Finance of the future

A Guide for Business Users

KPMG Management Consulting

“Accountants could go the way of coal miners!

A mighty industry that once employed three quarters of a million and helped bring down a government today employs fewer employees than SmithKline Beecham.

I believe that accountants in industry could go the same way if they do not realise the fundamental changes they need to make.”

Hugh Collum
Executive Vice President and Chief Financial Officer, SmithKline Beecham

Introduction

There has been widespread recognition of the need for finance to develop from being a scorekeeper to a business partner. Many organisations have changed their finance function as a result. But there is much further to go.

The question now is whether there should be a finance department at all.

The rapid development of IT has removed many of the tasks which traditionally defined the finance department. Manual ledgers disappeared many years ago. Manual transaction processing is going the same way, replaced by electronic commerce.

The need for financial knowledge is no longer restricted to finance. There is much greater awareness of the financial implications of decisions throughout organisations. It is a necessary part of business. Equally, business knowledge is more highly valued than technical accounting expertise.

Much of the traditional finance department is moving out into the business, which means that the finance director is losing much of his or her traditional domain. Finance directors can see this as an opportunity or a threat. Those that see it as an opportunity are more likely to prosper.

Although there has been much debate lately about the future of finance, no one has put forward a comprehensive picture of what the finance function could look like. This is the first attempt, we believe, to do just that.

Barbara Morris-Welsh
Partner, KPMG Management Consulting

Contents | Page

Back to the future

an eye witness account from 2010

February 28 used to be Anna Walker's least favourite day of the year. It was the year end for FutureSystems plc and also happened to be her birthday. Ten years ago, that would have meant staying up until the early hours of the morning finishing the accounts books and preparing all the information for publication. These days, however, she can go out and celebrate, now that the finance department has changed and, with it, her role. She is now Head of Operations.

For the last ten years, FutureSystems has outperformed the market with an average growth of 35% per annum. Amazing, really, Anna thought, considering the rocky 12 years that the global economy had just experienced. The company had survived Year 2000 by the skin of its teeth. EMU had posed a huge challenge, but the executive committee saw the strategic opportunities it afforded, and took advantage. Many companies did not fare so well.

One of the obstacles to the growth of FutureSystems had been the finance department. Anna remembered the day that the board had announced the decision: the finance department would no longer exist. Although they expected a positive reaction from operational managers, they were concerned there might be mass pandemonium from distraught accountants. Instead they were inundated with requests for sponsored MBAs and training courses. Although the decision was unsettling, the finance people recognised the opportunity for career growth inherent in the decision.

The business success and change was masterminded through the 2010 Vision project. Anna was on the 2010 Vision committee, representing finance. Huge changes started taking place immediately. Finance people were moved into the business to sit alongside operational managers. Integral activities, such as control and cash management, became an essential part of day-to-day activities in operations. Transaction-based tasks, such as purchase order processing, were outsourced. Even the traditional budgeting process had been abolished in the transformation that dissolved the finance department. The success of the 2010 Vision project had been a real catalyst for her career.

These changes had shifted the emphasis away from activities that did not add any value to the business – a major step towards becoming a value based organisation. All strategic management was transferred to operational business managers. They were supported by one central cross-discipline advisory team for finance, IT, HR, training and development.

The result of all those changes, thought Anna, was a highly successful organisation in which the finance discipline was responsible for three things: delivering value to shareholders; challenging operational managers; and controlling the risks inherent in the business.

Activating the performance reporting suite of the information system, Anna called up a value based summary report, ready for the analysts' briefing. She accessed the back-up analysis, and made a final run through her presentation.

As she did so, she thought back to February 1998 when she had made her move from finance to operations. At the time, it had seemed such a huge decision. Now, the option of "staying in finance" no longer existed.

FINANCE

1998: in the beginning...

The traditional role of finance as the beancounter – the part of the organisation which always says no – is changing rapidly.

Organisations are expecting finance to act as a business partner. What does this mean? They want finance to be an ally in achieving their business objectives by focusing on the three key financial accountabilities:

- to deliver value to the shareholders in accordance with their expectations;
- to challenge business managers to generate value and monitor their success in doing so; and
- to manage financial risk and maintain financial control.

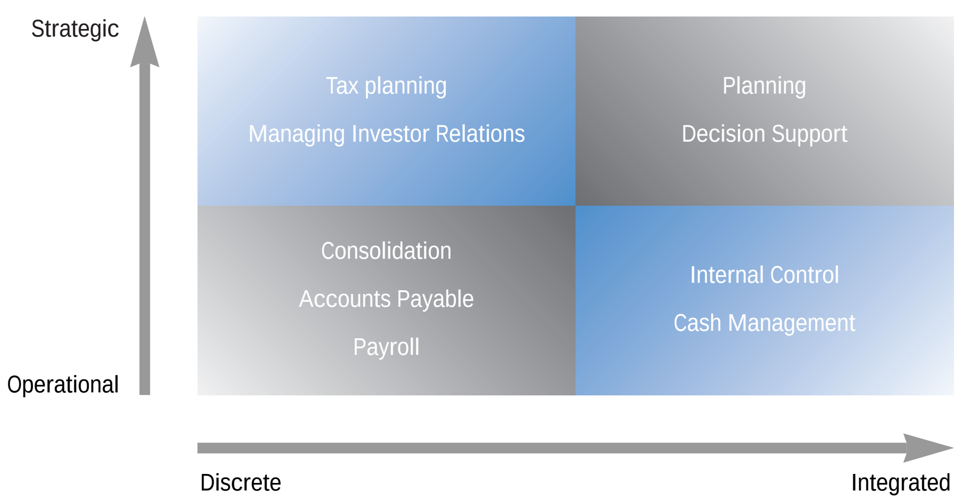
These three accountabilities are unique to the finance discipline and are not likely to change in the future. What *will* change is who holds the responsibility for the activities which underpin them. Traditionally, the responsibility has remained inside the finance department. In the future, the responsibility will go to other parts of the business.

To help organisations see how these responsibilities might change, KPMG Management Consulting has developed a framework for analysing the various finance activities *(see Figure 1)*. The activities are placed in the quadrant which best describes their underlying characteristics. This analysis will vary from business to business.

A typical example might be:

- operational/discrete – payroll;
- operational/integrated – cash management;
- strategic/integrated – decision support; and
- strategic/discrete – tax planning.

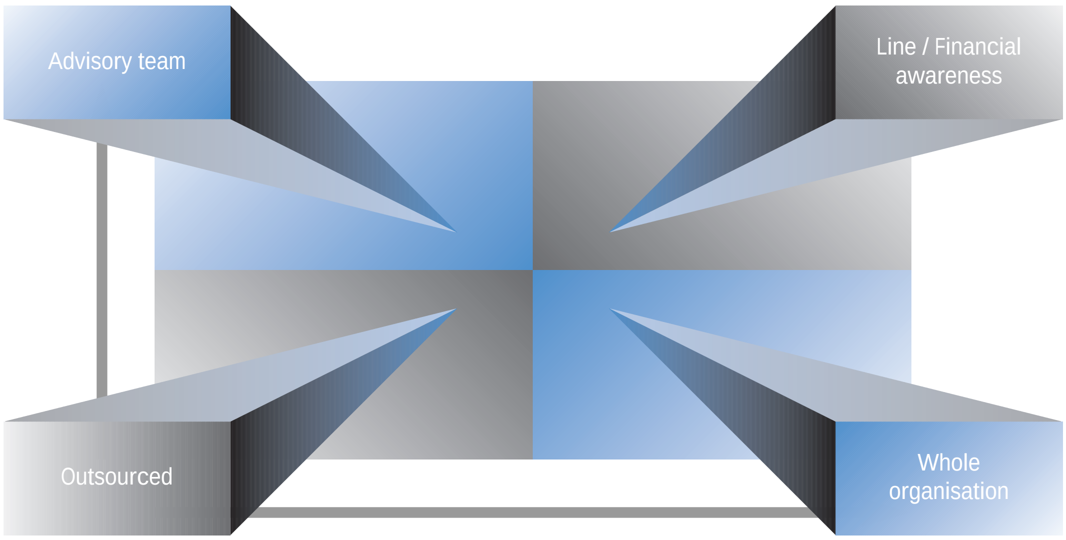
Figure 1: **A framework for analysing finance activities**



FINANCE

2010: the finance department will no longer exist

Figure 2: **The future of finance**



Looking at each quadrant in turn, we can consider how finance might change.

Operational/discrete

Those activities which are operational and discrete can be handled by shared service centres or outsourced completely. They are not an integral part of the business nor do they have strategic importance or confer competitive advantage. In the US, transaction processing such as accounts payable or payroll is often located in shared service centres. In Europe there are now a growing number of shared service centres, and we expect this trend to accelerate with the further integration of the single European market. Some organisations have even outsourced these activities. There are a number of well publicised examples of outsourcing agreements, especially within the oil industry.

Looking further ahead, the vast majority of transaction processing, even for small organisations, will be done through electronic commerce. This might change the nature of outsourcing agreements as they look to take on additional activities such as consolidation and reporting.

Operational/integrated

Those activities which are operational but integrated, such as control and cash management, can remain within the organisation without residing in the finance department. In many leading organisations they have already been delegated. For example, a salesman can be trained to have a clear understanding of his contribution to the business. He is expected to focus not just on generating sales but on generating *profitable* sales, with responsibility for control and cash management, and he is rewarded accordingly.

Strategic/integrated

Effective decision support is fundamental to an organisation's drive to maximise value: a thorough understanding of the business together with commercial acumen are essential to take effective decisions. Equally important are the appropriate skills required to understand the financial implications of the range of opportunities open to decision makers. Some leading organisations are partnering finance people with line managers. Some are moving finance people out of the finance department into line positions. As well as reorganising finance, businesses are asking finance people to educate non-finance people.

Strategic/discrete

The specialist skills such as tax planning, treasury, setting standards and accounting policies are strategic but discrete. They also cross into other disciplines such as IT and HR. Small companies have led the way in outsourcing these activities. For large organisations, the solution may be the establishment of an "advisory team" to provide multi-disciplinary advice.

Is group finance any different?

It has been argued that group finance will never disappear, but will always be required to probe the business and to manage risk. This, however, is not the case.

Much like finance professionals moving alongside line managers, it would be more effective for members of group finance to sit alongside directors, to support them in their probing role. The advisory team would be responsible for managing risk for the whole organisation since specialist knowledge is required for the range of risks facing businesses today and in the future.

The result of all these changes is that the finance department loses many of its traditional responsibilities.

Taking advantage of strategic opportunities

There are forces outside all organisations which will drive changes in finance.

Globalisation

As trade barriers are reduced and electronic commerce breaks down geographic boundaries, markets will become more homogeneous, greater economies of scale will be realised, and domestic operators will shift to become global.

Finance must support the business as it evolves into a global organisation. Operationally, this may involve coping with different time zones, cultures, languages, and regulations, as well as many more locations. At the strategic level, there will be a greater variety of options for raising funds as the barriers in the financial markets come down. Opportunities for strategic alliances, mergers and acquisitions will increase, as will the threat from predators.

Globalisation is not just an issue for large organisations. Even the smallest company will face increasing global competition.

Power of investors

Investors are becoming more active and demanding, and their information needs continue to increase. Analysts evaluate the performance of organisations using a range of techniques including cashflow analysis, value based approaches and the benchmarking of operational drivers against competitors.

This has several implications for finance. Organisations must focus on value if they are to satisfy the new active style of investment. Value based management gives organisations the ability to align their decisions directly to the interests of investors. The move towards more balanced measures for internal and external reporting rather than purely financial measures reflects this, and is a challenge for finance.

Focus on core competencies

Organisations are focusing on sources of sustainable competitive advantage. They are seeking to make the most of whatever they do best, for example, by focusing on one market or on one specific skill. This explains the trend towards outsourcing. Organisations will cede territory and sacrifice customers, markets and supply channels where these do not create value.

There is a growing realisation that strategy is as much about choosing what not to do as it is about choosing what to do. This has a dramatic effect on finance. Finance must give the organisation different information in order to support these new types of decisions. In addition, finance must be prepared to focus on its own core competencies and, ultimately, to outsource itself either in part or in whole.

Changing style of management

Major shifts are occurring away from traditional styles of management. Layers have been stripped out and innovative approaches to management and new styles of leadership have been introduced. Those at the top are bolder in their actions. They thrive on discontinuity and are able to make revolutionary, unpredictable and risky but rewarding decisions. They make them quickly and rely on simple measures of success.

This new management style requires a very different finance department. Leaders are often less interested in detailed financial information and comparisons. They need a clear view of the business and its performance. They will be impatient with accountants who are bureaucratic, internally focused, and do not provide the information they need on time. They will expect control to be exercised through tight computerised information and a clearly value based culture. The finance people will need to be alongside decision makers, giving immediate advice without prevarication.

CHANGING STYLE OF MANAGEMENT

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CHANGE

INFORMATION TECHNOLOGY

Change

There is no reason to believe that the pace of change will slow down. The organisations which succeed will be those that thrive on change. The most successful organisations are those which do the unthinkable. It was unthinkable for ICI to cut itself into two. It was unthinkable for Hanson to turn its back on its conglomerate philosophy. It was unthinkable for Virgin to sell its music business. These radical reactions to change require a supportive finance function.

The output of many finance departments is geared towards slow incremental change. It rarely gives a world view of the current and future pressures on the business. It therefore supports tactical and not strategic decisions. Finance professionals need to look outward and forward as they serve the business. Much of what they do now looks backward and inward. Finance should examine itself within the context of the organisation and plan how it will serve the organisation as it may look in five or ten years' time.

Information technology

IT has been the single most important catalyst for change in the finance function over the last two decades. The use of fully integrated enabling systems along with new technologies such as electronic commerce is transforming routine transaction processing in all sizes of organisation. In some companies "web browsing" software is replacing the traditional management information pack, enabling executives to access management information on line from anywhere in the world.

Increasingly powerful IT systems will continue to change other aspects of finance. This presents strategic opportunities by putting a premium on the correct interpretation of data, rather than just its collection and consolidation.

Finance must react to take strategic advantage.

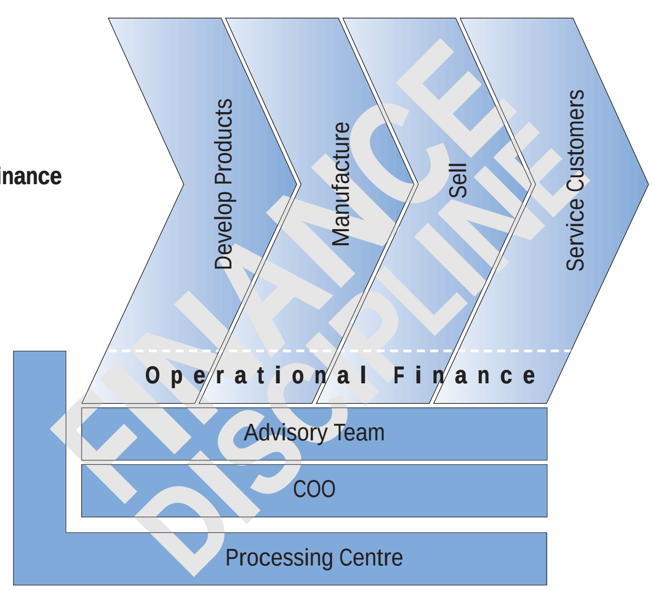
FINANCE The way forward

> Finance is moving away from being internally focused, manually intensive and standalone to being customer-focused with a commercial understanding of the business, and with the processes and systems in place to support the business partner concept.

To take full advantage of the strategic opportunities that the forces for change present, there are five key ways in which finance should change:

- **Financial awareness** within the business should be raised so that the financial implications of strategic and operational decisions are understood before those decisions are taken. This can be achieved by moving finance professionals into line positions – including alongside board members – and using them to train and develop line managers to become more financially aware.
- **A finance discipline** should be established and managed to allow people using finance skills to share leading-edge techniques, experiences and issues, to develop the challenging mentality that finance professionals should possess.
- Organisations should build centres of excellence for specialist skills such as finance, HR and IT. The financial centre of excellence, for example, may include tax planning and treasury. Organisations can then pull these centres of excellence together in one cross-discipline **'advisory team'** that will provide information and advice on significant strategic issues, in the way that a consulting firm is asked to provide a cross-discipline team to tackle these issues today. Many small companies have already done this by outsourcing these services.
- There should be internal or external **processing centres** (shared services or outsourced) for transaction processing. Transaction processing "factories" may emerge to support small companies.
- The role of **Chief Operating Officer** (COO) should develop further. The COO will have board responsibility for managing the advisory team, i.e. the finance, HR and IT centres of excellence, and the functional disciplines.

Figure 3: **A new structure for finance**



What should the characteristics of finance be once it has changed?

The finance strategy should be:

- aligned with the strategy for the business;
- clearly linked to the business objectives; and
- practical and measurable.

The finance structure should:

- distinguish between accountability and responsibility for finance activities;
- be integrated with the business to encourage customer focus; and
- include a central advisory team.

The professional finance staff will need:

- strong commercial acumen;
- good analytical skills;
- effective interpersonal skills;
- a consultative approach; and
- an excellent coaching ability.

The finance processes should be:

- focused on adding value;
- integrated with other business processes;
- automated where cost effective to do so; and
- efficient and effective.

The finance systems should support the change by:

- being flexible;
- using emerging technologies where appropriate;
- being integrated across the business;
- reflecting users' requirements;
- having controls embedded within them; and
- enabling rather than constraining.

The finance culture should:

- be forward looking rather than backward looking;
- appreciate value, rather than cost;
- encourage openness and the sharing of best practices; and
- encourage partnering with the business.

En Route to 2010 with SmithKline Beecham

Critical to the pharmaceutical sector is the ability to develop new products and bring them to market. The challenge is to maximise the value that can be derived from the funds available, given the numerous opportunities that present themselves. The finance function has a significant role to play.

SmithKline Beecham Pharmaceuticals R&D Division has been transforming its finance function from scorekeeper to business partner by focusing on:

- streamlining transaction processing;
- establishing decision support tools and processes;
- developing skills and technologies; and
- building the finance discipline.

Transaction processing has been moved from the individual businesses to company and country-wide shared service centres. “This has produced significant benefits in terms of reduced costs, increased accessibility, and improved process quality,” says David J Smith, Finance Director, Worldwide Development, “thereby freeing up finance people to analyse and interpret the business rather than tracking invoices and checking ledger codes. In addition, the shared service centres have improved the quality of and access to purchasing data, enabling enhanced supplier management.

SmithKline Beecham monitors the boundary between the enhanced service centres and the business, to identify whether other activities such as regular reporting and consolidation can be migrated.

Finance plays a critical role in supporting the R&D decision-making process. Finance has built up a team with skills to support decisions which encompass:

- identifying priority projects and aligning resources to reduce cycle time;
- determining the impact of new enabling technologies and investments;
- assessing project terminations and reallocation of resources; and
- selecting appropriate in/out licence opportunities.

The finance organisation mirrors the overall business structure, providing specific financial support to the heads of each business/therapeutic area. “The feedback from internal customers has been extremely positive,” says David Smith. “A typical comment is: ‘My confidence in Finance has grown – four years ago the finance function simply added up the numbers.’”

A central team maintains the finance discipline within R&D. Its role includes the continual development of processes, tools and systems, adopting best practice wherever possible. Specific aspects include:

- managing finance process development;
- training finance staff in the latest processes, tools and systems; and
- developing and supporting the use of financial modelling methods, project and process analytical techniques, and new financial tools.

“Our success so far is prompting us to consider a comprehensive review of financial decision support roles in R&D,” explains David Smith, “and I know similar reviews are being carried out in the rest of the organisation.”

‘My confidence in Finance has grown – four years ago the finance function simply added up the numbers’.

The importance of the finance discipline

If the finance department disappears there is a risk that no one in the organisation is focusing on the three key financial accountabilities.

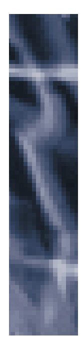
The key accountabilities of finance in 2010 will be the same as today, even though the responsibilities will change. These accountabilities are:

- to deliver value to the shareholders in accordance with their expectations;
- to challenge business managers to generate value and monitor their success in doing so; and
- to manage financial risk and maintain financial control.

Without a strong financial backbone underpinning all finance activities, these accountabilities could be at risk of being forgotten. There is a key role for the finance discipline to manage this risk and to ensure alignment of all finance activities. It follows that the finance discipline should include:

- maintaining a network of finance people throughout the organisation to share techniques, best practices, experiences and issues;
- developing the awareness of value throughout the organisation;
- recruiting, developing staff and planning careers for finance people;
- training, retraining and coaching throughout the organisation on financial issues; and
- setting policies on control and accounting issues.

The importance of maintaining and managing the finance discipline in the future organisation should not be underestimated. Without it, the significant benefits of changing finance could be outweighed by failures in financial control, an inability to challenge the business, or the failure to meet shareholder expectations.



The importance of the finance discipline should not be underestimated.

The future: a catalyst for your career

The future is not in fact as bleak as it seems for accountants. Rather, the future holds new possibilities.

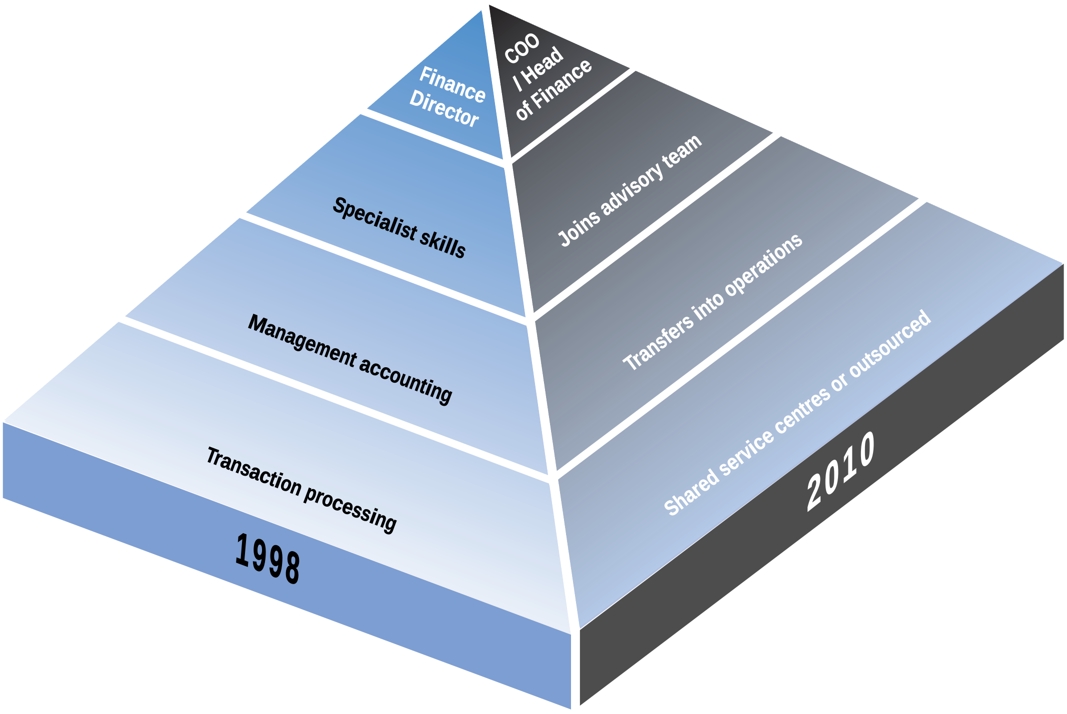
So what does this mean for you?

Although we have argued that there will be no need for a finance department in the future, this does not mean that there will be no roles for good finance professionals. Finance activities will always be needed, and financial skills will always be in demand. Possibilities for your career progression might include:

- moving to the role of Chief Operating Officer or Head of the Finance Discipline;
- building your specialist and interpersonal skills to join the advisory team;
- combining your financial skills and business acumen to take on an operational role; or
- developing your management skills and capitalising on your technical background to manage a shared service centre.

We believe this offers more challenging and fulfilling opportunities than the traditional finance department ever did. You will always be in demand.

Figure 4: **The future for finance professionals**



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