THE STATE OF THE ART IN FINANCE
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO Notes</td>
<td>1</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Is Cost all That Matters?</td>
<td>3</td>
</tr>
<tr>
<td>Conclusion</td>
<td>10</td>
</tr>
</tbody>
</table>
THE STATE OF THE ART IN FINANCE

By Katharina Muellers-Patel
In the wake of recent accounting scandals and the increasingly competitive business environment, many CFOs and the finance organizations they lead have started to take on new strategic roles within the enterprise. They are aiming at enforcing stricter control processes to ensure legal and regulatory compliance, offering strategic insights into the internal and external business environment, and connecting the business strategy with daily operations through performance tracking.

The trend toward a more strategic role is echoed by the responses of participants in recent APQC surveys (formerly known as The American Productivity and Quality Center). Respondents indicated that, three years down the road, they would spend 30% more time on decision support and management. According to the same surveys, however, these respondents have not made much progress toward a greater strategic role. Finance organizations, no matter what their size, report to APQC that they still spend almost two-thirds of their time on transaction processing and controls and only one-third on decision support and management.

The difficulty lies in bridging the current gap between the finance function that emphasizes greater efficiency and the finance function that becomes a partner in managing the business. The best companies have found that reaching the goal of a more strategic finance function warrants a two-step approach, as follows.

1. These companies deal with the complexity of the various functions that come under the finance umbrella, making them as efficient as possible and, in the process, freeing up corporate resources for other activities. As one global treasury manager put it, “We must develop a finance function that is as efficient as it can be, replicate it globally, and then use it effectively to help us quickly establish brands and enter new markets.” Companies like this one choose a variety of approaches to streamline and automate finance functions while ensuring that they keep customers happy (in the case of shared-services arrangements).

2. With the efficiency of the transaction and control functions assured, they can turn to devising a more strategic approach for finance - not only giving finance more of a decision-making responsibility in risk management and compliance, but also a proactive role in managing the daily cash position to help increase resources for quick strategic moves.

One global consumer products company took the following approach to a more strategic path for finance. In the first step, the company developed a more efficient cash management, accounts payable, and accounts receivable group of functions in its worldwide operations, based on greater transparency of information. In the second step, the company developed “straight-through processing” along every level of the finance function, leveraging its global reach to maximize cash management efficiency, foreign-exchange exposure, and the global supply chain to help fund growth, participate in new marketing and distribution arrangements, and comply with worldwide regulations. The following point of view will discuss the results of the APQC survey, as well as research performed by SAP, in light of the current state of the finance function in U.S. companies, the challenges to that function, and the road map to increasing its strategic capabilities.
INTRODUCTION

Benchmarking is an important tool that finance organizations use to stay competitive. It allows them to determine the value of adopting best practices and changing business processes. To assess the trends in the finance function and identify best practices, APQC has evaluated the performance of over 130 finance organizations. The study included the following key processes:

- Financial strategy and planning
- Internal controls
- Treasury
- Revenue accounting (order to cash)
- General accounting
- Fixed assets and project accounting
- Accounts payable and expense reporting
- Tax
- Payroll

This SAP Insight will discuss recent trends and best practices, as well as provide examples for those companies with best-practice processes, models, and technologies.

The research group encompasses a wide sampling of organization size. Although the majority of respondents are billion dollar-plus organizations (in U.S. dollars), their size in terms of revenue and number of employees covers a complete spectrum.

Study Demographics

1 As of August 2005
2 All monetary amounts cited herein are in U.S. dollars.
**IS COST ALL THAT MATTERS?**

Despite more than 10 years of lip service paid to the idea of a strategic finance function - and the increasing strategic demands on finance - most companies admit that, while they do want to focus more on decision support and management, they are in reality still spending almost half of their time on transaction processing (see Figure 2).

However, some finance organizations have already made significant progress on their journey to becoming a strategic business partner, as illustrated in Figure 4. First-quartile performers spent only 30% of their resources on transaction processing, enabling them to invest 45% of their resources in decision support and management activities.

The right staffing mix, however, does not necessarily imply cost-efficient operations. From an overall cost perspective, the survey identified three insights worth highlighting, as follows:

- Finance costs tend to be relatively lower for larger companies.
- Among companies with comparable revenues, there are still significant cost differences.
- The main source of differences are the types of organizational structure for finance (for example, whether there are shared services and the level of centralization) and the type of IT (the level of automation and/or degree of systemic integration).

---

**Figure 2**

![Figure 2](image)

**Figure 3**

Finance Costs as a Percentage of Revenue

<table>
<thead>
<tr>
<th>Business Unit Revenue</th>
<th>SMB 50k</th>
<th>Medium 500k</th>
<th>Large 5b</th>
<th>Enterprise Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average</strong></td>
<td>5.4%</td>
<td>5.7%</td>
<td>1.1%</td>
<td>1.0%</td>
</tr>
<tr>
<td><strong>Median</strong></td>
<td>2.7%</td>
<td>0.7%</td>
<td>0.6%</td>
<td>0.8%</td>
</tr>
</tbody>
</table>
The first insight is not surprising, as larger companies will be able to leverage economies of scale (see Figure 4 below).

**Size Means Little to Costs**

![Figure 4](image)

However, within each revenue band, some companies had as much as 16 times relative higher finance costs than other companies with approximately the same revenues (see Figure 4). Among all the cost drivers discussed above, the extent to which the company established shared services was the strongest driver for cost efficiency (apart from revenues). In fact, the survey showed that, given the average company revenue of $4.7 billion, each additional shared service saves an average of $3.4 million!

It is logical that, in line with the focus on transaction processing, personnel represent the largest cost element, on average, comprising more than 65% of all finance function costs.

SAP research has shown that leading companies maximize the efficiency of transactional activities as a first step on the road to a more strategic approach. One globally diversified industrial manufacturer, for example, which considers itself world-class in every strategic respect, has been coping with the complexities inherent in an acquisition growth strategy that resulted in more than 60 acquisitions and an almost equal number of divestitures (55 in all). The CEO wished to hone in on the segments where the company’s product line leads the market and exit those where it had no competitive advantage. While the strategy succeeded and growth was maintained, operational difficulties began to show up in the early 2000s. Each of the acquisitions brought along its own type of IT system; each had its own finance function and its own approach. The result was a nightmare for the CFO. Working with a benchmarking firm to determine which finance functions were not in the top quartile of productivity, he found that finance transaction processes clearly needed to be changed.

Shared services seemed to be an obvious target, especially for transaction-based functions. The first chosen was payroll, which suffered from inefficient processes and lack of automation. Now the financial center operates so effectively that it has begun to show a profit when employees ask for extra processes (cash advances, stop payments, manual checks, and so forth). The internal customers whose staff members use direct deposit and the self-service portal are charged less than those whose employees prefer paper transactions. The keys to success are the use of service-level agreements and a well thought-out performance management process to establish and track productivity goals with customers.

**WHETHER TO OUTSOURCE OR SHARE SERVICES**

If you want to reduce costs or improve service levels, should you move to outsourcing - or is shared services the answer? Outsourcing is becoming increasingly prevalent as a way to decrease costs. For example, the APQC survey found that when three or more functions are outsourced, average costs of finance as a percent of revenue are only one-fourth of those costs without outsourcing.

Companies normally approach outsourcing in waves, with payroll and tax among the first to be outsourced, and fixed assets, general accounting and accounts payable and expense as part of a second
wave. Finance strategy and planning, internal controls, and treasury are not typically outsourced; revenue accounting and order to cash might emerge as another outsourcing application in the future.

The outsourcing strategy varies among industries. While order-to-cash functions are not widely outsourced today, public utilities and energy are a notable exception. In these industries, where the number of customer payments is high and customers tend to get behind in their payments, many companies outsource both their accounts receivable and credit functions, checking all customers through outside services. At that point, when collection becomes critical, the utility can concentrate on enforcing collection rules where necessary, while the outsourcing service deals with the majority of customers who do not overstep the rules.

Companies also like to use shared services; when managed well, shared services can improve process effectiveness while helping decrease costs. APQC research found that the lowest-performing companies most often had not implemented shared services for any function and as a result, incurred the highest cost of the finance function as a percentage of revenue (see Figure 5).

One consumer products company made the move toward shared services and gradually improved the performance of the finance function. The company optimized both IT systems and organization. The person in charge of finance shared services consistently improves the function by measuring and tracking improvements. Its transaction center has become largely automated, freeing up finance employees to perform more value-added, customer-oriented financial work.

Another example is a global pharmaceutical company that has used shared services for more than 15 years and simply changed the technological foundation. The company had developed a philosophy of centralization as part of its long-term strategy to standardize, reduce costs, and increase control and economies of scale as it embarked on a path of growth through acquisitions in the 1990s. Accounts payable has been a shared service ever since. The process was run on various legacy systems, but then upgraded to an overall enterprise resource planning (ERP) system that handled the parent company’s transactions. Now, however, the company realizes that processes cannot be made more efficient without changing the technology again. The company is experimenting with a fully integrated procure-to-pay approach, which will require integrating systems and developing the omnibus measurement system necessary to track transactions.

In another case, a large utility turned to shared services with the initial intent of increasing cost-efficiency. The utility, which serves a large metropolitan area, is diverse and decentralized. Costs from shared services are shared by its customers; performance measures are based on the results of shared services from other utilities around the country. The flexibility of the payroll shared-service system has helped the company streamline processes and dramatically reduce cycle time. The unit more quickly isolates problems (such as employees who do
Companies that had automated more than 66% of their finance processes had average finance costs of 1.2% of revenues, while companies with less automation had average finance costs of 3.0% per revenue.

First, the APQC survey showed that companies with a higher degree of automation have lower overall finance costs. Companies that had automated more than 66% of their finance processes had average finance costs of 1.2% of revenues, while companies with less automation had average finance costs of 3.0% per revenue. For example, companies that relied on manual techniques or spreadsheets for cost accounting and cost management had average costs three times as high for that process ($2.21 per $1,000 of revenue) than companies with an automated process (only $0.72 per $1,000 of revenue).

Even more interesting, the APQC survey found that while more automation means decreased costs, little automation even impedes reporting. APQC found that more than two-thirds of companies with less than 33% automated processes were unable to provide process cost data. Only 32% of companies with more highly automated processes were unable to provide detailed process cost data.

Looking further into the impact of automation, APQC found that packaged financial software (versus custom applications or spreadsheets combined with manual processes) is used in most core finance processes, including accounts receivable and payable, payroll, general accounting, and fixed-asset accounting. As a result, companies have succeeded in

not enter the required number of hours) and addresses them before a payroll run. Continual benchmarking against other companies in the same industry helps the utility firm find places to consolidate and eliminate duplication of effort.

Besides the cost-efficiency inherent in these improvements, an unforeseen benefit of shared services is that employees in the payroll function can take on other responsibilities with a longer-term impact, such as developing new-hire orientation programs and providing training programs in financial management. As the finance function takes on more strategic roles, it has been able to provide a new level of incentives for its employees and has seen its historically high turnover rate moderate over time.

MORE EFFECTIVE IT LEADS TO MORE EFFICIENT FINANCE FUNCTIONS

The APQC survey reaffirmed that more effective use of technology helps companies achieve greater levels of efficiency and gradually frees up personnel for more strategic tasks requiring more thought and managerial capacity. Let’s first discuss how the right use of information technology leads to greater efficiency and lower costs.
reducing staffing levels in these areas (see Figure 6). On the other hand, less than 40% of the companies surveyed had off-the-shelf software implemented in the areas of cash management and planning, budgeting, and forecasting. These areas were among the most staff-intensive processes within the finance function.

**Reducing Staff at the Core**

![Figure 6](image)

The research also found a correlation between the level of cost decrease and the lack of IT complexity. Companies in the APQC survey reported that their average costs decreased dramatically when they used a single instance of ERP software and a common chart of accounts (see Figure 7). When they used multiple instances or even multiple applications, the cost was more than 50% higher than with the single instance and common chart of accounts.

**MORE EFFECTIVE IT ENABLES MORE STRATEGIC FINANCE FUNCTIONS**

The use of an integrated ERP system by the finance function also paves the way to a more strategic approach. If a company establishes a more integrated process, planning and reporting cycle times are much reduced, providing data for critical decisions much sooner and enabling improved decision making by company executives. For example, looking at budget preparation cycle time or closing of monthly accounts, the APQC survey revealed that companies relying heavily on manual processes or spreadsheets took an average of 90 days to prepare their annual budgets, versus an average of 62 days for companies relying on an ERP system. The survey showed that companies with a rolling forecast reduced annual budget preparation time to 60 days from 85 days on average. The average survey participant generated $330,000 in cost savings each additional day the budget cycle time was reduced (through technology and improved processes).
Finance professionals echoed the fact that, moving forward, IT would take over more of the transactional aspects of the function, while they themselves will take over decision support and financial management activities, helping to make the finance function more strategic. This forward thinking is revealed in the APQC survey: despite the current focus on processing transactions, APQC respondents all indicated that, three years hence, they would be more involved with decision support and management activities, underscoring the basic importance of these more strategic capabilities.

These respondents reflect the fact that CFOs and finance functions must deal with a wealth of new difficulties, including many that are at the heart of the company’s strategic goals—such as increasing shareholder wealth. The CFO’s function has become pivotal to a company’s health in the following ways:

- Balancing revenue generation against cost efficiency
- Assessing risk daily
- Siphoning off risk into the future through sophisticated use of derivatives
- Managing earnings expectations and the need to create shareholder value
- Mitigating the deleterious effects of exchange rate fluctuations

Yet it is difficult for the finance function to manage the earnings flow and shareholder expectations for those earnings, given increasing global competition and regulatory constraints. To achieve excellence in finance requires a greater attention to a balancing act between operational efficiency and strategic effectiveness. The foundation for both is a great deal of analysis, data, and management time devoted to each, as well as more automation of nonstrategic, more operational processes, freeing up manpower to perform the data collection.

**AN EXAMPLE OF A STRATEGIC FINANCE FUNCTION**

A global consumer products company has created highly successful strategic finance functions based on a four-phase approach and using software from SAP. The end point: complete transparency of financial data across all global divisions. The CFO believes that cash generation is the lifeblood of a consumer products company, affecting all parts of the organization. Cash, in fact, is the barometer of the success of the company’s brand-building exercises; sales indicate the strength of the brand, and sales generate the cash that allows the company to fund its brand-building activities in new regions and new product areas. To develop the capability to monitor and understand the company’s cash flow, however,
the CFO realized he had to take care of four endemic and chronic inefficiencies and data difficulties in the following areas:

- Cash management
- Foreign exchange processes
- Funds transfers
- Month-end closing and accounts receivable

The problems with cash management were symbolic for the CFO as the root of all other evils. The process was essentially manual, took most of the day, and resulted in many mistakes. That led to missed funding opportunities in the commercial paper market, whose rates rise during the day; seizing opportunities required understanding the cash position immediately at the start of the day. From there, according to the CFO, the finance function could achieve all other strategic objectives.

In Phase One, the company standardized and established new processes to reconcile bank accounts daily, concentrate cash, determine a final number to borrow or invest each day, improve control, enhance accuracy, and pare down the number of full-time equivalents (FTEs) involved in the function. In another development, global vendor payments were integrated with the bank payment systems, and customer receipts posted to the general ledger. Each day, the company could then reconcile all global account information. Contracts in the ERP system were linked to the daily cash position, providing performance reporting and investment calculation.

In Phase Two, the CFO integrated the systems of the offshore divisions into the main system. That tactic assures that he can see the state of cash management in operations around the world.

Phase Three involved implementation of straight-through processing, whereby payments are transmitted directly to the bank from payment data. A single platform uses payment files extracted from the SAP® accounts payable and treasury applications for all types of payment. In effect the central treasury department has become the house bank for all of the company’s far-flung subsidiaries. The company believes straight-through processing eliminates costly errors caused by processing different payments in different countries. In addition, the straight-through processing of foreign exchange has cut down on difficulties in reconciling payments and revenues in the 30 or more currencies in which the company operated.

Phase Four completed the process of developing this strategic approach. This final step entailed entering all foreign exchange and commodities hedging contracts into the system, enabling the company to reconcile them itself without going through a third-

The company went so far as to do away with all manual processing in accounting for derivative contracts, as well. Not only did the company reduce costs; it also created the type of transparency and audit trail necessary to truly comply with the U.S. Sarbanes-Oxley Act.
party processor. The company went so far as to do away with all manual processing in accounting for derivative contracts, as well. Not only did the company reduce costs; it also created the type of transparency and audit trail necessary to truly comply with the U.S. Sarbanes-Oxley Act.

As a result, of the joint research between SAP and APQC, we found that the best companies, and their CFOs, recognize the importance of ready access to the right information to drive the right choices between different variables. Achieving this access requires the right system that will deliver the following benefits:

- Accelerate closing processes through automation, workflow, and collaboration
- Improve business analysis and decision support by providing historical and forward-looking views
- Deploy performance management tools that analyze the company and its resources
- Maximize cash flow through improved billing, receivables, collections, payments, and treasury management
- Increase effectiveness of compliance efforts through comprehensive auditing, deeper reporting, and management of internal controls (Sarbanes-Oxley)

In addition, the integrated systemic foundation will help companies meet the following objectives:

- Structure strategy and communicate goals throughout the entire organization
- Monitor the performance of strategic key success factors using external and internal benchmarks
- Use tools that support a financial planning process that integrates global strategic planning and specific operational planning problems in a closed-loop process