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Shifting sands: focusing finance in the 21st century

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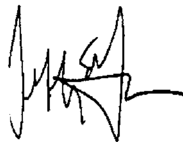
Before you read this Innovation in Action paper, let me warn you – it's a shot across the bow of finance organizations everywhere.

But that's the purpose of The IBM Cognos® Innovation Center for Performance Management: Provoke. Stimulate. Engage. Our member organizations share a belief that business as usual is not an option, if you want to improve performance dramatically.

This is the first in a series of six articles establishing a new agenda for finance by David Axson and Greg Hackett, partners in The Sonax Group and co-founders of The Hackett Group. They contend that finance is stalling in its necessary transformation from low-value bean counters to value-added business partners.

David and Greg are advisors to the Innovation Center. They also are unflinching advocates for innovation in business management practices and uniquely suited to question the effectiveness of the status quo and to urge companies toward better ways of doing business.

Subsequent articles will describe this new vision in more detail and lay out an implementation road map. Read on as David and Greg make the case for change and deliver a wake-up call to today's finance leaders.



Jeff Holker
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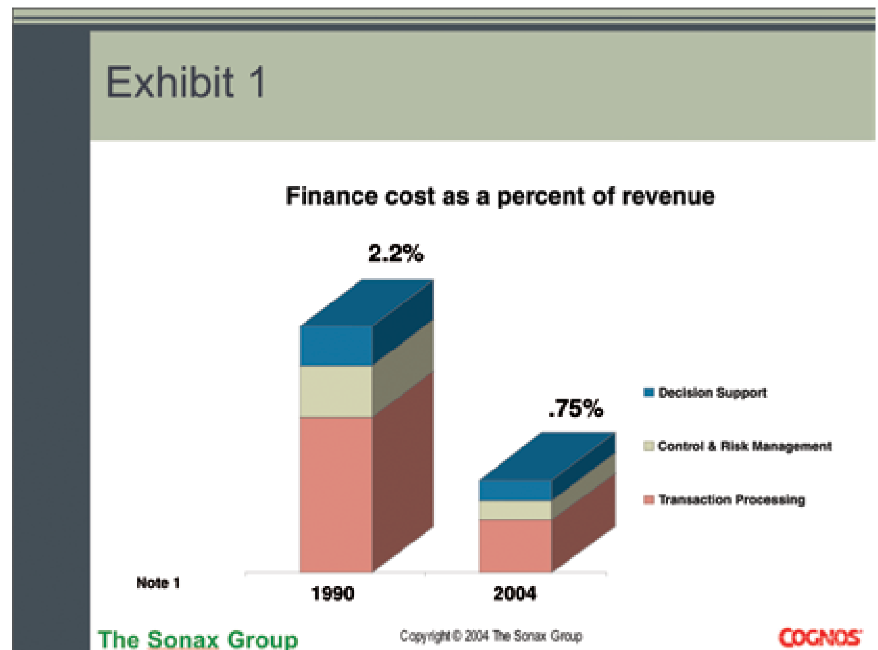
Finance is wasting its time

Over the past 15 years, finance has embarked on a much-needed turnaround from being unresponsive bean counters processing lower-value transactions and enforcing controls. Dissatisfied with being seen as expensive overhead, finance laid ambitious plans to operate more efficiently, refocus on higher value-added activities, and contribute as a true business partner.

But a progress check shows that finance's vision has only been partially realized. True, costs have declined significantly, and productivity has improved. In 1990, finance cost the typical company 2.2 percent of annual revenues; today that cost has dropped to 0.75 percent – a 66-percent reduction. (See Exhibit 1.) Re-engineering has decreased work steps and headcount, with the reengineering opportunity sized by benchmarking. Shared services proved that transactions could be processed centrally, rather than in a distributed fashion. ERP systems forced process standardization, provided more and better data and enhanced communications, with the Web introducing further streamlining and automation. Balanced scorecards brought new insights to management. A stricter regulatory environment gave responsibility to finance to keep greater vigilance on behalf of stakeholders. Finance upgraded its skills to align with the new tools.



The Hackett Group, Best Practices Conference 2004

But looking more closely at the results reveals that transaction processing still accounts for two-thirds of finance work, unchanged over more than a decade. Redirecting resources to higher value-added activities was the goal. Yet planning and budgeting remain burdensome and ineffective. Risk management has in many cases weakened, permitting scandal after corporate scandal, due to reliance on detective-based reporting and controls. Decision support is not noticeably better, still embedded in reactive mode rather than delivering insightful, predictive information that can help executives make better decisions faster.

In short, the job is only half done. Finance has not switched gears. The liberated resources were not redirected. Finance is still largely viewed as overhead. The bean counter image reigns.

But, astonishingly, finance remains mired in cost and productivity improvement activities such as benchmarking, chasing after best practices, and streamlining processes and controls. Teams beaver away at continuous improvement efforts, building and running shared service centers, installing or upgrading ERP systems, and migrating processes to the Web.

Finance is wasting time. Marginal cost reductions are all that remain to be realized. External yardsticks such as world-class cost metrics have run their useful lives. Shaving another $0.02 per transaction is not worth the effort; it diverts resources from realizing true business partner status and providing genuine organizational worth.

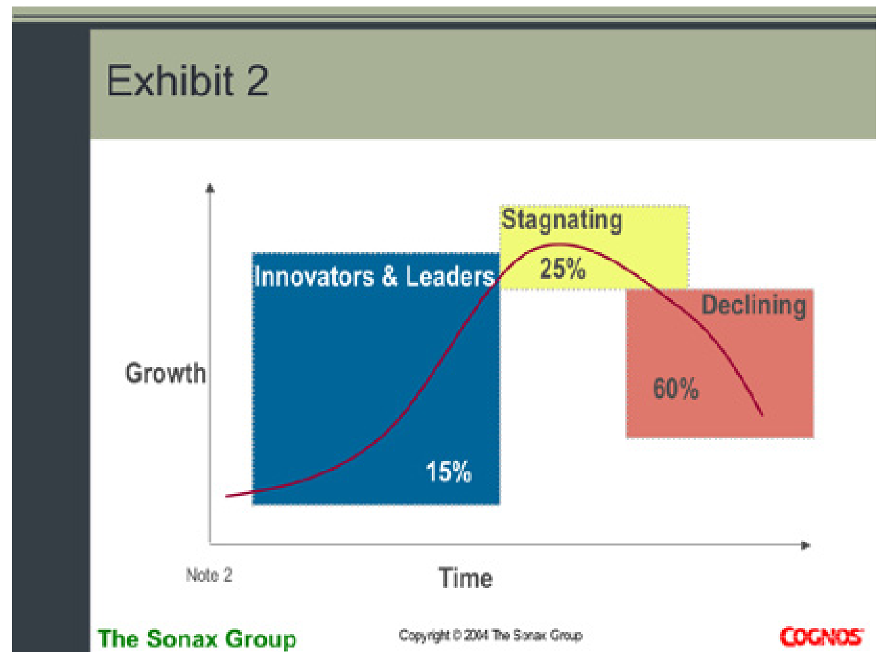
The answer is clear—finance should stop performing all transaction processing and administrative work as soon as possible—whether or not the organization is approaching world-class cost and productivity performance. Finance should outsource such work to experts who will sustain lower costs, ensure service levels, shoulder technology risk, assume capital investment— and free up significant finance staff time. Further, finance should lead the entire organization in this direction, outsourcing not only finance and accounting work, but also the employee, supplier, and selected customer processes and all information technology. Outsourcing to third-party experts has reached a degree of maturity and competence largely not available ten to 15 years ago.

Finance should not be in the business of transaction processing or management reporting in the 21st century. Instead, finance should be focusing exclusively on the shifting sands of organizational survival.

The tough battle for corporate survival

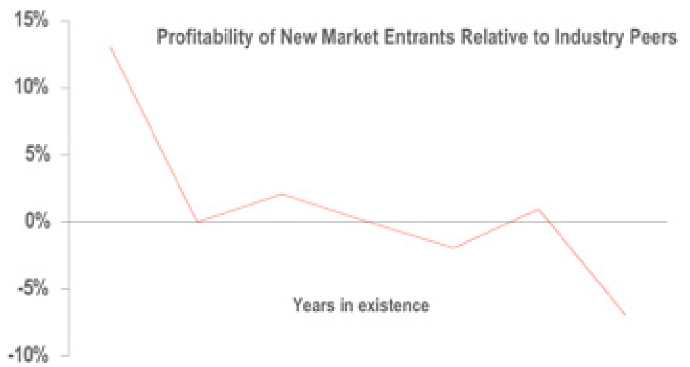
Indeed, many companies today are fighting a tough battle for continued existence. Yet, most are unable to recognize that they are stagnating and dying. And finance is best positioned to sound the wake-up call, lessen the steepness of decline, lengthen the life of a flagging company, or seek new opportunities that can fill the void. But finance cannot do the job if its focus is on the wrong thing: processing transactions and reporting results.

If the life cycle of a corporation were plotted on a standard bell curve, at any given time, only about 15 percent of companies would be in their ascendancy – today's innovators and leaders. An additional 25 percent sit at the top of the bell, mature (and stagnating). The remaining 60 percent are encumbered by moribund products or markets and are in decline. (See Exhibit 2.)

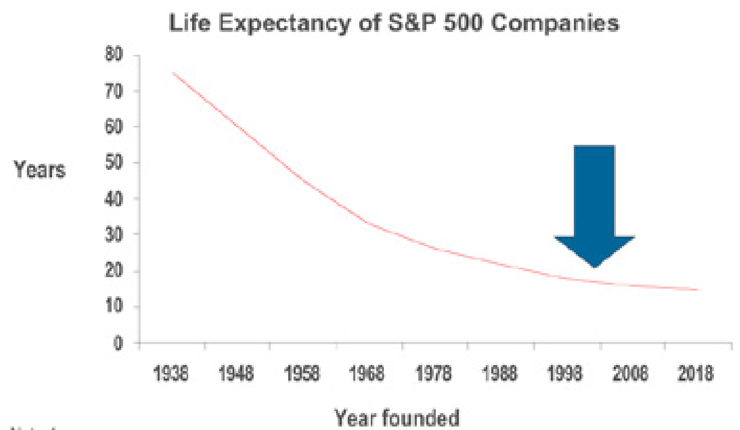


Research by the Sonax Group

About five years is all that companies enjoy as innovators and leaders until competitors achieve parity. For the next ten to 15 years of life, companies typically idle; they become risk averse in guarding their success. There is little insight into the shifting sands around them – no voice of reason inside sounding the clarion. Further evidence of the increasingly transitory nature of success is shown by the average time a company achieving Standard & Poor's 500 ranking can expect to remain a member of this elite group. (See Exhibits 3 and 4.)



Foster & Kaplan, Creative Destruction, Doubleday 2002



Foster & Kaplan, Creative Destruction, Doubleday 2002

Only about 20 years is typical tenure as a top company. As evidence, examine the list of companies esteemed as outperforming peers by Peters and Waterman in the 1982 book "In Search of Excellence." Few remain in existence; many are troubled. Further proof of transitory success resides in analysis of Fortune's 10 most admired companies. Only three of the top 10 in 2004 have been in business for more than 40 years. Many of the top-ranked companies over the past 20 years certainly are no longer venerated today.

Missing profound external changes

Unexpectedly, it is not poor execution that endangers organizational survival. There are two threats. One is external tumult, the other relates to management practices. Each is discussed in turn.

Very often, companies stagnate, decline, or die because they minimize or miss profound external changes. The factors are many. New competitors gain strength, and old ones deteriorate. Product life cycles compress. Innovation is stifled. Channels evolve. Demographics shift, and customer loyalty is tenuous at best. Stakeholders are increasingly active and vocal. Technology advances unabated. Regulation surges everywhere. Offshoring tempts. Special interest groups claim entitlement. Globalization is undeniable.

These factors progress to issues stealthily, emerging as pressure points over decades. Recent examples include Microsoft®'s prolonged regulatory woes and the twin threats of class-action lawsuits and community activism targeting Wal-Mart. Such issues do not emerge overnight. But the cumulative effects across time are not noticed by companies because no one inside is answerable for watching. Unquestionably, individual issues are monitored in pockets of the company, but no one department or function is observing external factors holistically to assess their implications on the health of the company. Then a cascade of dominoes stuns—and wounds or kills.

Companies miss the danger signs for a number of reasons. For one, the challenge of running day-to-day operations is so great that little time is left to look outside. In addition, management and stakeholders have a short-term focus. No one has responsibility for understanding the environment – no one internal organization has ownership. Success tends to breed a paralyzing desire to protect the status quo and a fear of risk-taking. Plans are predicated upon success – and rarely contemplate failure or build in contingencies; unheard of are criteria for abandonment or termination clauses. No early warning mechanisms exist. Useful, actionable information on external factors is scarce, with no systematic collection and no one dedicated to analysis of it.

Suffering from too much good management

The second major threat to organizational survival relates to organizational practices. Companies have too much of what the father of modern management, Alfred P. Sloan, would consider "good management." Business schools and their employers have perfected the professional manager who excels at developing a business plan and adhering to it. Unfortunately, this cadre of professionals is poorly suited to handle today's uncertainty and ambiguity. Companies are prosecuting 21st-century business with mid-20th-century practices and methodologies.

These unwittingly outmoded managers follow a professional approach to decision-making – creating, executing, and reporting on detailed action plans. The focus is on short-term results – the current month or quarter. Trends and their interrelationships are missed because the only data reported are results against plan. This approach presupposes that analytics are better than intuition, a bias that has bred a generation of managers often void of experience and instinct and incapable of action without data. Analytics should inform intuition, not replace it.

In addition to the fault of over-relying on the Sloan approach to decision-making, today's managers can become captivated with the latest managerial fads, leaving little time to focus on external trends that can affect future success. Further, managers craft listening programs involving their biggest customers and suppliers, a mistake because they undoubtedly are plagued with the identical organizational stagnation and decline. More valuable will be the insights gained from your smaller customers and suppliers who are likely to detect disruptive innovations long before their larger brethren.

These failing managerial methodologies are reinforced by an inflexible culture, propagated by "good" management. An organization typically stiffens over time as the founders' energy dissipates and the business scales. The company operates under the assumption of success and continuity, blinded to the effects of potentially adverse environmental trends. Stakeholders reward predictability. There is resistance to shedding dying parts of the business. An inflexible corporate culture also is manifested in a poor track record of effecting major organizational changes and/or a singular focus on incremental improvement.

A new management model needs to emerge

The stagnation and decline of companies promises to accelerate if companies persist in ignoring the preponderance of external trend threats, in prosecuting work with 20th-century practices, in grasping every managerial fad du jour, and in perpetuating an inflexible culture.

A new management model is needed – one that promotes a holistic environment for decision-making. This involves an understanding of market turmoil, the development of dynamic planning processes, and the maintenance of operational control in the face of continuous turmoil.

Virtually everything must change. There are seven critical steps companies must take to ensure the longest survival:

- Stop all incremental process improvement efforts.
- Initiate the outsourcing of all transaction processing and administrative work.
- Establish a risk-based early-warning system, to recognize major threatening trends that take years to emerge and to assess the degree of exposure to the business.
- Radically refocus performance reporting and analysis on relationships and linkages; rebalance measures in terms of leading, lagging, internal, and external information.
- Gut the annual planning process so that it takes less effort and time and yields better results.
- Recapture intuition as a factor in decision-making, utilizing scenarios and identifying the first signs of flawed decision-making.
- Re-energize the corporate culture in terms of risk acceptance, contemplation of failure as well as success, market sensitivity, intuition, and internal dialogue, debate, and discovery.

Finance needs to be the vanguard in bringing these changes to the organization—and cannot get started too soon. Each of these actions is explored more fully in subsequent articles in this series.

About the Sonax Group

The Sonax Group is a consulting and advisory firm redefining business management practices. Established by David Axson and Greg Hackett, founders of the renowned benchmarking and finance transformation authority The Hackett Group, the firm works with executives to improve the effectiveness of their planning, performance management, and decision-making processes, radically simplifying and refocusing them to achieve flexibility, agility, confidence, and consistency.

About the authors

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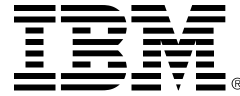

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