



Introduction

Reinventing the CFO

EXCERPTED FROM

Reinventing the CFO:

How Financial Managers Can Transform Their Roles and Add Greater Value

BY

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INTRODUCTION

In the post-capitalist society it is safe to assume that anyone with any knowledge will have to acquire new knowledge every four or five years or else become obsolete.

—Peter F. Drucker, *Post-Capitalist Society*

TOO MANY CFOs have failed to heed Drucker's advice and keep their knowledge up-to-date. They remain prisoners of dysfunctional systems and mental models that were developed for a role that is fast becoming obsolete. Many spent their formative years working in accounting departments and had little contact with other people inside the organization. They focused on recording transactions, managing budgets, getting the accounts out on time, and preparing tax returns. They weren't expected to be part of the team running the business. And many operating people didn't seek their advice. CFOs were seen as unhelpful, always demanding answers to trivial questions about budget variances or expense claims. Now they are expected to be business generalists, risk management experts, and business intelligence sources. They are expected to provide instant replies to just about any question that the CEO asks about business performance. And

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they are expected to meet these new challenges with lower costs, which of course usually means fewer people.

CFOs are feeling these added pressures and leaving their jobs in droves. In a recent article in the *New York Times* entitled “Where Have All the Chief Financial Officers Gone?” one CFO encapsulated the feelings of many of his colleagues: “I got tired of spending years defending strategies I knew were flawed, of working with values that weren’t my own, of being responsible to chief executives and boards that were under huge pressure to perform.”¹ In the three years to November 2004, 225 CFOs of the *Fortune* 500 left their jobs.² This disaffection has also spread to their finance colleagues (a 2004 survey found that 34 percent of financial executives planned a career change in the next two years).³ They are often working extended hours and weekends to keep up (the average working week in 2004 was fifty-three hours, compared with forty-nine hours two years earlier).⁴ Sixty-two percent of finance executives indicated that they were under “great” or “very great” pressure at work, and 68 percent said they were under more pressure than two years earlier.⁵ Sixty-three percent said that the strain was affecting their health. Around 40 percent blame regulatory rules and staff cuts for their newly dismal working lives.⁶

While finance jobs have been cut the workload has remained the same and, in some cases, has intensified. One of the problems is that new technology has complicated rather than simplified finance practices. Managers are overwhelmed with irrelevant data and spurious measures. Though most have invested in enterprise resource planning (ERP) systems—companywide (integrated) accounting and management information systems that handle all related transactions from taking a customer’s order to collecting the cash—many have simply automated inefficient and ineffective processes. The potential gains have been lost. The truth is that the CFO’s resources are stretched to breaking point. The finance function has been benchmarked to death in recent years (the average cost compared with revenue has halved over the past ten years). Two-thirds of their shrunken departments are fighting to keep their transaction processing systems afloat while implementing new systems.

Despite this doom and gloom picture, there are many shining examples of CFOs who have made a real difference to the success of their organizations. These CFOs (some of whom we will meet in this book) have built highly competent teams that satisfy the needs of their management colleagues in a consistent and uncomplicated way. While they are recognized as integral members of the strategic management team, they maintain a strong, independent view and oversee effective internal controls and risk management systems. But, perhaps above all, they have time to spend with their people and with important stakeholders, including non-executive directors and investment analysts.

Why the CFO Is Under Pressure

Before we can talk about “reinventing the CFO” and “transforming finance” we need to better understand the pressures bearing down on the CFO. They come from two directions. One is from extensive changes in the external environment such as the rise of new competitive success factors, a new regulatory environment, and the increasing demands from shareholders. The other is from the changing needs of hard-pressed managers inside the business, especially the demand for better information and support to cope with the challenges of a more competitive marketplace and changing customer needs.

The External Pressures

Until the 1980s, the world of the CFO hadn't changed much for decades. Success was seen in terms of balance sheets bristling with buildings, plant, inventories, and receivables underpinned by income statements showing a healthy return on capital. The annual planning process dictated what was made and sold and informed people what they had to achieve by when. It was assumed that knowledge was accumulated at, and best deployed from, the center. But this view of corporate success was to change radically as

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the balance of power shifted from producers to consumers and from aging directors to young talented managers. Ex-CEO of General Electric Jack Welch neatly encapsulated this changing climate when he said, “we had constructed over the years a management apparatus that was right for its time, the toast of the business schools. Divisions, strategic business units, groups, sectors, all were designed to make meticulous, calculated decisions and move them smoothly forward and upward. This system produced highly polished work. It was right for the 1970s, a growing handicap in the 1980s, and it would have been a ticket to the boneyard in the 1990s.⁷ The boneyard is indeed where many stellar performers of the 1970s and 1980s found their resting place as they failed to adapt. Of the original thirty-six “excellent” companies listed in Peters and Waterman’s 1982 book *In Search of Excellence*, only two (Wal-Mart and IBM) remained in the *Forbes* top 100 companies in 2002 based on similar criteria.⁸

NEW SUCCESS DRIVERS. Many CFOs now realize that business success is no longer driven by physical assets and financial capital but by intellectual assets and human capital. Whereas in the industrial age the primary constraints on growth were access to capital and distribution channels, the primary constraints in the information age are talented people and information systems. To succeed in today’s marketplace, organizations need to respond rapidly to new threats and opportunities, attract and keep talented people, produce innovative products and strategies, continuously improve operational excellence, and attract and keep the right customers. The implications for performance management systems are far-reaching. CFOs need to rethink their planning, resource allocation and performance measurement systems to enable managers to focus on these new success drivers. Planning what to make and sell twelve to eighteen months in advance just doesn’t make any sense when markets are changing rapidly and customers can switch loyalties at the click of a mouse. Managers need to know where they are right now (not seven days after the end of the month) and what the next six to twelve months looks like so that they can influence those outcomes. These are challenging demands for most CFOs.

A NEW REGULATORY ENVIRONMENT. In recent years a wave of corporate governance scandals has shaken the self-confident world of finance to its core. Like a financial tsunami, the wave first hit U.S. companies such as Enron, WorldCom, and Tyco; devastated global accounting firm Arthur Andersen; and spread around the world to damage a range of companies from Parmalat in Italy and HIH in Australia to Vivendi in France and Ahold in Holland. These problems have driven governments and regulators worldwide to act. The best known example is the Sarbanes-Oxley (SOX) legislation in the United States. It mandates that both CEOs and CFOs must personally certify quarterly and annual financial statements as well as take responsibility for their accuracy. It has forced CFOs to tighten their internal controls and reporting procedures to the point of recording and documenting just about every transaction and communication. And it demands that directors must disclose any material changes in their financial conditions or operations on a “rapid and current” basis (i.e., within two working days). These regulations have absorbed huge amounts of time and cost and invariably deflected the resources of the finance team from the pressing needs of business managers (though in most of my CFO interviews the view was that much of the SOX work was necessary).

Another regulatory burden has been the upsurge in standards/pronouncements issued by accounting standards bodies. In particular, the switch from national to international financial reporting standards has absorbed the time of some of the brightest finance managers. Some of this is taken up by difficult consultations with (often unsympathetic) external investors as CFOs attempt to explain why the new rules have decimated reported profits but left the business fundamentals unchanged. Their message to investors is to look at cash flow instead of earnings per share, but in most cases it falls on deaf ears.

MORE DEMANDING SHAREHOLDERS. Shareholders used to be a fairly passive bunch, rarely turning up at annual meetings and almost never initiating motions. But shareholder activism has arrived with a vengeance. Not only are investors demanding more

information about current and future performance but they are also more prepared to challenge board proposals at annual meetings. According to the Investor Responsibility Research Center, shareholders filed some 1,126 proposals with U.S. corporations in 2004 compared with around 800 in 2002. Finance executives are dismayed by this new wave of investor radicalism. In a recent survey, 53 percent indicated that they are spending more time with shareholders than ever before, yet only 11 percent believe that adopting these shareholder activists' recommendations will improve their ability to create value for those investors.⁹ CFOs today need to be skilled communicators, especially when it comes to discussing the meaning of strategies and accounting results with analysts, investors, and financial journalists.

The Internal Pressures

A number of CEOs and their boardroom colleagues have been asking awkward questions about what finance does and how it adds value. Some are even asking, "While we need accounting do we really need accountants?" "Can't we buy in these services like cleaning or catering?" Replies such as "We are needed to prepare accounts," "We've always had a strong finance function," or "There are two hundred of us, so we must be adding value" are no longer sufficient answers.

CFOs have not taken these stinging criticisms lying down. Their aspirations for change were expressed in the 1997 book *CFO: Architect of the Corporation's Future*, written by the Price Waterhouse Finance and Cost Management Team. It used survey evidence to suggest that over the next three years, the costs of finance would be substantially reduced and that decision support would move from 10 percent to around 50 percent of the work of the finance operation.¹⁰ Looking at these predictions with the benefit of considerable hindsight confirms that their first prediction has come true. Finance costs have reduced from around 3 percent of revenue to around 1 percent for average companies. But their second prediction has been a long way wide of the mark. In fact,

decision support as a percentage of finance's work has hardly changed at all (it's still around 11 percent for average companies).

While most boards are happy enough that finance costs have been reduced, the rest of the organization is less than overwhelmed by the poor level of support it receives. The evidence of poor performance is extensive; indeed, finance has been subjected to more surveys and benchmarking studies than most functions over the past five years. Finance journals and consultants do regular surveys of the finance operation. While these surveys are not always as rigorous as they might be, they are so numerous and their results so similar that they paint a credible and consistent picture of poor performance. They show that there is too much detail and complexity, not enough time for decision support, inadequate forecasting capability, too little understanding of how to reduce costs, too many measures, and a lack of risk management expertise.

TOO MUCH DETAIL AND COMPLEXITY. The technology "bandwidth" is widening every year, and the resulting data flow throughout the organization is overwhelming managers' ability to make sense of it. Of 158 corporate executives surveyed in late 2003, half said that the amount of information available to their businesses had doubled or tripled since the previous year.¹¹ "Can't see the forest for the trees," "swamped with information," and "drowning in detail and thirsting for knowledge" are all regularly heard comments. And the problem has got worse since the introduction of Sarbanes-Oxley, which demands that organizations keep just about every document (including e-mails) that flows through the organization every day. According to one expert, between 10 and 30 percent of recorded data is inaccurate, inconsistent, incorrectly formatted, or entered in the wrong field, so one can only imagine what the storage and retrieval problems will be.¹²

The average large organization wrestles with ten different ledger systems, twelve different budgeting systems, and thirteen different reporting systems—in comparison, best-practice companies have standardized on a single platform.¹³ And within these systems

there are far too many accounts. One large U.K. company had over five thousand general ledger accounts, but when it analyzed the data flow it found that only 250 accounts had more than two entries in a year. The trouble is that each account is a building block in the budgeting and reporting system with consequences for further analysis and management workload. Part of the reason for this level of detail is that local managers don't want to be caught out if and when they are asked detailed questions. Too many boardroom members demand answers to trivial questions about, for example, why this quarter's telephone account was higher than budget when they should be more concerned with where the organization is heading and whether managers are taking the right actions to execute its strategies.

One of the key drivers of detail and complexity is the annual planning and budgeting process. For the typical company, this takes up to nine months, with four months spent on strategy and another five months spent on financial planning and budgeting.¹⁴ A senior manager at a global carrier explained the problem: "At 475 pages and 3.5 kilograms in weight, our budgeting manual is a major cause of deforestation! There are thousands of budget centers and it takes nine months to put together, soaking up around 20 percent of management time (we estimate the annual cost at around €30 million to €35 million). It all amounts to a huge distortion of people's behavior and a complete waste of everyone's time."

There is a pervasive belief that greater detail leads to greater accuracy—the average company's plan has 372 line items.¹⁵ This doesn't make sense. Finding and focusing on the right performance drivers (and there are only a few of them) is far more important than spending weeks and months preparing detailed budgets and forecasts. Mistaken assumptions at the bottom of the budgeting or forecasting pyramid can grow exponentially as they affect other assumptions higher up. The best finance functions spend 44 percent of their planning time on forecasting and action planning, compared with only 20 percent in average companies.¹⁶ Detailed and complex planning and budgeting systems make it difficult for finance professionals and operating managers to focus on the key issues.

NOT ENOUGH TIME FOR DECISION SUPPORT. While the finance function has shrunk under the pressures of benchmarking, few CFOs have realized their aim of transferring resources from transaction processing (e.g., accounts payable/receivable, travel and expense, fixed assets, credit, collections, customer billing, general accounting, external reporting, project accounting, cost accounting, cash management, tax accounting/reporting, and payroll) to decision support (e.g., cost analysis, business performance analysis, new business/pricing analysis, and strategic planning support).¹⁷ Average finance operations spend 66 percent of their time on transaction processing and only 11 percent on decision support (compare this with 50 percent and 20 percent, respectively, for leading-edge finance operations).¹⁸ And analysts at average companies spend 51 percent of their time just searching for data for standard reports, against just 13 percent of the time of analysts at world-class companies.¹⁹ It is hardly surprising that only 37 percent of senior executives believe that their own finance department does a good job of decision support (54 percent said it was average and 9 percent said it was poor).²⁰ Part of the problem is that finance keeps adding new measures and reports without taking anything away. And analysis codes and reports remain in the system long after anyone can remember why they were needed in the first place.

One way to reduce routine work and create more time for decision support is through the effective use of technology. But finance has not taken advantage of this opportunity. Only 2 percent of systems are fully integrated and 69 percent partly integrated; 29 percent are not integrated at all (i.e., they are made up of multiple-legacy systems).²¹ This means that a lot of time is spent rekeying in data. “You’ve got people customizing and formatting spreadsheets for the majority of the day rather than providing insights into business performance,” notes Cody Chenault, finance practice leader at the Hackett Group.²²

INADEQUATE FORECASTING CAPABILITY. Many CFOs are trying to focus less on annual budgeting and more on regular

forecasting. But it takes an average of fifteen days to develop a forecast. At one global company there were seventy-five levels of review and consolidation; consequently, it took a huge amount of time and effort to produce a forecast. Such was the detail involved that it took one business unit alone 585 people days over eight weeks to produce a forecast that was immediately out-of-date. Not only do forecasts take too long, but their quality also leaves a lot to be desired.²³ According to a 2004 survey, only 21 percent of executives said that finance was any good at preparing forecasts (25 percent said they were hopeless).²⁴ The forecasting system is also too limited in outlook. In most cases, forecasts are geared to keeping on track to meet the target numbers rather than informing strategic reviews that go beyond the next fiscal year-end.²⁵ Consolidated forecasts take too long and often involve too many spreadsheets with variable methodologies and algorithms.

TOO LITTLE UNDERSTANDING OF HOW TO REDUCE COSTS. Leading-edge companies have lower costs than their rivals. They spend less on finance than their average counterparts (0.56 percent versus 1.06 percent of revenue); they spend less on human resources per employee (\$1,008 versus \$2,299); and they spend less on information technology (IT) per user (\$391 versus \$661).²⁶ Some of the reasons are structural; for example, flattening the hierarchy and moving transaction processing to shared services units (or outsourcing it to a third party). Others are based on process improvements, making more effective use of technology and removing the “budget protection” mentality. Cost budgets have a lot to answer for. They set a ceiling for spending but they also set a floor below which no self-respecting manager will allow his or her resources to fall without a fight. They will justify every expense line item and make every argument as to why their business will suffer if resources are cut. And to support their claims, they will spend every cent whether justified or not. CFOs need to be more aware of the hidden costs inside their organizations—poor quality, unnecessary work, misaligned (or unnecessary incentives), absenteeism, staff turnover, errors and rework within the

transaction processing system, wrong acquisitions, and many more—that don't appear on budgets or profit and loss accounts.

TOO MANY MEASURES. The number of measures keeps growing. Companies report an average of 132 metrics to senior management every month (83 financial and 49 operational).²⁷ This is more than six times the number recommended by Kaplan and Norton for a balanced scorecard.²⁸ This measurement mania has been one of the primary factors why the majority of balanced scorecard implementations fail to realize their potential.²⁹ The average management report is not only far too long and complex (usually including thousands of data points) but managers typically use only a fraction of the information.³⁰ This complexity slows down month-end reporting and makes organizational change a nightmare for the finance department. For the average company, monthly close times *rose* from an average of 5.2 days in 2003 to 5.5 days in 2004. It takes a further six days to provide monthly reports—that's eleven days after the month-end.³¹

Managers are lost in a fog of measurement. Few measures provide useful information about what's happening now and where the business is heading—for the average company, 85 percent of measures are internal and 75 percent are based on lagging indicators.³² Even fewer lead to action and change behavior—57 percent of companies still report all budget variances.³³ Another problem is that most measures focus on what can be easily measured (e.g., functions or activities) rather than what *should* be measured (e.g., customer value). An effective measure should help managers to understand and improve performance and to this extent should be an integral part of the work they do. Few measures pass this test. The real casualty is learning and improvement.

LACK OF RISK MANAGEMENT EXPERTISE. Only 19 percent of executives believe that their finance colleagues do a good job of managing risk.³⁴ Too much reliance is placed on keeping within budget guidelines and not enough support is focused on how risk and uncertainty affect decision making. Inappropriate stretch targets

reinforced by financial incentives are often the cause of excessive levels of risk taking and unethical behavior as managers strive and strain to meet them. A divisional director whose compensation is loaded with short-term profit incentives is more likely to accept a high-risk opportunity with a payback within the fiscal year. A purchasing manager given a target of reducing costs is likely to order in bulk or pay suppliers late but has no responsibility for the poor quality of the products bought, the costs of high inventories, or the deteriorating relationships with suppliers. A pensions salesperson will sell those products that provide her with the highest commissions rather than those that fit the client's needs. These behavioral problems are not caused by mischievous managers, nor are they isolated examples. They are *systemic*. That's why the CFO needs to transform the whole system.

A New Vision for the CFO

I've spent the past twelve years talking to finance managers about how to improve their performance. With my colleagues at the Beyond Budgeting Round Table, I have spoken to hundreds of managers and written dozens of case studies about a wide range of organizations and across a variety of industries and countries. I have little doubt that there is a striking correlation between excellent financial management practices and wider organizational performance—in a recent survey of European companies the top-ranking CFO and CEO came from the same company in fourteen out of thirty-one industry sectors.³⁵

Part of the reason is the link between performance management processes and management behavior. Whenever I see management processes that are designed to control performance through a plethora of targets, budgets, incentives, and measures, I see bureaucratic systems, uninspired leaders, and frustrated managers who are not trusted to make decisions. This usually points to an organization with a poor-to-average long-term growth record. Conversely, whenever I see management processes that are designed to

FIGURE I-1

Two visions for improving the finance operation

Vision A	Vision B
<ul style="list-style-type: none"> • Increase targets, measures, and controls • Improve financial and accounting expertise • Tighten top-down planning and control • Manage costs through tighter budgets • Measure to tighten accountability • Manage risk through better procedures 	<ul style="list-style-type: none"> • Reduce targets, measures, and controls • Improve business analysis skills • Enable local managers to respond to events • Eliminate costs that add no value • Measure to learn and improve • Manage risk by raising competences

support local decision making within a framework of clear principles and values, and with measures designed to support learning and improvement, I see a lean head office with few directives, inspired leaders, and energetic managers who are trusted to make decisions based on continuously improving their performance. These organizations are usually at or near the top of their peer groups.

I also attend many conferences for finance executives and listen to their visions of improvement (invariably reinforced by consultants and IT vendors). These often include using the increasing power of IT systems to tighten top-down financial control (Vision A in figure I-1). IT vendors play to the audience by emphasizing fast drill-down capabilities and detailed analysis. Their systems can tell you how many blue pens were bought in the Mauritania office in the third week of February this year compared with last year. And their planning systems allow you to key in the desired profit figure and tell you how much of product A or B you need to make and sell.

It is a vision of control by detailed analysis and measurement, usually against a predetermined target or budget (one practitioner, the U.K. National Health Service, sets around 750 targets, of which 450 were added in one year alone!). It is rooted in the age-old (but dismal) economic theory that people are driven by self-interest and respond only to the “carrot-and-stick” style of management. It is a vision of cost reduction through economies of scale, either through acquisition and rationalization or through frequent reorganization. And it is a vision of “fixing” identified

problems (e.g., using key performance indicators (KPIs) to fix the “measurement” problem or a rolling forecast to fix the “forecasting” problem) rather than seeing the whole interdependent performance management system itself as the problem. This vision comes from a mind-set that sees business performance improvement through the lens of managing results through accounting numbers. W. Edwards Deming once said that while we need good results, “management by results is not the way to get good results. It is action on outcome, as if the outcome came from a special cause. It is important to work on the causes of results—i.e., on the system.”³⁶ Those who manage by results focus on the bottom-line target and consider that achieving financial goals justifies short-term actions. The result, alas, is usually more complexity, more work (and higher cost), and the wrong behavior.

Unlike Vision A, Vision B (see figure I-1) is not about more contracts and controls. Nor is it about quick-fix solutions. It is about applying a number of clear and simple principles and practices that lead to the liberation of both the finance team and their management colleagues. It is rooted not in self-interest but greater trust and cooperation. It means simplifying everything finance does and freeing them to provide effective decision support and performance insights that really help managers to improve their results. Instead of using crude targets to drive performance results, the CFO believes that a better and more sustainable approach is to relentlessly focus managers on improving processes that, in turn, will lead to increasing levels of customer value and higher levels of profitability than peers. This approach encourages managers to eliminate costs that add no value, use measures to improve their work, and make sensible risk-adjusted decisions. Managers are accountable with hindsight for their results compared with peers, prior years, and benchmarks. Words such as *clarity*, *simplicity*, *transparency*, and *accountability* best describe this vision. This is how finance becomes a valued and trusted business partner.

This book explains how Vision B has been implemented at a number of leading organizations around the world. The CFO can be its champion and, in some cases, even its leader. Gary Critten-

den, CFO of American Express, articulated this vision when he said that, “an ideal finance function spends very little time on reconciliations and a minimal amount of time reporting on what has happened. Instead, a great organization spends the majority of its time trying to anticipate what’s going to happen in the future, making sure the company’s resources are allocated to the most important opportunities that it has, and to ensuring that the company operates with tight controls and great processes.”³⁷

In the seven chapters that follow, we will look a number of key issues that the CFO and the finance team must deal with to travel along this road successfully and transform the finance operation.

- *Chapter 1—The CFO as Freedom Fighter.* The first task for the CFO is to liberate both finance and business managers from huge amounts of detail and the proliferation of complex systems that increase their workload and deny them time for reflection and analysis. This means purging their systems, measures, and reports and eradicating work that adds little value (e.g., detailed planning processes, redundant systems, and irrelevant reports). It also means being more wary of implementing new tools and IT systems that soak up valuable time and money but fail to provide reasonable value. Creating space and time for higher-value work is the crucial step that turns transformation rhetoric into practical reality.
- *Chapter 2—The CFO as Analyst and Adviser.* Breaking free from detail and complexity creates time for finance to provide the information that managers need to make effective decisions. But that alone is insufficient to build a credible finance team that will be seen by managers as a trusted and valued business partner. The CFO must also work hard to attract and keep the best people and build the right team: people who know the business, can achieve high-levels of analytical skills, and are able to contribute improvement ideas. They will also be able to communicate effectively and work in teams. They will become teachers and mentors as

they spread financial knowledge and decision-making capabilities across the organization. They will also use technology to eliminate low-value work, improve controls, and deliver information in a timely way. In this way the finance team can earn its place at the strategy table by delivering value-adding services and performance improvement insights. A strong, independent view on investment decisions will also add to their credibility.

- *Chapter 3—The CFO as the Architect of Adaptive Management.* Managers will feel truly liberated only if the CFO can release them from the chains of the detailed annual planning cycle and replace targets and budgets with more effective steering mechanisms, including continuous planning reviews and rolling forecasts, that enable managers to sense and respond more rapidly to unpredictable events and to changing markets and customers. The CFO must also be prepared to devolve some planning and decision-making scope and authority to frontline teams, otherwise the benefits of faster response will be lost. But controls are not compromised; in fact they are strengthened as managers use fast actuals, key performance indicators, rolling forecasts, and trend analysis to influence future events rather than dwell on past results. Target-setting and performance evaluation systems also need to be changed. Measures of relative improvement against peers and prior periods replace annual targets as the primary approach to performance appraisal. This enables managers to focus on managing reality rather than the plan.
- *Chapter 4—The CFO as Warrior Against Waste.* With more time to add value, the CFO and the finance team are able to focus on eliminating huge swathes of costs that have remained unchallenged for years. The aim should be to flatten the hierarchy, centralize and standardize transaction processing, and ensure that all projects are necessary and add value. The CFO must also learn and apply the lessons

from lean thinking, a concept elegantly summarized by Taiichi Ohno, architect of the Toyota Production System: “All we are doing is looking at the time line from the moment the customer gives us an order to the point when we collect the cash. And we are reducing that time line by removing the non-value-added wastes.”³⁸ Eradicating non-value-adding work from all processes has the potential to cut costs while improving cycle times and customer service. Such cost reductions will make the organization more flexible and competitive. But some of this work will need the support of other key people including the board.

- *Chapter 5—The CFO as Master of Measurement.* The CFO needs to bring measurement back under control and provide clear guidance about its meaning. Managers at every level only need six or seven measures. Measures should relate to purpose and strategy and be used to enable local managers to learn and improve. They should not be linked to targets, otherwise managers will change their behavior, taking actions to meet those targets instead of more value creating alternatives. At the higher level, senior managers see patterns and trends and need intervene at local levels only if these show abnormalities that warrant detailed explanations.
- *Chapter 6—The CFO as Regulator of Risk.* The CFO needs to provide an effective framework for good governance and risk management. This can be done by using multiple levers of control that support corporate governance controls, internal controls, strategic controls, and feedback controls. The pressure points that encourage excessive risk taking need to be identified and dealt with. Risk management also moves from a narrow focus on individual units and projects to a wider focus on the whole enterprise and the project portfolio so that the right balance of risk can be effectively managed. Managers should be encouraged to approach future uncertainty with an open mind rather than see risk

management as just another hurdle to overcome to get their investment proposals accepted. The CFO must insist that risk management is everyone's responsibility, not just the province of specialists.

- *Chapter 7—The CFO as Champion of Change.* In this final chapter we will look at how a number of CFOs have transformed their finance operations, examining how they started, what vision or goals they set for themselves, how they got buy-in from key people, and how they implemented the changes. It will include a number of case examples, including American Express, Tomkins, and the World Bank.

The Transformation Journey

The transformation road is a tough one to follow because it challenges many of the finance team's accepted practices and systems. These problems must be recognized and the difficulties faced before the journey can begin. A good place to start is by understanding what transformation really means. The formula $D \times V \times F > R$ describes the task well (D = dissatisfaction, V = vision, F = first steps, and R = resistance to change). It tells us that dissatisfaction, no matter how deep, is not enough on its own. There must also be a compelling vision of how the new organization will look and feel when we get there. But even these two together require a third partner—a clear understanding of the first steps along the journey to build credibility and thus take key people with you. All three must be in evidence and in sufficient strength to overcome the resistance to change.

An increasing number of organizations are building first-class finance operations that support a management culture of learning and improvement. Though not an exhaustive list, here are some that stand out (in alphabetical order).

- *Ahlsell:* A \$1 billion Swedish distributor that is consistently at the top of its peer group in terms of profitability. It has acquired twenty-three companies over the past eight years.

Each one immediately becomes part of its unique performance management model. Fixed targets disappear. Business units are placed in league tables (they are usually shocked to find how poor their relative performance is). Each unit is accountable for its profitability and can make its own decisions. There is a constant dialogue with central support. Quarterly rolling forecasts are prepared by each team and quickly consolidated at head office. Performance management systems support self-regulation rather than central control.

- *American Express*: A \$29 billion U.S. financial services company that has improved to such an extent over recent years that it now has the highest price/earnings ratio in its peer group. It has introduced a streamlined planning process with an emphasis on driver-based rolling forecasts. It no longer allocates resources months in advance. It looks at its forecasts every month and decides its funding priorities from a list of applications from business units. The result is less gaming of resource requirements, more accountability for funds and better alignment with strategy. The company has also reduced costs dramatically by moving from many data centers to only a few low cost shared services centers.
- *Cognos*: An \$800 million Canadian software company that is one of the software industry's fastest growing and most profitable companies. It is a world leader in corporate performance management (CPM) and business intelligence systems that enable continuous planning, forecasting, reporting, and control. In recent years it has upgraded its internal systems and now provides business intelligence and real-time performance information to many users, thus improving its compliance and control systems dramatically.
- *GE Capital*: A U.S.-based company with assets of approximately \$600 billion that serves consumers and businesses in forty-seven countries around the world. It has a reputation for being one of the best finance functions in America and has often been called the "jewel" in the GE crown. The way

it develops finance talent is exceptional and many graduates of its development program go on to become stars in the wider General Electric group and beyond.

- *Svenska Handelsbanken*: A \$2 billion universal Swedish bank with ten thousand employees and six hundred profit centers, Handelsbanken is one of the most cost-efficient and profitable banks in the world. It transformed its performance management systems over thirty years ago. It produces fast and reliable numbers with no fixed performance contracts to distort behavior. Each region and branch are compared with their peers in monthly league tables based on a few simple metrics. Information is fast and open. Branches can produce income statements online and deconstruct them by customer.
- *Telecom New Zealand*: An innovative telecommunications company that provides a full range of Internet, data, voice, mobile, and fixed-line calling services to customers in New Zealand and Australia. With revenues of around NZ\$5.2 billion (70 percent in New Zealand and 30 percent in Australia) the company has overhauled its performance management systems in recent years; this has contributed to its exceptional performance. In the past few years its share price has outperformed its rivals to a significant degree.
- *Tomkins*: This \$5 billion Anglo-American multiproducts company has a hundred separate units reporting directly into a small head office. Units now report with the aid of “flash” rolling forecasts on the fourth working day *prior* to the month-end, together with eighteen-month quarterly rolling forecasts. This puts the board in control. There are no fixed contracts; teams are rewarded based on their improvement over prior years. Units have more autonomy and more accountability. Forecasts are now the primary management tool and are separated from performance measurement. Gaming behavior has evaporated and the willingness to disclose problems has improved. In the past

few years, Tomkins's shares have outperformed the index by 25 percent.

- *Unilever*: An Anglo-Dutch organization with sales of €43 billion and 234,000 employees that is one of the world's leading suppliers of fast-moving consumer goods. For the past few years it has been transforming its finance operation, including reforming the target-setting and performance evaluation process. Though it's still early days, the signs are that these changes are supporting a companywide transformation in performance.
- *The World Bank*: Provides loans, policy advice, technical assistance, and knowledge sharing services to low- and middle-income countries to reduce poverty. While the bank invests around \$20 billion p.a. in developing countries, it also spends around \$1.9 billion p.a. on operating expenses and has always operated with a traditional budget. But in recent years the finance team has been challenging how this process works, and concluded that it takes too long, costs too much, and adds too little value. So the team has introduced a more strategic, cost-effective process underpinned by quarterly performance reviews. The new project is known as "budget reform."

This book will explain how CFOs and their finance teams can remove many of the major barriers that otherwise prevent the transition to a more *adaptive*, *lean*, and *ethical* organization. It is a challenging road to follow, and I am not promising an easy ride. All I can say is that the prize on offer is well worth the effort.

A CHECKLIST FOR THE CFO

- If you and your finance team are regularly working overtime and weekends (usually unpaid!), don't you owe it to yourself and your team to do something about it? Start today!

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- Ask yourself what's causing this overtime and stress. Are your efforts at improvement making the organization less or more complex? Are you trying to cope with too much detail? Are you implementing too many systems? Have you cut jobs but left the workload the same (or actually increased it)?
- Look at the finance operation in the mirror and make an honest assessment of its performance compared with best practice organizations. How good are you at planning, budgeting, forecasting, reporting, and risk management? Conduct an opinion survey among both finance and business managers.
- Talk to board members and operating managers and ask them whether they are getting the information they need when they need it. What more do you have to do?
- Do you know your critical success factors? And are they aligned with your strategies, measures, goals, and actions? If not, this could be a major cause of the wrong actions and behavior. If they are, communicate them to all stakeholders (including investors).
- What is your vision for improving the finance operation? If it is Vision A (more top-down targets and controls) then think again. You are probably tinkering at the edges and not tackling the real (systemic) problems. What's worse, you are probably stifling ambition and innovation.
- Set your course for Vision B. This will take you in a different direction—toward an adaptive, lean, and ethical organization. It is not just more uplifting, but it will also enable finance to have a huge impact on the performance of the whole organization.

NOTES

INTRODUCTION

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