FINANCE UNDER PRESSURE:

How innovative CFOs do more with less

A report published by CFO Research Services
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ABOUT THIS REPORT

In November 2003, CFO Research Services (a unit of CFO Publishing Corp.) conducted a research program to identify how innovative CFOs are responding to the demand for finance to do more with less. DLC, Inc., a finance consulting firm, funded the research and the publication of our findings.

Our research consisted of interviews with nine senior finance executives from the following companies:

- American Express
- CBRE Holding
- Charles Schwab & Co.
- Delta Connection, Inc.
- Educational Testing Service
- Sony Pictures Entertainment
- Technicolor Entertainment Services
- Virgin Entertainment
- Yan Can Restaurants

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INTRODUCTION

Life has been getting harder for finance professionals. Increasingly, CFOs and their staffs struggle to do more with less, compelling finance employees to work longer hours. In many companies, morale is slipping and turnover rates are rising. A survey by Financial Executives International found that 34% of finance executives plan a career change in the next two years.

On one level, this situation is the result of a set of well-known pressures. New regulations—Sarbanes-Oxley, especially—are driving finance departments to devote time and effort to compliance. "I believe that there is a tremendous amount of work that most companies have to do in order to comply with the documentation requirements of Sarbanes-Oxley," says Gil Borok, global controller for CBRE Holding, a real estate services company. In addition, uncertain economic conditions have prompted companies to demand greater productivity—which, in many cases, means layoffs—from non-revenue generating functions such as finance. At the same time, business units demand a greater level of analytical support from finance to help them negotiate a changing business environment.

The result is a squeeze on finance employees. "[The pressure of regulatory compliance] is compounded by the fact that companies' performance is down over what we had in the late 90s," says J.T. Fisher, CFO of Delta Connection, Inc., a unit of Delta Air Lines. "As a result, most companies don't have more finance people than they did then—they have fewer. It just makes for longer, harder days."

THE PROBLEM WITH FINANCE ORGANIZATIONS

The trouble isn't solely the product of external forces, however. The real problem lies at a deeper level—within the finance function itself. In particular, the culprit appears to be the way companies organize finance employees and the work they perform. For years, finance—like other parts of the company—has operated as a rigid hierarchy. Just as companies did a hundred years ago, most finance departments continue to model themselves on the standard pyramid-shaped organizational chart: CFO at the top, VPs on the tier below, directors on the next level down, and the administrative support staff on the bottom. Each box in the pyramid represents a full-time worker with a defined, unchanging set of duties.

This structure sufficed at a time when work was predictable, repetitive, and largely manual. More is expected of finance functions today. The CEO and operations heads want finance to provide fast, customized advice on subjects ranging from investment optimization to supply chain management. Finance departments are expected to run leaner, automating repetitive tasks and devoting more time to value-added work. And they are expected to do this while responding to the pressures mentioned above.

The traditional finance function is ill-suited to respond to these demands. There are at least three problems with the way finance departments organize themselves today:

3 PROBLEMS WITH THE WAY FINANCE DEPARTMENTS ORGANIZE THEMSELVES TODAY:

inflexibility
instability
inefficiency

Inflexibility

First, the traditional structure is inflexible. Companies usually hire employees whose skills are the best match for the specific tasks of the job. But the needs of the business often change faster than the abilities of its specialists. As a support function, finance's purpose is to serve the needs of the organization—a finance function unable to adapt quickly to the changing demands of the business fails its internal customers.

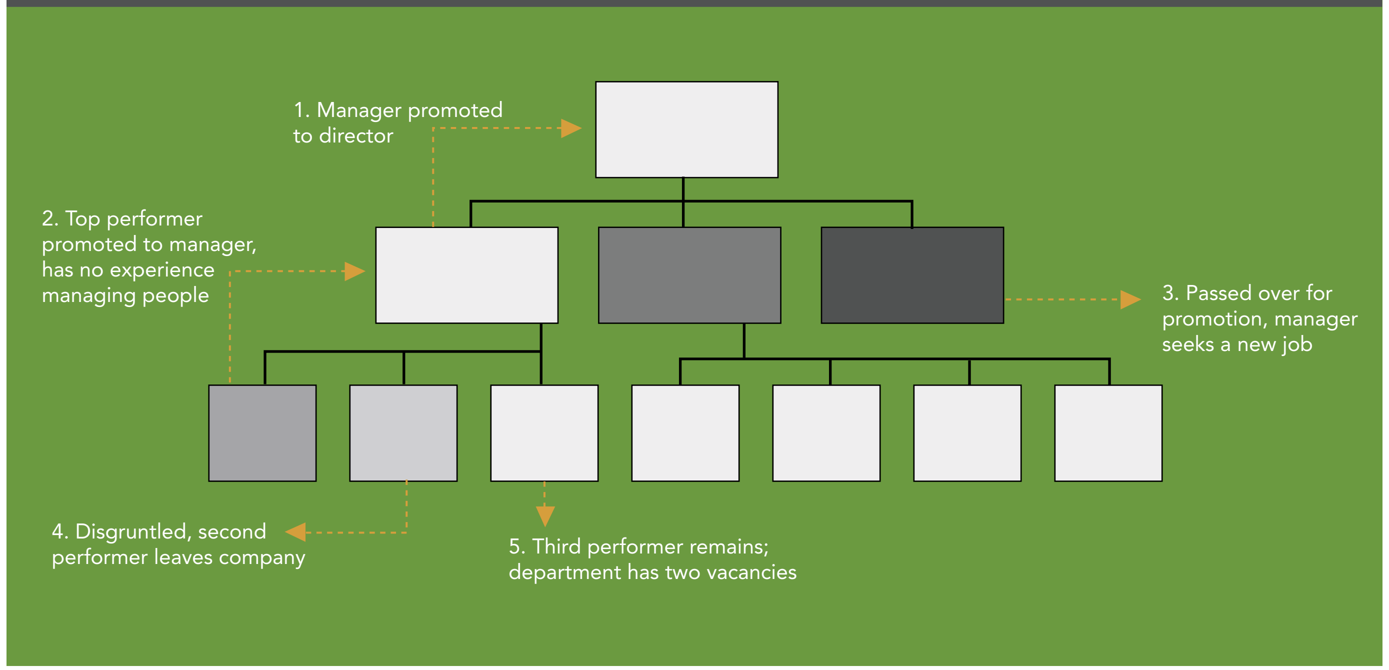
"Flexibility and adaptability are very important to us," says Fisher of Delta Connection. "The last thing you can afford to have is too many people on your staff who are limited in capability, who may do one job great but are not adaptable. We need people who can do a great job in Job A and, tomorrow, do a pretty good job in Job B and learn to be great at it."

Instability

Second, the structure is inherently unstable. Consider what happens when an employee is promoted or leaves. When this happens, there's an empty box in the organizational chart. Because of the emphasis on bringing in a full-time, specialized replacement, the vacancy can be hard to fill. In many industries, employees switch jobs every three years on average, meaning that companies lose one-third of their employees annually. And given that the median number of days to fill a vacant finance position is 40 (according to Hackett Group data) most departments will never be fully staffed, even when business conditions are steady.

Add an outside factor such as job uncertainty in the wake of a merger or a change in the competitive environment, and it's even harder to maintain a full workforce. "If the company announces in the press that it's going to be laying off 10,000 people and it's not identified where in the company those people will be," says one executive, "people get antsy and say, 'I'm not going to wait for the fire to hit my door. I'm going to pack up my belongings and get out.'"

Figure 1: Instability of the traditional organizational structure



Another problem occurs when someone is promoted. When the top performer moves up in the hierarchy, that person's colleagues—passed over for the promotion—often become disgruntled and look elsewhere for work, making them less productive in the meantime. When the number two performer finds a new job, the company is left with the number three performer. Studies have shown that in most organizations, 20 percent of the employees perform 80 percent of the work. This suggests that by the time the company is down to the number three performer in a small organization, it may have someone who contributes little. The instability resulting from understaffed organizations and reduced productivity can be a source of great frustration for managers (see Figure 1).

Inefficiency

Finally, the traditional organizational design hampers efforts to attain higher levels of efficiency. When a company identifies a set of activities, creates a job around it, and hires someone for that job, that person has little incentive to find ways to streamline that job out of existence, even if they are capable of it.

Furthermore, as managers rise in the organization, they tend to hire people in their own image, and encourage them to perform the work in the same way they did. This can perpetuate an outdated process.

By themselves, such deficiencies are rarely fatal. But when a weak organization is subject to exogenous factors—such as M&A activity, a systems implementation, or new accounting rules—the outcome is wasted time, lost productivity, and unhappy employees. Like a poorly designed skyscraper that cracks under strong winds, the typical finance department is usually not supple enough to withstand these pressures without damage.

TOWARD A SOLUTION

What can a CFO do to build a resilient finance function? Although many of the challenges facing finance have their roots in organizational design, a major overhaul of the function's structure may not be the answer. Such upheavals—under the guise of reengineering, e-transformation, and others—often shuffle the boxes of the organizational chart without addressing the fundamental problems.

Fortunately, there are steps companies can take. Many are simple and relatively easy to implement. Others require more time and money. All have been shown to work (although not all will be appropriate for every company). The companies we spoke with who are successfully addressing the challenges facing finance are pursuing solutions that fall into one of two broad categories: those focused on what finance does and how it does it, and those that address the composition of the finance department's staff.

EXAMINING THE WORK OF FINANCE

For many years, companies have explored ways of performing finance tasks better and more cheaply, but most still have a long way to go. In fact, much of what finance does can be streamlined, automated, or shifted off to a shared service center or outsource provider.

STREAMLINING

Most corporate functions continue to perform work that is either no longer needed or can be done far more efficiently. Reporting is one example. Financial reports generated for management tend to acquire a life of their own—request a report once and it keeps being created long after it has stopped being useful. A simple review of these reports can save work. Companies often find that 50 percent of reports can be eliminated, and 20 to 50 percent of what remains can be consolidated. Many of those consolidated reports can be automated. A smaller number of people can generate what is left.

Sony Pictures Entertainment is adopting such an approach. According to Irwin Jacobson, the company's VP and controller of the Studio Services division, the finance function has been able to reduce its workload by trimming and improving reporting. "We're constantly pushing back to corporate to see if the things that they're requesting are: one, truly needed; two, being looked at; three, are useful; and four, could be done in a different way altogether." At least once a year, representatives from the finance function visit the major business users to ask these questions. In addition to eliminating some reports, finance has found others that can be dramatically shortened or presented in a better way.

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Similarly, Technicolor Entertainment Services, a service provider to the entertainment industry and a unit of the electronics giant Thomson, has found that it can consolidate many of its reports. "We've found that there are several places in the organization where the same information was being collected by different people without realizing it," says CFO Mary Ann Fialkowski. "So we've been able to consolidate so there's only one source of information and one report."

Streamlining doesn't have to be limited to reporting or data entry. Some companies are reviewing the entire planning process, with an eye toward making it more accurate and less time-consuming for finance. At American Express, for example, planning and forecasting used to be the same difficult process as it is at most companies. "Our planning cycle was an iterative cycle that almost never ended," says Priyan Fernando, SVP of finance and CFO of the company's travel and global corporate services business.

To correct this, American Express devised a standardized set of financial models for each of its major businesses. The finance function worked with the business heads to determine the key performance drivers—both financial and operational—for each business. Using the numbers from these drivers, the company conducts a monthly rolling forecast. According to Fernando, achieving consensus on the business models and drivers has meant that the company avoids the usual back and forth about the performance estimate, thus saving time that finance can spend on other activities. "The whole planning cycle has been significantly streamlined," he says.

Automation

In addition to pruning and streamlining, companies can automate many finance activities out of existence. For example, mundane activities such as reconciling journal entries aren't necessary when the company has an integrated financial system. Sony Pictures Entertainment has eliminated the need to compile telephone records each month by implementing an automated, Web-based telephone accounting system. "We're estimating that we'll save over 5,000 pieces of paper a month and a couple hundred hours of labor time," says Jacobson.

Technology also enables companies to spend less time on reporting. Through the finance portals provided with ERP systems, business users can generate their own reports. Virgin Entertainment, which runs the Virgin Megastores, plans to do this as part of a data warehousing project. "I'm trying to get to the point where people in the organization who need financial information don't need to rely on the finance department to get it," says CFO Jeff Moxie. "I want to help them analyze what they're seeing, not just generate things."

Many CFOs argue that this automation is essential if their functions are to continue being a value-added business partner in light of the increased burden imposed by new regulations. "The certifications and the control assertion reports are becoming a bigger part of the job and are taking away our ability to add value," says Dave Martin, SVP of finance for Charles Schwab & Co. "I think we're going to have to continue to automate piece by piece and get more efficient in all that we do, and try to free up time for what we think is the value-add."

Shared services and outsourcing

Shared services are another way of lightening finance's burden. Admittedly, shared services centers have had their problems at some organizations. But when done well, they allow a company to take advantage of economies of scale for tasks such as transaction processing—or even reporting—and allow CFOs to shift resources to value-creating work. American Express is one company that has managed to overcome many of the traditional challenges facing finance through a combination of efforts, including a shared services program (see case study).

Outsourcing is another way of achieving the same result. Delta Connection routinely evaluates outsourcing opportunities for all of its functions, including finance. "It isn't necessarily a matter of getting a lower hourly rate from the third party," says Fisher. "I might get good efficiency as well as better quality."

Case study: American Express

In 2000, when Gary Crittenden became CFO of American Express, he and CEO Kenneth Chenault articulated a new goal for the finance function. "Their vision for finance was to be more than a reliable, efficient business partner," says Priyan Fernando, SVP of finance and CFO for the company's travel and global corporate services businesses.

"Their goal was to make sure that finance was at the forefront of strategy and driving business results." Three years later, the function has made significant progress toward that goal. Finance now creates monthly rolling forecasts, advises the businesses on how to respond to changing business conditions, and helps guide the company's capital investments.

The platform for these achievements has been American Express's work with shared services. From 46 different locations handling transaction processing, the company has now consolidated to three centers—in Phoenix; Brighton, England; and Delhi, India. Having achieved what Fernando terms "huge savings" and six sigma-level processes, the company has now added routine reporting and analysis to the shared services centers.

More important than the cost savings, the shared services centers have created reliable, standard information for use in the company's business planning efforts. It has also permitted the decision-support functions to concentrate on providing ad hoc reporting, forecasting, and a new investment optimization program. "Our objective is to continue shifting resources from core finance work to what we term value-added," says Fernando.

Sarbanes-Oxley may provide a ready excuse for many companies to reevaluate the way finance does its work. Because Section 404 of the law requires companies to document internal reporting processes, many companies are hoping to make improvements at the same time. "It is my hope that as we go through the Sarbanes-Oxley documentation next year that we won't just do it as a documentation exercise, but we will look at our processes in terms of streamlining and improvement," says Borok of CBRE Holding. Even so, he admits that the pressure facing his function makes it hard to find the time to do so. "With everything else you've got going on, it's awfully hard to sit down and carve out the time to put a program in place to improve processes."

FOCUSING ON FINANCE EMPLOYEES

The second way CFOs can mitigate the problems created by an outdated organizational structure is by making changes to the workforce. The objective is to develop a workforce that's more flexible, better at what it does, and more efficient. There are at least three factors to consider: whom to hire (and how to go about hiring), how to develop the workforce, and how to structure it.

Hiring

As businesses have come to demand that finance functions provide advice as well as data, CFOs now realize that they need employees with abilities in fields other than accounting (although there is obviously still a need for such employees). This does not mean hiring new kinds of specialists—the demands of the business change too quickly for that. Instead, finance departments are adding employees with strong finance skills, but who are also adaptable.

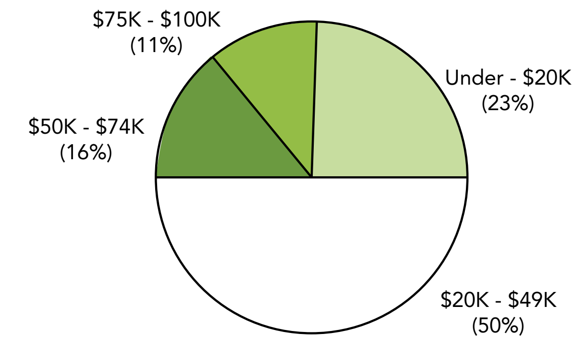
Blake Barnet, CFO of Yan Can Restaurants, a unit of Yum! (which also owns Pizza Hut and Taco Bell, among others), says his goal is to hire fewer, but better, employees. His main criteria are that they be bright, be able to learn about the various aspects of the business quickly, and be relationship builders. "The need is greater for this kind of person today," says Barnett. "Previously, you had people who were strictly finance, but now you need both depth and breadth."

"The demands [on finance] are changing all the time," says Borok of CBRE Holding. "But if you hire a certain basic skill set—someone who has had some public accounting experience, for example, or someone who has an MBA—they're going to be able to adapt."

CFOs cautioned not to rush the hiring process. One reason is to ensure that the company chooses the right person.

Figure 2: The cost of replacing finance employees

(For finance employees earning between $70K and $150K)



SOURCE: Financial Executives International and Watson Wyatt

The direct costs of hiring a new finance employee are high (nearly one-third of companies spend over $50,000 to replace a mid-to high level finance employee, according to Financial Executives International and Watson Wyatt), not to mention the costs of disruption (see Figure 2). With finance staffs shrinking, companies can't afford to have to rehire for the same position. Recognizing this, Sony Pictures Entertainment has been taking a cautious approach to hiring new finance employees (see case study).

The second reason not to hire right away is that there is a good chance that the position is not necessary anyway. If typically 20 percent of workers do 80 percent of the work, then the remaining 80 percent of workers are doing only 20 percent of the work—on average, they are creating only 1/16th of the value of the top workers. So when a new position opens, there is a one-in-five chance that it is one of the lower-value jobs. Rather than automatically rehiring, it may make more sense to have a task force or an outside consultant investigate ways of streamlining that work out of existence.

Delta Connection routinely takes this approach, says Fisher. "Today, it's almost a default that we look and say every job vacancy ought to be thoroughly explored as an opportunity to streamline before adding resources." The options include consolidating the tasks with another job, thereby giving someone else a greater span; or recreating the job as a lower level position, and giving someone a level down a chance to develop. When this gradual restructuring succeeds, says Fisher, the function is leaner and employees feel that they have been given more important work without being overburdened. And, of course, the CFO has resources left over to deploy elsewhere.

Developing the workforce

CFOs should also examine the existing staff, of course, and determine whether retraining can help create the skills the function needs. Princeton-based Educational Testing Service has put a rigorous performance management process in place to gradually improve the function and help it respond to the business's needs more easily.

According to Frank Gatti, the company's CFO, every finance employee has a set of very specific goals for the year—goals that will tangibly improve the department's performance. These might include reducing the close time by three hours, or partnering with someone in the business. Based on their performance, employees are annually ranked in four tiers; those in the bottom tier receive a development plan. To keep their jobs, they must move out of the bottom tier by the next year. "What we're evolving to is fewer people but with higher levels of skills and multiple skills," says Gatti.

Case study: Sony Pictures Entertainment

Like most finance departments today, the studio finance group at Sony Pictures Entertainment is struggling to make the most of shrinking resources. According to Irwin Jacobson, VP and controller of the company's Studio Services division, the finance function has seen layoffs, restructuring, and reengineering, requiring finance to be more productive. "We've had to work more efficiently and work longer hours," he says. And that has meant changes to the way the company hires employees: "We've had to hire talent that is much more versatile and much more willing to stick it out through difficult times that sometimes appear endless."

Although Jacobson's group has worked to streamline and automate its processes, employees have been a focus of its improvement efforts. Because his staff is now smaller—reduced from 24 to 15—there is a need for employees who can handle a variety of tasks. Finding the right person to fill a vacancy can be hard, though. Positions can remain empty for as long as six months, creating an urge to settle for someone who may not be good enough. Jacobson pushes his staff to hold out for the right person.

In the meantime, the company may secure an outside resource to perform the tasks associated with an open position. For instance, one director position is being handled on an interim basis by a consultant. "We decided instead of settling we would go the route of contract employee and get someone really strong." Until it finds a full-time replacement, Jacobson's team is looking at ways of streamlining the job so that its more advanced duties can be handled by a more senior manager, and then eventually the position can be downgraded to a less expensive manager role.

Recommended CFO actions

- Streamline routine tasks. Much of the routine work of finance can be done far more efficiently—or even not at all. In particular, examine the reports the department generates today and determine whether they are necessary and whether they can be shortened.

- Automate where possible. What can't be streamlined away can often be automated, freeing time and resources for more important work. "You start to see the light at the end of the tunnel when you start to put in the technology," says J.T. Fisher of Delta Connection. "It's better than just trying to dig faster to keep up with the demand."

- Consider shared services. While they require a large initial outlay, shared services centers are a good way of creating economies of scale and allowing finance to concentrate on its decision-support activities.

- Ensure that finance continues to add value. CFOs emphasized that, as finance departments struggle to keep up with demands such as regulatory compliance, it's essential to continue to contribute to business decisions. When the business stops seeing finance as a value-added function, finance is likely to lose even more resources.

- Don't immediately rehire for vacant positions. Use an employee departure or promotion as an opportunity to ask whether the position is necessary in the first place.

- Use flexible staffing resources. Using contingent employees is one way to create the flexibility and process improvement companies are demanding of their finance functions.

- Don't go for an "A" in compliance. Make sure your company is fully compliant with regulations, but don't compromise finance's ability to perform its other duties in the process. "An 'A' in financial compliance probably means you've spent too much and you're impairing the business," says Dave Martin of Charles Schwab. "You need to figure out what a good score is—that's probably a 'B-.' Operational compliance (for a financial services firm) is a different story; zero tolerance for errors could be an acceptable goal there."

Reconsidering the structure

Finally, it's worth assessing the way the function is structured. There are two aspects to this. One is where in the organization finance employees should work. Many companies are moving to a model whereby much of the repetitive work of finance is done centrally—in shared services or at corporate headquarters—but the more ad hoc, customized work is done within the business units, alongside the customers of finance. This model has the advantage of freeing the decision-support employees from time-intensive routine activities, allowing them to focus on responding to the needs of the business.

Another aspect is whether or not to rely on a staff made up entirely of full-time employees. The alternative is to use a mix of full-time and contingent workers. In addition to creating a more flexible cost structure, using specialized expertise on an as-needed basis allows the department to be more responsive to the ebb and flow of workload periods and better manage periodic high-visibility and high-ROI projects.

Educational Testing Service, while it minimizes the use of outside resources, has someone working to ensure that proper financial controls are in place for each of the company's products. The challenge, says Gatti, is to ensure that the contingent worker's knowledge gets transferred to the organization. "You don't want to wind up in a situation where this very valuable knowledge and experience winds up in that individual's head and after six months or a year, they're gone." Gatti's solution is to team that person with a full-time employee.

Other finance departments use contingent workers to bridge the gap when high-level employees leave the company. Jeff Moxie of Virgin Entertainment comments that when his company does this, it does so with an eye toward improving the way that job is done going forward. "Typically, I like to hire somebody whose qualifications are maybe one step higher than what the job would normally call for," he says, "with the idea that they are going to come in for the time they're here and say, 'okay, this is how we think we can make it better.'"

CONCLUSION

The problems confronting finance are unlikely to ease soon. As the economy begins to recover, companies will almost certainly continue to demand the same level of efficiency from supporting functions as they did during the downturn. At the same time, a stronger economy means more job opportunities for dissatisfied finance employees. And many provisions of Sarbanes-Oxley have yet to take effect—the hardest parts of compliance remain ahead for most companies.

As the experiences of the companies profiled in this report suggest, however, there are specific actions CFOs can take to address the problems. Some are large-scale, such as American Express's transformation program. Others are more incremental, such as the changes at Sony Pictures. But all call for recognition that much of the difficulty flows from the way finance is typically organized and managed. While it is probably counterproductive to start redrawing the organizational chart, an improvement effort that provides the missing flexibility, stability, and efficiency stands a good chance of success.

