123	Coca-Cola Enterprises	John R. Alm
202	Pepsi Bottling Group	John Cahill
410	Maytag	Ralph Hake

## Energy/Utilities

86	Duke Energy	Paul Anderson
96	Plains All American Pipeline	Greg Armstrong
136	Premcor	Jefferson Allen
177	Tesoro	Bruce Smith
195	TXU	C. John Wilder
196	PG&E	Peter Darbee
199	Public Service Enterprise Group	E. James Ferland
209	CenterPoint Energy	David McClanahan
213	FPL Group	Lewis Hay III
221	Entergy	Wayne Leonard
256	Xcel Energy	Richard Kelly

288	Pepco Holdings	Dennis R. Wraase
310	Northeast Utilities	Charles Shivery
314	El Paso	Douglas Foshee
471	Wisconsin Energy	Gale E. Klappa
Financial Services		
53	Merrill Lynch	Stanley O'Neal
51	Allstate	Edward Liddy
81	TIAA-CREF	Herbert M. Allison Jr.
85	St. Paul Travelers	Jay Fishman
99	Nationwide Mutual Insurance	William G. Jurgensen
124	Northwestern Mutual	Edward Zore
161	Chubb	John D. Finnegan
208	UnumProvident	Thomas Watjen
319	Thrivent Financial for Lutherans	Bruce Nicholson
378	SLM	Thomas Fitzpatrick
461	Jefferson-Pilot	Dennis Glass
Health-Care/Medical		
73	Caremark Rx	Edwin Crawford
137	Express Scripts	George Paz
168	Tenet Healthcare	Trevor Fetter
172	PacifiCare Health Systems	Howard G. Phanstiel
371	Coventry Health Care	Dale Wolf
465	Henry Schein	Stanley M. Bergman
499	Kindred Healthcare	Paul Diaz
Manufacturing		
3	General Motors	G. Richard Wagoner Jr.

47	Lockheed Martin	Robert J. Stevens
57	Caterpillar	James Owens
63	Delphi	Robert S. Miller Jr.
70	International Paper	John Faraci
106	Deere	Robert Lane
149	United States Steel	John Surma
262	Smurfit-Stone Container	Patrick J. Moore
432	York International	C. David Myers
360	Ball	R. David Hoover
368	Harley-Davidson	James Ziemer
376	AK Steel Holding	James Wainscott
456	Engelhard	Barry Perry
481	Sealed Air	William V. Hickey

#### Media/Communications

33	SBC Communications	Edward E. Whitacre Jr.
446	NTL	Simon Duffy
449	MGM Mirage	J. Terrence Lanni
451	Avaya	Donald K. Peterson

#### Retail/Wholesale

43	Lowe's	Robert Niblock
45	Sears Holdings	Alan Lacy
147	The May Department Stores	John Dunham
347	CDW	John Edwardson
350	AutoZone	William Rhodes
358	Asbury Automotive Group	Kenneth Gilman
476	Nash Finch	Ron Marshall

#### Other

24	Pfizer	Henry McKinnell
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44	Archer Daniels Midland	G. Allen Andreas
101	Halliburton	David Lesar
168	Waste Management	David Steiner
269	CSX	Michael J. Ward
386	Darden Restaurants	Clarence Otis Jr.
405	Temple-Inland	Kenneth M. Jastrow II
406	Emcor Group	Frank T. MacInnis
428	Newmont Mining	Wayne Murdy
442	C.H. Robinson Worldwide	John P. Wiehoff

Source: Executive biographies