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Transforming finance for the future

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Abstract

Significant changes in external market conditions have resulted in operations placing greater demands on the finance function. Traditional finance departments are increasingly expected to deliver more value and be more proactive in supporting the organization's overall business strategies. Unfortunately, many finance departments are not yet ready to meet such challenges. This article proposes a transformation process to reorganize present day finance functions to become a 'finance of the future'. The proposed process applies tools such as best practices, outsourcing and technology to achieve a 'desired future outcome'.

Keywords

finance function
best practices
outsourcing
technology

1. Introduction

Significant changes in external market conditions have led organizations to launch new products and services and explore new markets with greater frequency. Within the organization, operations now place greater demands on finance as the need for financial analyses and projections to support growth plans increases (Baxter and Chua 2003). Traditional finance departments are increasingly expected to deliver more value and be more proactive in supporting the organization's overall business strategies (Burns, Ezzamel and Scapens 2003; IFAC 2002; Porter 1985). The expectation is to spend less time on transaction-based finance processes such as billing and collections and focus more attention on analyses that help line managers make quick and effective decisions. Unfortunately, many finance departments are not yet ready to meet such challenges (Bromwich and Bhimani 1989; Guilding, Cravens and Tayles 2000). The reasons could be that most lack a strategic process to transform the changing role of finance and are, also, not fully aware of the range of tools available.

Addressing issues of a lack of strategic process and unawareness of tools available, this article proposes a strategic transformation process to reorganize the present day finance functions to become a 'finance of the future'. The transformed finance department will be a flatter and leaner function with stronger business integration through technology. The proposed process applies tools such as best practices, outsourcing and technology to achieve a 'desired future outcome'. The purpose of the article is to provide a conceptual transformation process for finance and introduce various tools to help create a structure to meet tomorrow's challenges.

The article is organized into the following sections: changing role of finance, tools for transformation, overview of transformation process, future research and conclusion.

2. Changing role of finance

Key trends towards proactive business partnership and customer orientation have transformed finance's role in several ways (Jamison 2007; Silvers 2006; Williams 2000). First, as a result of the need for closer business collaboration between operations and finance, many integral finance activities such as control and cash management have become essential part of day-to-day operations (Baxter and Chua 2003; Busco et al. 2005; IFAC 2001). Second, there have been major shifts in fundamental thinking behind finance improvement programs where value-adding, and not cost cutting, is the dominant goal. More and more of the traditional transaction-based finance activities such as payment processing have been outsourced. Last, rapid technological developments have removed many of the tasks that traditionally defined the finance function (May 2002). Manual transaction processing is replaced by electronic commerce. These trends have significantly impacted the traditional finance function resulting in a need to re-look at the role of finance in providing value-driven support, creating a matrix organization to facilitate effective decision-making and outsourcing of non-core activities (Boedeker and Hughes 2005; Johnson and Kaplan 1991; Lebovits 2006; Renner and Tebbe 1998).

2.1. Providing value-driven support

Boedeker and Hughes (2005) proposed that, in order to maintain effective business partnerships, finance must understand key business drivers and have a keen understanding of the 'big picture'. Finance must understand the issues and objectives from an operations standpoint, develop a common understanding of costs and risks, and work towards the best financial solution (Iversen 1998). Driven from this need to better understand the business, the traditional finance department is moving out into the front-line to work alongside line managers. Consequently, the role of finance has evolved from being a scorekeeper to a business partner (Boedeker and Hughes 2005; Pierce and O'Dea 2003). Finance is acting more like a consultant to operations rather than a controller of financial resources. Fundamentally, finance is in a better position to provide advice on value creation where operations generally lack such focus and may not fully understand how their decisions affect the financials. For example, through the sharing of financial knowledge during corporate planning, finance has a huge opportunity to provide value-driven support to operations in business strategy development.

2.2. Creating a matrix organization

As part of the control mechanism, finance was preoccupied with transaction-based processing and not very responsive to customers' needs. It used

to be that finance was responsible for paying the bills and book-keeping (Favarro 2001; Lee 1987). There is now much greater awareness of the financial implications of decisions throughout organizations. The need for financial knowledge is no longer restricted to finance but is a necessary part of the business (Jamison 2007; Lebovits 2006; Lord 1996). Line managers require instant access to relevant financial data, for example, rolling forecasts of operating profit by products, services and channels so that they can better deploy resources during, and not after, the current fiscal period. They also need help with cost management when new products are still on the drawing board (Shank 1989). Consequently, finance needs to focus on value added business analyses to help line managers understand the financial consequences of their strategies and decisions (Arthur 1996; Johnson and Kaplan 1991). The finance function has to move from a command and control paradigm to one that embraces teamwork, co-operation and customer service.

2.3. Outsourcing non-core activities

During the 're-engineering wave' of the late 80s and early 90s, everything was focused on cost. Today, that emphasis has shifted to value. Organizations are increasingly looking for ways to obtain maximum value for the money spent. For example, finance may be called upon by operations to establish target costs based on historical information so that organizations can better manage operational costs. These changes have shifted the emphasis away from activities that do not add value to the organization and made outsourcing a viable alternative (Renner and Tebbe 1998). Thomas and Wilkinson (2006) have argued for the case for strategic outsourcing. The case is particularly compelling for finance activities. Outsourcing is a very powerful strategic tool because nobody can be good enough at everything as a result of the rapid pace of technological change and competition today. Outsourcing affords an organization the option of focusing on its core competencies and leveraging the service provider's expertise in non-core areas. The critical success factors in outsourcing, however, are a strong working relationship with the outsource service providers (OSPs) and clearly defined goals and performance metrics established at the start. Increasingly, organizations are farming out their finance functions to service providers such as banks and accounting firms. Thus, the role of finance has also shifted to one which helps the organization identify areas within the business where non-core activities can be outsourced. Of course, this process includes looking at the various finance activities which provide minimum value add to the business.

3. Tools for transformation

Various tools are available and may be applied systematically in the transformation of the role of finance. This section discusses three such tools: best practices, outsourcing and technology.

3.1. Best practices

Best practices serve as goals and benchmarks for organizations to achieve superior performance (Mathaisel, Cathcart and Comm 2004). They represent a continuous quest to find optimum ways to perform processes (Maire, Bronet and Pillet 2005). Best practices, whether qualitative or qualitative, are good starting points to shed insights on how to close current performance gaps in finance activities. As a form of performance metric, best practices help to measure and assess whether an organization's goals have been achieved. They enable organizations to monitor progress and set standards and targets. To illustrate this point, examples of finance best practices that can be used as performance metrics are discussed next.

Billing, accounts receivables (AR) and collections require inputs from several inter-related functions such as order entry, credit, production and logistics. The process requires timely communication across these departments. When the functions work together efficiently, organizations lay the foundation for improving its cash flow – a key performance metric as fewer outstanding accounts balances mean fewer bad debt write-offs which enhances profitability. To prevent billing errors, the finance department could provide customers with a single point of contact for inquiries, use summary statements for high volume transactions, and consolidate invoice printing and distribution. To better manage AR and collections, finance could also offer incentives to encourage timely payment, and identify and act early on distressed accounts.

The purchasing function has, traditionally, been managed outside the finance function. As a result, organizations are missing tremendous opportunities for cost savings and improved efficiency in purchasing. This is due, in part, to the fact that purchasing and account payables (AP) are usually treated as two separate processes. For AP processing, organizations are usually confronted with tons of paper invoices from small and mid-sized suppliers. Therefore, there is a need to figure out a cost-effective way for the smaller trading partners to send their invoices electronically. To achieve this, the purchasing process would have to be streamlined to electronically link the purchasing systems to internal customers and suppliers to speed ordering and simplify billing. By treating purchasing and AP as a single process and relying to a greater extent on blanket purchase orders and long-term contracts, problems such as invoices mismatch with purchase orders and inaccurate coding of expenses can be minimized. For AP best practices, it may be prudent to involve suppliers in new product development and value chain analysis, eliminate multiple levels of corporate approval and increase expense authorization limits.

3.2. Outsourcing

Outsourcing is one way to increase an organization's focus on value-added. To make the most of outsourcing, organizations need to assess its impact on operations (Thomas and Wilkinson 2006). One approach is to look at the organization's core competencies and non-core areas and ask

some fundamental questions such as, 'Which process gives the organization a competitive advantage over its competitors and value adds to the business strategy?' and 'What is the strategic importance of the activities involved?' These questions apply to within the finance function as well. For example, in most finance departments, the collection sub-function is usually a labor intensive and time-consuming activity. As a result, this sub-function could be a prime candidate for outsourcing. The organizations, however, need to ensure that it is not getting rid of activities just because they are 'problematic' and retaining activities that are easy to manage. Otherwise, the organization could experience surging costs, lost of control and plummeting service levels in some instances. In addition, the organization would need to realistically assess whether it has the capability to improve the operation's performance within a short period of time. Organizations must consider the possibility that they may not be able to achieve their objective of improving the non-core activities.

Corporate finance is an example of a knowledge-based process which requires more professional staff inputs. In larger organizations, corporate finance usually consists of a treasury and a tax arm. By definition, treasury management is the process of controlling interest rates and exchange rates risks while tax management is the process of optimizing tax returns through tax avoidance and incentives (Marjamaa 2005). These are highly specialized areas which require in-depth financial knowledge. Bloxham and Borge (2006) mentioned that the real challenge for finance today is that while some risks are well known and easily quantified, many others are less well understood. Except in the case of conglomerates and multinational companies, it is usually not feasible to maintain a large corporate finance department besides a core group of corporate finance advisors. The reason is because of the problem of ensuring that in-house expertise is better than those in the industry. As corporate finance is a very dynamic field, it is very unlikely that in-house talent is able to keep pace with the myriad of financial instruments and techniques developed each day. Consequently, the quality of financial advice may be compromised. Therefore, it may be wise to leave such activities to the external professionals and monitor them through clearly defined performance metrics.

3.3. Technology

Technologies such as networking and e-commerce can be used to create a leaner finance structure. However, finance departments that are increasingly involved in business planning and analysis are failing to effectively utilize technology to support their new role (Williams 2006). The problem seems particularly acute amongst those organizations using more sophisticated analysis techniques such as balanced scorecard (Epstein and Manzoni 1998; Kaplan and Norton 1996). Even very simple technologies can be used to boost productivity significantly (May 2002). For example, finance could develop online catalogues and requisitioning or use purchasing cards and bar coding. An organization may also utilize the operating system for

management reporting requirements instead of using off-line spreadsheets which duplicates effort and increases the risk of errors. However, such management accounting information must be capable of identifying costs and value-adding processes across traditional organizational boundaries (Cullen and Metcalf 2006). Taylor (2006) suggested that software for real-time monitoring and continuous auditing can provide finance with an automated way to strengthen the organization's control environment. In addition, finance can apply technologies such as electronic data interface (EDI), enterprise resource planning (ERP) and radio frequency identification (RFID) to improve efficiency.

The general ledger (GL) process is an area in which technology can play a part. The 'closing-the-books' is the process of reconciling, consolidating and reporting financial information on a periodic basis. For most organizations, closing-the-books is an unexciting but necessary, back-office process. The problems associated with closing usually arise because of the difficulties in striking a balance between time spent in supporting operations and 'number crunching'. Other problems include the different GL systems used at various locations – each with a different chart containing thousands of accounts and inconsistencies when accounting for the multitude of inter-organizational transactions that routinely occur. While technology has a role to play, the most effective improvements come from changing requirements and procedures for getting the work done. However, it is worth noting that the GL process can be eliminated totally from human intervention if all sub-systems flowing into the GL system are fully integrated. The benefits of a shorter and more accurate closing process allows for more time in strategic financial activities such as identifying patterns, trends and warning signs in financial data.

4. Overview of transformation process

After highlighting the tools available for finance transformation, this section describes the transformation process to achieve a 'finance of the future'. Essentially, the transformation process looks at how best practices, outsourcing and technology may be applied to transform current finance departments. More importantly, how such tools can be linked synergistically and strategically to build core finance capability, and aligned to business objectives (Dixon 1998; Williams 2000). The aim of this section is to provide an overview of the end state, current state and transformation process.

4.1. The end state: 'Zero Finance'

Beginning with the end state in mind, a 'finance of the future' represents a 'desired state' as the final outcome of the transformation process. In the future, finance can be expected to become deeply involved in organization-wide business performance. To fulfil this role, finance must be viewed as the steward of the organization's overall management and decision-making process. Finance should also be a part of an integrated system that

extends its links outside the traditional financial boundaries of the organization (Coad and Cullen 2006).

To stretch even further, more can be done to create a finance that can meet future needs. Even if organizations do succeed in transforming finance, a crucial question remains, 'Should there be a finance department in the future at all?' This is because, in the future, it is envisaged that the finance department will be replaced by groups of finance individuals that are scattered within the organization. There will not be a specific department to house all these finance staff because all of them will be working alongside operations at the front-line. Therefore, it is proposed that the ultimate challenge is 'zero finance', that is, a finance structure that is fully integrated with business such that it ceases to exist as an independent unit.

The idea of 'zero finance' does not suggest a total absence of finance staff in the organization. 'Zero finance' means that groups of individual, that is, 'business finance managers', will perform core financial tasks alongside operations and are not within the confines of a specialized finance department. These 'business finance managers' will provide direct support to the business in terms of financial analysis, capital budgeting and valuation within the respective line departments. In addition, there will also be a group of in-house 'finance strategist' consisting of a financial controller, a management accountant and three to four corporate finance managers who will provide senior management with the needed financial inputs unique to the business and the group. Such areas include economic analysis, forecasting, strategic planning and business process improvements (Bromwich 1990). Both 'business finance managers' and 'finance strategists' shall become the 'future knowledge workers' within the finance function (Booth 1998). The other line managers could then be trained in basic financial skills to perform day-to-day work and only call upon these finance strategists whenever more advanced financial and accounting modelling is required.

4.2. Current state

In the current state, most finance processes could be divided into two main categories, namely, transaction-based and knowledge-based processes. The transaction-based processes are operational in nature and provide direct support to the business. Examples of transaction-based processes are AR and AP processing. Conversely, knowledge-based processes require more professional staff inputs and analysis. Examples of knowledge-based processes are budgeting and corporate finance.

Improvements made to both transaction-based and knowledge-based processes depend on the business context and the organization's requirements. These improvements could be achieved using the tools such as best practices, outsourcing and technology. To fulfil its new role in the future, finance should de-emphasize operational processes and devote more resources to support business decision-making through knowledge-based processes. Budgeting, a knowledge-based process, will be used to illustrate how improvements can be made.

Most organizations accept that their budgeting process is ineffective, costly and time-consuming but few take any action to rectify this situation (Segelod 1998). Finance tend to spend too much of their time on the mechanics of budget preparation, leaving limited time for further analysis. Also, budgeting and forecasting processes are usually not linked to strategic planning or performance measurement. Therefore, there is a strong impetus to integrate budgeting with corporate planning and also link it to performance metrics. Budgeting can be an ongoing and powerful management tool to develop operational plans that support strategic objectives, allocate resources and assign accountability. Thus, before beginning the budgeting process, organizations should define the strategic goals, both quantitative and qualitative targets. The budgeting process should start with a strategic plan, not a spreadsheet.

4.3. The transformation process

This sub-section describes how finance can apply the various tools to transform itself from the current state to become 'zero finance'.

4.3.1. Synergy among tools

All finance departments typically begins at a certain level of current practices. Through various initiatives such as market trends analysis, business process re-engineering and benchmarking, an awareness of external best practices is generated. These best practices can then be introduced into the organization as new ideas for improvements. Furthermore, these best practices, qualitative or quantitative, can be developed and customized as performance metrics specifically tailored to the organization's needs to close performance gaps.

In considering outsourcing alternatives, the performance metrics developed can be used as the basis for service contracts that form part of the standards to monitor OSP performance. This procedure is one aspect usually overlooked by most organizations. The development of performance metrics should be used initially for internal finance activities and subsequently as the basis for setting standards and measurements to monitor external OSP performance when an activity has been outsourced. This procedure is one way where knowledge gained in developing internal performance metrics using best practices can be built upon. It ensures that knowledge is not 'lost' within the organization. After outsourcing an activity, the lessons learned can serve to enhance the present level of best practices. This, in turn, could lead to more activities being 'farmed out' later as the 'comfort level' for outsourcing increases. This sub-process demonstrates the synergistic effects that can be achieved from discovering external best practices to developing internal performance metrics to monitoring OSP performance.

Best practices that involve harnessing technology always lead to a better definition of information and reporting requirements. Similarly, such informational needs and defined requirements can be further developed into

performance metrics. These performance metrics help to ascertain the degree of financial knowledge required by the various internal and external customers. Consequently, the investments required in producing outputs such as financial and management reports to meet internal customer needs can be used for comparison with the OSPs' charges and level of service. A decision on the possibility of outsourcing can then be made based on the costs and benefits calculated.

4.3.2. Building core capabilities

Finance should also continuously identify, build and strengthen its core capabilities in specific areas. For example, a future core finance capability would be in the measurement and valuation of knowledge assets (Johnson 1999; King and Henry 1999; Roslender and Fincham 2001). Besides measuring physical and monetary assets, finance must have the capability to value intellectual capital (Booth 1998; Edvinsson 1997; McConnachie 1997). With the increasing importance of knowledge in sustaining an organization's competitiveness, there is a growing need for finance to develop competencies in the measurement of intellectual capital (Dzinkowski 1999; Guthrie, Petty and Johanson 2001; Roos and Roos 1997; Tayles et al. 2002). Such intellectual capital includes relationships with customers and partners, innovation efforts and knowledge and skills of organizational members. Traditional financial measures are no longer applicable to knowledge assets (Mintz 1999; Rennie 1999; Williams 2000). New metrics to measure intellectual assets need to be further developed and finance must be equipped with skill sets to perform such tasks.

4.3.3. Linking with business strategy

After revamping finance from within, there is now a need to put finance back into the 'big picture', that is, to link finance activities to business strategy development. However, care should be taken that the act of business strategy linkage should not be performed towards the end of the transformation process as there should be a constant feedback in the transformation process. Finance must, constantly, be aware that it is providing support to a larger entity, that is, the business. Thus, while moving towards the goal of a 'finance of the future' using the tools available, it must also be able to relate itself back to the overall business objectives. Finance should perform regular reality checks on its improvement efforts. The final step in the transformation process highlights the importance of linking finance to business strategy. The business strategy must be the basis to guide finance in the capability development.

5. Future research and conclusion

The article has introduced best practices, outsourcing and technology to enable finance transformation. It has also proposed a strategic process to transform the traditional finance department into 'zero finance' for the

future. This section discusses future research directions and concludes with practitioner implications in adopting the range of tools and achieving improvements in the finance function.

One area for future research could be the relative effectiveness of best practices, outsourcing and technology in improving the finance function. While there may be individual studies done on each of the tools in enhancing finance activities, there is a need to better our understanding through the application of a combination of tools to accelerate such improvements. The methodology applied could be survey questionnaires to collect data on the effectiveness of these tools in supporting operations. Another area for future research is to undertake long-term case studies using interview and archival data to trace the development of finance functions in applying best practices, outsourcing and technology. Since the proposed transformation process is not expected to be linear nor orderly, the case studies approach would be able to present qualitatively the steps taken during the transformation process and the eventual 'end state' achieved. The series of case studies on real-life organizations would potentially deepen our understanding of such transformation processes.

Practice-wise, the article has also provided insights into a finance transformation process that can help managers improve finance for the future. Specifically, managers would be able to use the proposed transformation process as a blueprint for change. This transformation process could serve as a guide for managers to develop approaches and introduce best practices, outsourcing and technology at different points of the change roadmap to achieve optimum synergy.

In conclusion, the transformation process for the 'finance of the future' highlights the synergistic effects of using tools such as best practices, outsourcing and technology. The transformation process also emphasizes the need to strategically link finance to business strategy. The 'desired outcome' would be a leaner, flatter and more integrated finance that is linked to business through technology.

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