The strategic CFO: Charting the course for GE Capital
Today's Chief Financial Officers (CFOs) are playing a larger role in strategic planning than ever before. A 2010 Ernst & Young survey found that 35% of global CFOs already play an active role in defining overall strategy,¹ and according to KPMG, 62% of global CFOs believe they will play a larger role in developing and executing business strategy over the next five years.²

At GE Capital, our CFO, Jeff Bornstein, has always been involved in every aspect of strategy because our business is his business: finance. Jeff works closely with GE Capital's CEO, COO, CRO, Chief Regulatory Officer and Treasurer to create overall guidelines for strategic planning, maintain the focus on GE's growth strategy, manage risk, and monitor the execution of strategy. Elsewhere in GE, our CFOs also contribute heavily to business planning because strategy, finance and operations are so closely linked at GE that pivotal decisions cannot be made without them.

Since the financial crisis, the role of the CFO in strategic planning has become even more vital. In financial services, new rules are increasing both the time CFOs spend with regulatory compliance and the importance of incorporating regulatory risk into strategy. Across all industries, there is a greater focus on strengthening the link between enterprise risk management and strategy, and this is an area Ernst & Young believes will increasingly be the CFO's responsibility.

¹ Ernst & Young, The DNA of the CFO: A study of what makes a chief financial officer, 2010
Now more than ever, Jeff Bornstein is making sure that GE Capital’s strategy takes proper account of risk management and regulatory compliance. “As a result of the financial crisis, stress testing has become much more intense,” says Jeff. “We stress test several times a year, and this directly informs our strategic planning.”

Creating guide rails

Every year the CFOs of GE’s various businesses help to develop a strategic plan, known as the Growth Playbook, that includes three-year financial implications. Developing a Growth Playbook requires a rigorous evaluation of our business lines, portfolios and products. The process has the flexibility to accommodate unique characteristics of each business but the same overall framework is used by every business.

We consider how we have performed against the previous year’s goals, and look at both the present and future of our market. In light of those market conditions, we analyze our strengths, weaknesses and future prospects. Then, we set the strategy for meeting our growth targets and we consider the key actions necessary to implement the strategy, including how we will manage potential downsides and how we will keep our strategy on track. Finally, we consider the three-year financial implications and measures of our plan.

The purpose of this process is to ensure we allocate capital in the best way for meeting our growth targets. This translates into two fundamental questions for our CFOs:

1. What capital do we have available?
2. How should it be deployed?

At GE Capital, Jeff directs this analysis by creating what he calls “guide rails.” First, he considers a business’s ability to originate volume, the outlook for profit pools and opportunities in adjacent businesses. Then, he sets targets for the size of the balance sheet, the amount of equity and capital to deploy, and minimum return thresholds.

“Great ideas do not provide an advantage for long. It’s the ability to execute and underwrite that makes the difference over the long term.”

—Jeff Bornstein, CFO, GE Capital

In 2004, for example, Genworth Financial was a wholly owned subsidiary of GE that conducted most of our consumer insurance business, including life and mortgage operations. It was generating a return on equity (ROE) of about 10%. This was historically competitive in the insurance sector and, therefore, may have met the hurdle rate of many other investors. For GE, however, the ROE no longer met the target established by GE’s leadership. From 2004 through 2006 we spun off and then sold our remaining stake in Genworth Financial.

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Exhibit 1. Six steps in developing a growth strategy

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<thead>
<tr>
<th>Review last year</th>
<th>Define the market</th>
<th>Determine your future</th>
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<tbody>
<tr>
<td>How did we do against the list of actions from last year?</td>
<td>In the context of customers, suppliers, competition, and regulation, for what products, segments and geographies is your business distinctive?</td>
<td>In light of the realities you face, what are the key imperatives for your business over the next 15 years?</td>
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<th>Set the course</th>
<th>Go to action</th>
<th>Show the numbers</th>
</tr>
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<tbody>
<tr>
<td>What changes do you want to make to your business?</td>
<td>What are the key actions you are going to take?</td>
<td>What are the near-term financial implications and measures?</td>
</tr>
<tr>
<td>Consider new businesses, new technologies, changing your portfolios, growth from core business and the pace of change.</td>
<td>How will you ensure you stay on track? What potential downsides merit your closest attention?</td>
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“We try to stay in front of the market in terms of pricing, return and product innovations,” says Jeff. “Financial services is dynamic. Great ideas do not provide an advantage for long. It’s the ability to execute and underwrite that makes the difference over the long term.”

Focusing on core businesses
With the guide rails in place, the leaders of each of GE Capital’s businesses develop their own Growth Playbooks (which will be “rolled up” into the single Growth Playbook for all of GE Capital). The business leaders then discuss their Playbooks with GE Capital’s senior leadership team. One of Jeff’s key responsibilities in this conversation is to consider the context in which each business will operate for the next three years.

This context includes our customers, suppliers, competitive landscape, regulatory environment and long-term outlook. Jeff uses external sources of information that test our assumptions and conclusions in these areas. He also asks for analysis from money center banks (which are banks that lend to governments, corporations and other banks) and consulting firms based on the strengths of those external experts in particular areas of analysis. One group of experts, for example, with a solid reputation in debt analysis will provide a three-year forecast for the debt markets and the implications for our funding costs. Another group may have a specialty in providing the regulatory outlook.

Jeff also helps to make certain that growth plans are aligned with the strategic imperatives laid out by GE’s leadership, such as seeking growth from core and adjacent businesses and investing in new technologies.

“The key question is whether our expertise can be applied to create an outsized advantage and attractive returns.”
— Jeff Bornstein, CFO, GE Capital

Jeff feels he has an advantage in evaluating the expected risk-adjusted returns of such investments because of GE’s operating experience. For instance, our aviation financing business draws on our experience as the world’s leading supplier of aviation services and producer of jet engines. We are also a large investor in energy companies as well as a provider of energy products and services in 120 countries.

Our experience with midsized growth companies and with the beverage and agriculture segments was key to evaluating and supporting Duckhorn Vineyards. We understood how the long cycle times from planting to release would affect Duckhorn’s working capital, and we believed Duckhorn would satisfy our hurdle rates despite the worsening economic environment in 2008. We decided to participate in a multilender, senior loan facility. We continue to act as the lead bank and
administrative agent on a $124 million asset-based revolver and term loan. In 2010, Duckhorn posted its largest revenue and case volume ever.

As Jeff explains, the process of deciding to make investments like Duckhorn is often one of vigorous debate among leadership. “We don’t always agree and that’s good. Challenging strategy is an important step. GE has an ability to operate almost any business we would consider taking on. The key question is whether our expertise can be applied to create an outsized advantage and attractive returns.”

Proactively managing risk
Although the risk management and compliance functions technically report to the CEO at GE Capital, Jeff is responsible for regulatory compliance and controllership. In other businesses without a CRO or enterprise risk manager, the CFO’s direct role in risk management may be even greater.

Risk is part of the foundation of strategic planning within financial services. The potential for credit losses, for example, is fundamental to deploying capital. Jeff works closely with GE Capital’s CRO to understand risk and then ensure the risk contemplated in GE Capital’s Growth Playbook is within the risk appetite established by the board and senior management of GE.

The financial crisis demonstrated the importance of these efforts to manage risk proactively. GE Capital anticipated many of the risks that we ultimately faced, but in some cases we underestimated their magnitude. Our stress tests prior to the crisis, for example, showed some investments at breakeven in what we thought was the most likely worst-case scenario. Ultimately, those investments dropped below breakeven because of the unanticipated severity of the crisis.

The US Congress responded to the financial crisis with new regulations. The Dodd-Frank Wall Street Reform and Consumer Protection Act is changing the compliance landscape in financial services and requiring that CFOs spend more time working to anticipate and address regulatory change. At GE Capital, Jeff works with the CRO, the Chief Regulatory Officer and the Treasury team to make certain that their Growth Playbook includes the implications of known and potential outcomes of regulatory change. In a yearly session devoted to compliance, this team also considers their compliance obligations in much more detail, including the steps and resources necessary to meet them.

It’s a warning sign if performance, however good, doesn’t align with common sense.
Today Jeff oversees stress testing that is designed to be significantly more accurate than before the crisis. It occurs several times per year across GE Capital in extraordinary detail. The results inform the strategic planning process. If a portfolio, business or product no longer fits our risk-reward requirements, we change course, even though exiting the business will mean finding a replacement for that revenue stream. That revenue “hole,” however, is also a great opportunity to improve the quality and sustainability of our business.

Monitoring results
Winston Churchill said, “However beautiful the strategy, you should occasionally look at the results.” Each GE business holds regular results reporting and review sessions with the business’s senior management, including the CFO. In addition to monitoring strategic execution, these sessions provide information for GE’s required quarterly, annual and ad hoc reporting as a publicly traded company.

In the first half of the year, these sessions feed into the Growth Playbook, particularly when we compare our annual results to the prior year’s goals, describe the current state of each business, and contemplate the three-year financial implications of our proposed strategy. CFOs throughout GE, including Jeff, focus not only on businesses that are underperforming but also on those that outperform their targets. The first question we ask is how the targets compare to performance among peers; i.e., are we really under- or outperforming the market? The second question is: can we understand why? It’s always a warning sign if the performance, however good, doesn’t seem to align with common sense.

In the second half of the year, we take the Growth Playbooks, which have been approved by GE’s board and senior management, and turn them into operational plans for the following year. Current results are important to the operational plans, which can pick up where our businesses actually end the year. Once again, the CFO is vital in determining the basic elements of the operational plan and then approving the plan as it develops.

Conclusion
Jeff Bornstein thinks of the strategic and operating plans as GE Capital’s commitment to GE’s management, board and shareholders. His role is to help ensure those plans are based on the right assumptions and shaped by the right objectives. He also helps identify the downside risks, ensure they are managed, and prevent one of the biggest risks to business—poor execution. Throughout GE, our CFOs play a similar role, bringing not only finance expertise but also strategic vision to our most important business decisions.