Are companies optimizing the suboptimum?

What are the interdependencies between addressing the financial operating model to reduce complexity and the migration of controlling activities to shared service centers? Are companies optimizing the suboptimum or are they taking an important step on a real transformation journey?
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Many companies look for ways to increase the efficiency and quality of their finance function. An upcoming trend is to streamline and migrate routine and lower value add controlling activities (referred to as “rule-based controlling activities”) to shared service centers (SSCs) within the controllers’ domain. Controlling activities are normally less standardized in a company. Does it make sense to dictate from headquarters what kind of controlling activities are expected in the operating companies? The setup of the finance operating model (FOM) and content of the controlling function are heavily interrelated. An effective program to implement a new FOM will look for ways to reduce complexity and improve accountability. What kind of detailed insight is required to draw and implement such a blueprint and to what extent is it beneficial to do it from a central perspective?

This article discusses the benefits and costs of streamlining and migrating rule-based controlling (RBC) activities in a project to SSCs before formally redesigning the FOM. Is this RBC project “just” a good opportunity? Is it a step on a road map to draft and implement a broader finance blueprint? Or is it, in order to maximize the business case, necessary to implement the desired, broader FOM first before streamlining RBC activities?

Figure 1. Balancing priorities in the finance function

This article focuses on two approaches to balance these priorities. The outcome of the assessment and the willingness to change will determine the approach: a full scope blueprint program or a bottom-up, isolated RBC project.
A new economic reality, what does this mean for finance?

The economic and global structures of the 21st century, which have been shaped by the global financial crises, produce a challenging new environment for controlling. Tougher competition, higher market volatility, shorter innovation cycles and strong pressure on margins force companies today to act faster and more strategically in order to be successful.

These trends have consequences for companies’ finance functions. Firstly, there is increased pressure on reducing the total cost of finance (normally benchmarked on an aggregated level as percentages of sales). Secondly, there is an increased need to better fulfill the “business partner role.” Shifting to a more proactive, strategic and business-oriented controlling, the modern controller builds on traditional management accounting, and offers a more strategic function that can help meet these challenges. The key challenge of the modern day finance function is to balance three priorities (see Figure 1):

1. Providing effective support to the business’ strategic decision-making
2. Promoting strong governance and control within the organization
3. Demonstrating operational efficiency

Leveraging finance shared service centers

Many companies have established shared services to standardize, streamline and consolidate supporting functions to improve efficiency and reduce costs. Generic motives for setting up shared services include an increased focus on the core business, service improvement, elimination of redundant functions and more control and transparency of costs. Typically, shared service centers execute standard accounting in accordance with group policies and standards regarding data definitions, reporting contents and processes. These are classified as pure transactional activities. Recently, companies have been looking to broaden this scope, thereby also changing the role these SSCs play in the total spectrum. The next step for shared services could be the (partial) migration of the rule-based activities within controlling processes (for example, part of the planning process, reporting and controls execution). See Figure 2.

The objectives for increasing the scope in SSCs or central functions are quality and cost related:

► Harmonizing and standardizing the finance and controlling processes eliminates waste and reduces errors in the process.
► Migrating RBC activities to low wage countries results in labor arbitrage.
► Eliminating non-value add tasks helps controllers focus on the business partner role.

Figure 2. Extending the scope of SSCs up the value chain

1. Although the risk profile is different we will consider migration of RBC activities to captive SSCs the same as outsourcing to an external service provider (BPO).
2. R. Minnaar and E. Vosselman, Shared service centers and management control structure change: exploring the scope and limitations of a transaction cost economics approach, 2011.

Roles of the finance function in the value chain

Decision support
Risk, controls and specialist
Planning and reporting
Transaction processing

Figural: Extending the scope of SSCs up the value chain

| Roles of the finance function in the value chain | Decision support | Risk, controls and specialist | Planning and reporting | Transaction processing | Figure 2. Extending the scope of SSCs up the value chain |
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Rule-based controlling, an insight

RBC activities are those activities in the process that are routine by nature and do not require deep business knowledge. They can be described (i.e., defined in a work instruction) and do not require frequent face-to-face contact with the business functions. RBC is the opposite of judgment-based controlling, which includes activities that are more complex, are not recurring and, therefore, difficult to operate from an SSC. Judgment-based controlling (which could also be viewed as part of the business partner role) requires good knowledge of the (local) business and interaction with the business functions.

The transfer of reporting, as a business process, to SSCs signals the first move in a shift in focus for shared services. It contains both rule-based (e.g., gathering data, running queries and preparing reports) and judgment-based activities (e.g., analyzing and commenting). Prior to the automation and migration of reporting, local controllers could spend up to 20% of their time preparing, often un-harmonized, reports. This makes migration of RBC reporting activities an interesting candidate for migration to SSCs.

When moving the first category of activities to a shared services environment, a business controller is best helped by focusing increasingly on the value-added activities, such as analysis and strategic decision support. Secondly, harmonized standard reports provide guidance for controllers, encouraging them to prioritize important areas for the company and to be more strategically aligned. Automation, reduction of reports and centralization of preparation will all contribute to a more efficient reporting process. This will reduce the time a controller spends on creating the report, time which can be spent on analyzing and commenting instead.

But how to identify these RBC activities?

RBC activities can be identified by following a bottom-up approach (see Figure 4) using a limited number of internal reference sites per type of business model (e.g., sales, production, research and development) that serve as best practice. Using time writing, the time spent on both rule-based and judgment-based activities can be estimated. The judgmental part of the controlling function becomes the blueprint for what the controller will focus on going forward. In this way, the workload is reduced because RBC and financial control activities previously done by the controller are migrated, enabling the controller to concentrate on more business-oriented activities.

Implementing an RBC project in isolation: the pros and cons

One of the work products of an RBC project is to define a standard per function or type of business model, i.e., service offerings. A typical service offering for a controlling process contains standardized process flows, definitions, guidelines and work instructions. Not infrequently, an RBC project is executed via a bottom-up approach with the following benefits and disadvantages:

Benefits

► Approach allows for a short design phase (three to six months) and
subsequent migrations; benefits are, therefore, realized quickly
► Solid estimate of time spent on controlling work
► Labor arbitrage on migrated activities
► Reduction of work by gaining insight into unnecessary activities performed in local controlling functions
► Scalable approach and, therefore, low risk of business disruption

Disadvantages
► Organizational complexity (many legal entities, management reporting layers, number of organizational units) and a potential lack of accountability for the company’s financials are both issues that are not directly addressed. This means the related complexity is moved to the SSC. Consequently, only labor arbitrage benefits are achieved, instead of the potential wider benefits from reducing the workload.
► Changes in the IT ERP (enterprise resource planning) landscape could lead to adjustments to standard finance processes and, therefore, lead to deviation from the RBC service offering.

A broader context to consider first
With good project management, sufficient resources and dedication lasting up until full implementation, an RBC project can be successful. The real breakthroughs in the effectiveness and efficiency of the finance function are only realized when it has clear top-down, empowered goals and when “the total system of enablers” is mature and in balance. This is visible by having good governance and high accountability standards, a strict compliance and control framework, focus on good quality and development of staffing and a close linked cooperation between finance and the other functional pillars.

Other important considerations are:
► Research by EY shows that companies perform better if functions (e.g., finance) have clear strategic goals and review their achievements frequently.
► Companies that are able to balance their resource allocation and management attention on outsourcing as well as simplification and automation of processes, are more effective.
► The more mature a shared service organization becomes, the more the focus shifts from cost-down to value-up. This requires a totally different way of cooperating with the SSC or outsourced party (other contracts, innovation boards, end-to-end thinking, etc.), other people and a more agile IT structure. In other words, the building blocks from the total system do change and evolve into a more mature organization with capabilities to handle this higher value and complex type of work.
► Strong central governance to which (local) controllers adhere and realistic top-down target setting based on insights from the time writing data.

The redesign of the FOM
There are various reasons why the FOM may not be supporting the business strategy as required. Most common is the fast changing business environment whereby finance as a supporting function is
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not adjusting quickly enough. Organizations evolve organically over time or with a focus on responding to issues and improving each element individually. The result is misalignment, often driven by technology or personality-based structures.

A comprehensive program to redefine the FOM normally includes an extensive analysis to reduce complexity and effort for the finance function and increase quality. Policies, processes and performance measures are addressed in combination with a clearly defined split of activities for the different roles and responsibilities relevant to the company’s various organizational layers. All supported by data structures, employees with the right competences and technology.

The advantages of redefining the FOM do vary from company to company and range from addressing organizational complexity to increasing finance’s focus on business support and improving governance within the finance organization of the company. However, experience has taught us that the throughput time for such a program can be quite extensive and, for an international company, can last for several years. Consequently, benefits are only realized after a considerable amount of time.

Optimizing the suboptimum?

There are benefits to migrating RBC activities without completely redesigning the operating model or finance blueprint. With this approach, however, organizational complexity, among other issues, is not addressed. Obviously, eliminating management layers or the number of business units will significantly reduce the effort of migration and realize a much bigger opportunity in terms of cost reduction, process improvement and value. This opportunity can become even larger, if the relevant changes in IT infrastructure are made at the same time. As a result, are we “optimizing the suboptimum” in order to realize a relatively limited business case, or are we taking an important step on a real transformation journey?

We recommend assessing the complexity of the current finance organization before starting an RBC project. The outcome and

The next step for shared services could be the migration of the rule-based activities within controlling processes.
the willingness to change will determine the approach: a full scope blueprint program or a bottom-up, isolated RBC project.

In both cases, the culture of the group or company plays a crucial role.³ Is there sufficient change management capability and persistence available to bring this change initiative to a successful closure?

We could also ask ourselves if it is possible to define the controller’s blueprint or streamline automation without detailed bottom-up insights. Changes to the organizational and IT structure normally have a long implementation time. Therefore, redesigning processes to reduce inefficiency for controllers in the field, without touching the broader IT landscape adds value and could be seen as a good first step on a longer-term road map.

By taking these steps, the endgame of that FOM road map is continuously adjusted and improved, using all the learning from the completed phases along the way. This could also prevent the pitfall of a project that turns into a lengthy and theoretical exercise, producing nice looking finance function organizational charts but forgetting to address what controllers are supposed to be doing on Monday morning when the workweek starts!

³. In this article, we won’t elaborate further on the role culture plays as this would require another article!

⁴. Controlling processes are centered around the right performance measures. If performance measurement is coordinated and consistently aligned to the related processes (e.g., a highly standardized planning process an RBC project could start straightaway, if, however, these activities are immature, an approach combining bottom-up views per business model from an RBC project and centrally cascaded performance management is, in our opinion, the most effective.

<table>
<thead>
<tr>
<th>Assessment areas</th>
<th>FOM redesign</th>
<th>RBC project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizational setup</td>
<td>Finance function is primarily a loose federation of decentralized teams that lack alignment with overall business objectives.</td>
<td>Finance function is centrally organized and aligned to strategy across the enterprise.</td>
</tr>
<tr>
<td>People</td>
<td>Finance skills and competencies are more traditional. Strong accounting skills but with limited business acumen and advisory skills.</td>
<td>Finance people are viewed as the next generation of business leaders. Formal programs exist to recruit, hire and retain strong finance competencies.</td>
</tr>
<tr>
<td>Policy</td>
<td>Finance policies and procedures are complex and have been accumulated over time.</td>
<td>Finance takes the lead in simplifying and streamlining global policies.</td>
</tr>
<tr>
<td>Technology</td>
<td>Systems are non-integrated and locally developed for each business unit.</td>
<td>More common global reporting and transactional systems are in place throughout the enterprise.</td>
</tr>
<tr>
<td>Performance measurement*</td>
<td>Performance measures are defined by each business unit (and may conflict).</td>
<td>Performance measures are coordinated and consistent across the whole organization, drive business performance and enable the creation of enterprise value.</td>
</tr>
<tr>
<td>Controlling processes*</td>
<td>There is little process orientation. Global controlling process standards are limited.</td>
<td>There is clear global ownership for all core controlling processes.</td>
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