



What is Finance Transformation?



PART 1: UNCOVERING MEANING

Finance Transformation (FT) is a broad term that is hard for people to precisely define. The word “transformation” is used so frequently that it is often hard to distinguish it from general improvement initiatives.

What is Finance Transformation?

We define transformation as the combination of people, process, technology and data changes to provide a dramatic improvement in overall performance. The key point is improvement in performance, which is not merely cost reduction. Many cost reduction efforts are cloaked in a transformation wrapper for a variety of reasons. Traditionally, transformations takes place because organizations evolve over time and are either not designed for outcomes or one not actively managed against those outcomes. A transformation program allows the organization to design an operating model that explicitly aligns to certain outcomes: mission/goals, stakeholder requirements, or measures of efficiency and effectiveness (cost or operational). A truly successful FT effort will result in more stability from which the CFO will be able to execute a culture of continuous improvement (CI) that will reduce the frequency of the upheaval that results from most FT efforts.

Why do we do it?

Organizations undertake transformation efforts due to a variety of reasons but they often fail to link the approach for the transformation to the underlying root cause for the transformation. For years the goal of finance transformation has been focused on reducing the cost of the finance function overall and cost to process individual transactions. This has led to CFOs being held to a pan-industry benchmark, finance spend as a percentage of revenue. The standard target being used, across industries CFOs are being asked to get this ratio to 1% or less. To achieve this, they focus on developing systematized solutions and the cessation of certain services.

- **Systems Solutions** – typically these are costly efforts that effect the broader organization. These large efforts are unwieldy and are seldom viewed broadly as a success.
- **Cessation of Services** – in order to meet the target, CFOs have had to resort to saying no to their customers. As one can imagine this impacts customer satisfaction and in turn CFO tenure.

Rather than focusing solely on reducing the cost of the finance function we would recommend undertaking FT efforts structured to better align finance to the key requirements of their customers. As a result, the outcomes of the FT effort should be directly linked to those requirements. For example, if the organization has a requirement for higher-end business services and analytics, then the finance function would need a more fulsome strategy than cost reduction alone. Here the organization would seek to reduce costs of transaction processing in order to re-deploy that spend toward providing an analytical hub with improved capabilities. This organization should also then look to recast target performance metrics to accommodate the new services being offered and as such the benchmark may be higher than 1% of revenue. Ideally, the finance function should identify leverage points so that the bundle of services demanded from their stakeholders is less than if those services were purchased ala carte but may still be more than the traditional 1% benchmark.

Root Cause vs. Metric Driven

While cost take out has been the objective for most FT efforts, these efforts typically relate to a set of common root causes. Understanding these root cause drivers can help your organization structure a more effective FT program.

- **System Driven** – a system driven transformation is exactly what it sounds like. If an organization has a mandate to switch out a major system (e.g. the system is an older version no longer supported by the vendor) then often it is a good opportunity for leverage to drive a step change in the performance of finance operations.
- **Culture Change** – organizations can become complacent or resistant to change. Also, due to “gravitational forces” work can become overly concentrated with a few individuals. In these cases, there can be a need to drive cultural change or rebalance the workload across the organization.

The Future of ERP Solutions

The underlying technology around financial ERP solutions has dictated the system driven transformation effort because there is no incremental way to introduce core accounting systems. However, FT efforts in the future will be less system driven as companies adopt more SAAS solutions. Smarter organizations are starting to build flexible financial systems architectures that leverage best-of- breed solutions that can be more easily replaced without having to replace the whole. To this end, we are seeing a shift back to the earlier days of ERP solutions where best-of- breed solutions were cobbled together versus acquiring one integrated solution from a single vendor. While integration offered obvious benefits the pace of innovation across the functional areas aggregated into that integration has slowed. As new SAAS solutions accelerate this innovation we are seeing a bit of a back to the future type renaissance of best-of-breed solutions (e.g. expense management, process management, etc).

- **Business Combinations** – business combinations are often a great leverage point and accelerant for enhancing the performance of the combined finance organization. This type of transformation can encompass all of the elements of the other types of transformation at the same time. This type of transformation is challenging as it must be woven into the process of post-merger integration which by itself is a difficult task. Often organizations will miss this opportunity to execute an effective FT program as other integration activities are often prioritized over FT.
- **Strategic/Skillset Driven** – due to shifts in the strategic direction or new regulatory or mandated requirements, new skillsets may be required within the finance function. Finance transformation can be utilized to identify new roles, develop robust training programs that align skills with the needs of the business, and realign career path opportunities to maintain and promote top performers.

By clearly defining the root cause for the FT effort, the organization will improve the alignment of outcomes with the expectations of the customers of finance. The organization can then develop an operating model that best meets these expectations. This will enable the finance function to focus resources on the activities that their customers demand.



Why Do We Repeat It?

Most finance organizations fail to execute skill development, career pathing, and creating a culture of improvement. For example, during the System Driven or Business Combination FT projects, which are the preponderance of FT projects, the following things typically happen to preclude organizations from executing these softer components that are critical for establishing a culture of continuous improvement (CI).

- 1 **Cost Cutting** – As the costs of the program rise, it is the natural reaction of every organization to seek to manage those costs down. FT programs often involve a systems transformation component and the core activities of which are hard to manage down or cut all together. The easier place to focus cost cutting is around the softer activities around org design and people development. These costs also tend to come toward the end of the project making them easier to cut.

- 2 Transformation Fatigue** – As the project wears on, the transformation activities naturally wear on your organization. Transformation Fatigue sets in. When this happens, executives and the collective organization will look for opportunities to waive the victory flag so that the transformation activities will end. Often the launch of the new system is what is latched on to and communicated as the victory event. Launching a new system is never the end of a successful project, there always remains a large amount of change management and process adoption required. People naturally want to revert back to the way “things have been done” which is obviously contrary to the FT effort.
- 3 Performance Metrics** – Every FT program should establish ongoing performance metrics. The issue is that many external advisors will throw standard metrics at their clients. While performance metrics are very important and can be a way to drive your organization to become more data driven, one must be careful in applying these metrics. You must factor in key business specific factors before blindly applying metrics. When evaluating metrics you must take into account situational factors such as organizational maturity, business strategy, industry type, etc. An example metric often used to drive cost reduction programs is finance as a % of revenue. However, if everyone is at 1% of revenue is the prize really reducing cost further? Should every organization blindly strive for this % of spend and as a result curtail potential opportunities for value creation?
- 4 Forward Looking Framework** – The FT participants are suffering from transformation fatigue and the success of the program is likely in jeopardy relative to success measures. Most organizations are looking for a way to close out their FT programs and save face. As such they tend to close out the project with an emphatic thud. That thud is your organization settling into the new paradigm and further progression is unlikely. Further progression is unlikely due to the fact that many organizations try to revert to a false sense of stabilization.

The construct of a stable environment is a framework that is a holdover of a bygone era and no longer applies to the realities of the current environment of constant change.

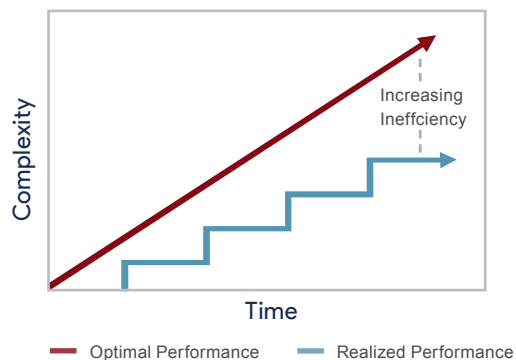
Organizations then miss an opportunity to create an organizational framework that will continue the desired trajectory for financial performance improvement. To create this framework, Finance organizations will need to shift their focus from pure annual cost take-out based to a multi-year portfolio return approach where the organization invests in finance capabilities but expects a return for that investment. Clarendon Partners has developed a framework we call the Finance R&D model that we expand on more fully in Part II of this series. This model is a hybrid between a venture capitalist (VC) and pure research and development (R&D) model in that it takes a multi-year portfolio view on investments in finance improvement initiatives.

If the finance organization does not come out of a FT effort organized and energized around a continuous improvement mindset, the organization will settle into how things are being done today. This causes the plateau effect. The organization will then remain at that level of performance until one of the following happens.

- New leadership arrives, a new CFO
- A step-change in technology forces the organization to evaluate new ways of operating
- A business combination occurs, which may also result in new leadership.

The following graphic demonstrates how the plateau effect results in organizational performance continuously underperforming the optimum.

FIGURE 1:
Total Complexity Over Time



Traditionally, the time from the beginning of the plateau to the emergence of a new transformation effort was about 10 years. Now given the more rapid development of disruptive technologies and the tenure of CFOs, the interval between transformation efforts has been decreasing rapidly. Many organizations are undertaking finance transformation efforts on similar intervals as they change their CFOs, around 5 years.

Requirements for a Successful FT Effort

As a company embarks on a finance transformation, there are a number of challenges that it will encounter across all levels of the organization.

A well-defined, integrated approach coupled with experienced personnel will help companies overcome these challenges.

To successfully execute a FT, your organization will need both experienced personnel who can design an operating model that is aligned to outcomes and personnel who can implement the changes necessary to achieve the operating model. The design team will provide the operating model which includes the future state organizational structure, the process architecture, the target systems environment, the optimal data model, and a targeted list of performance metrics. The design team should also define the roadmap of changes required to get from where you are today to the target state. The design team will often oversee the execution of the roadmap but specialist resources for each initiative should be engaged in order to implement the changes called for in the roadmap. If your organization has personnel internally with the right experience their participation can dramatically improve the result of the program. However, to be successful organizations typically rely on three knowledge components for success.

1 Knowledge and Experience – Typical transformation roadmaps cover numerous areas across organizational issues, processes issues, controls rationalization, systems implementation, data architecture etc. Often companies will try to fill all roles with outside resources from one consulting firm. There are pros and cons to this approach but the main thing is to make sure you do not sub-optimize the individual resources for the convenience offered by dealing with one firm.

2 Exceptional Project Management – Capability and discipline to manage the program and move it forward, this is more than standard project management. FT is a very daunting task and takes to deliver this capability you must have both strong functional project management expertise but also deep understanding of the breadth of activities that encompass a FT effort.

3 Institutional Knowledge – Knowledge of the intricacies of the organization. Typically this has to come from internal resources. Occasionally, organizations may have developed a long-standing relationship with a consulting partner who can fill this role but beware of trying to combine this role with components 1 and 2 above as the specific knowledge and experience with FT programs is paramount.

Choosing a partner for your transformation approach is a critical factor to your success. Some have compared transformation consultants to guru's but if you understand their motivation you can avoid the guru and find a true teaming partner {see call out}. It is important to remember that if done correctly your next finance transformation will become the first step in a journey of constant improvement. If your organization does not adopt the CI mindset you will find yourself caught in the transformation merry-go- round. See the next in our series on FT to find out how to get off the merry-go-round.

Beware of the Guru

Watch out for the FT Guru. They call themselves gurus because, charlatan not only doesn't fit in headlines ("FN1" required) well but it also doesn't inspire confidence of the people who will go through the transformational effort, YOUR ORGANIZATION! These Guru's will tell you that you will only be able to overcome the challenges faced by transformational efforts with their help and guidance. This is only partly true however as your Guru is likely operating in a manner that is akin to corner drug dealers. Their approach is to provide you with the encouragement needed to spur you into action, to get you to be like David and take the field against your Goliath. They tell you that they not only have the secrets of "Why" other companies have undertaken these efforts, but they also tell you that they have solved the mystery about "How" to address the challenges you will face. Last, they bring you to the tipping point by enticing you with the "Wow" of what you will get by successfully accomplishing this very dangerous mission. The Guru has an uncanny knack for knowing just how much "Wow" you need to taste in order to press you into action.

The problem with the Guru is that they are not there to help you create a sustainable method for avoiding transformation. They are there to provide you with a

combination of their experience and a framework that will help you through the transformation activities. These are very important things, however most gurus stop short of actually curing the root cause of your issue.

"I have been saying for many years that we are using the word 'guru' only because 'charlatan' is too long to fit into a headline."

*—Peter F. Drucker (b. 1909)
American Management Consultant*

These gurus are not in the business of curing you forever, they just want to have you go through cycles of remission. They know that once your new normal is established a performance gap will continue to compound over time and that will justify a new transformation effort that they can come back and lead you through the process again. This is great for them but bad for your organization. It is not a sustainable way forward as your company grow tired of these ongoing cycle of major transformation efforts and you will still not achieve the optimal performance you seek.

Clarendon Partners combines extensive industry knowledge with business skills that allow us to deliver pragmatic advice and guidance to help our clients improve performance, effectively manage risk, and gain insights from data in order to achieve their business objectives. Rather than following a formulaic methodology, we tailor our approach to each engagement to improve the outcomes for our clients.