How to Transform Finance Function?

By Kamal Kumar Agarwal, M. Com; FCA

==

20% 40% 60% 80% 100%

==

In the corporate context, Transformation means radical changes in the processes, functions or transactions with a view to increase efficiency, effectiveness, productivity resulting in cost reduction and cost control. Typical transformation includes integration & segregation, business process outsourcing, introduction of shared services and enterprise software.

Why transformation of Finance is required?

- ✓ Increase efficiencies
- ✓ Increase effectiveness and productivity
- ✓ Eliminate process gaps and control weaknesses.
- ✓ Cost Reduction and cost control
- ✓ Address key finance issues
- ✓ Facilitate the cross functional groups
- ✓ Adopt the best business practices

Transformation of Finance as Independent Function?

Transformation of finance function has become so important in the current scenario, it has been identified as an independent function within the finance department of the organization. The regular finance function is so overloaded in fulfilling stakeholders' requirements, struggling with various complex issues and they are pulled out from the operations on day to day basis by the stakeholders that they cannot concentrate on finance transformation task on priority. Even internal audit cannot take full responsibility due to independence issue and being staff function. In the fast-changing modern corporate environment, it is necessary to perform self-assessment on regular basis to remain competitive and effective. The transformation of finance has become so relevant and important these days, that the big corporate houses have started to recruit senior management staff for "Finance Transformation". Conceptually it is an internal control function (Control environment, Risk Assessment, Control Activities, Information & Communication, Monitoring) within finance function extended to implementation and to take this task up to conclusion.

Transformation Life Cycle

Broadly the transformation must pass through the following processes:

a. **Aspirations / Expectations:** Discuss with stakeholders' their expectations if any, objectives and scope of work.
b. **Design the strategy:** Formulate the strategy. Define mission collaboratively with your senior and middle management. Seek top-level clarity about mission. Make mission personal to every manager. Transform Strategically.
c. **Method:** Though there are no specific pre-defined methods for transformation of finance function it is suggested to use finance and audit knowledge for identifying the problems and find solutions. Some of the audit techniques that can be applied are:
   1. Process Mapping
   2. Flow Charting
   3. Risk Assessment
   4. Identification and Analysis of process gaps and control weaknesses.
   5. Bench Marking

   Based on the outcome of the problems, use Best business practices to drive the project forward. Integrate / segregate the activities, operation or processes as per the situation considering the potential cost and benefits.

   Split the project into various phases, group it as per closely related processes and relevant sub processes, complete one phase, analyze it, learn from mistakes, correct them and apply the experience in the subsequent phases with due professional care.
d. **Planning / Road map** Determine resources necessary to perform Transformation e.g. finding or developing a team of talented people with finance and audit background, align the transformation mission and objectives with organization's mission and objectives, create a sense of urgency, develop time bound plan with appropriate governance structure and initiatives. The transformation leader must design a compelling transformation plan so that it may yield purposeful changes /results.

e. **Acceptance:** Engage stakeholders at every Step. Communicate the purpose and objectives from top to bottom. If there is resistance to change due to cost, internal politics or other obstacles, the senior management should make themselves available and intervene.
f. **Implementation** Be realistic about the speed of transformation initiatives.
g. **Testing:** Test the results and compare with expectations. Internal audit can play a significant role in this area by performing the independent reviews.
h. **Corrective Action:** Review the findings of test results. Study the reasons for discrepancies and take corrective steps accordingly.

How to "Transform" finance function

Although there are no specific methods defined yet it is suggested to start transformation from the grass-root level in a sequential manner. However, depending on the situation any group of processes/ sub processes/ activities can be picked up, to commence the work. Below are the suggested guidelines which can be followed as per size/ structure/ volume/ geographical presence:

1. **Simplify and rationalize legal entity structure**
   - Simplify group organization structure e.g. transparent flow of ownership from subsidiary to holding and to ultimate beneficiaries or vice versa.
   - Rationalized legal entity and reporting structures
   - Streamlined reporting environment and requirements
   - Standardized policies, procedures and processes
   - Centralized business models (reduced redundancy and leveraging economies of scale)
   - Integrated acquisitions

2. **Review the Organization Structure**
   - Develop an idle organization chart.
   - Bring similar types of operations under one department
   - Consolidate similar types of activities / Operations
   - Establish clear line of authorities and responsibilities. Eliminate the overlapping.

3. **Improvement in the processing of transactions:**
   - Shared services are cost effective and efficient options.
   - Outsourcing is another option where organization can transfer certain critical or non-critical tasks depending on the capability and expertise of the service provider and confidentiality of the processes.
   - Web portal for customers, vendors, employees, etc., via the internet and the bridge to organization's main system will automate the work i.e. fast, cost effective and efficient.
   - Identify the areas of manual working and change it to automatic. This will increase efficiency and productivity.

4. **Improvement in processes and Sub processes**
   - Integrate the processes and transactions.
   - Focus on analysis, risk mitigation, strategic planning and decision making rather than exhausting the energy on transaction recording, processing and reporting.
   - Management of core processes ("Order to cash" (O2C or OTC) "Opportunity to Order", "Procure to Pay" (P2P).
   - Continuous improvement

5. **Implement Standard Operating Procedure and Authority Matrix**

   Well defined Standard Operating Procedure and Authority matrix automates the work flow with minimal intervention of top / senior management in routine working.

6. **Standardized financial reporting process and reduce processing time:**
   - Use consistent and common chart of accounts across the group companies.
   - Use standard reporting formats.
   - Reduced processing time for key reports.
   - Improve reporting style and add value to the business, provide more value-added commentary, include Key Performance Indicators e.g. inclusion of Notional Rate of interest on working capital in the management account to demonstrate how effectively a specific business segment is performing. More interest will reduce operational profit and will force management to realize sales promptly, maintain optimum level of inventory and obtain credit period from suppliers as per prevailing market practice.

     Depending on the nature of business some more KPIs and efficiency ratios can be developed.
     - Salesmen wise sales amount/ Qty and gross profit margin.
     - Number of customers attended by each staff at front counter and gross profit generated.
     - Yield, recovery, breakdown, wastages, strip ratios,

7. **Efficient data management and adoption of latest technology**
   - Fully integrated systems—single ERP system globally
   - Implement ERP modules in all areas of operations.
   - Standardized and simplified system platforms.
   - Integration between subsystems and corporate F&A systems
   - Improved governance and data management

8. **Efficient Human Resource Management**
   - Clear, well-defined roles and responsibilities
   - Appropriate alignment of skill sets to roles
   - Performance measures directly tied to company strategies
   - Knowledge-sharing and continuous-learning environment
   - Incentive compensation structures to align pay to performance

Example:

Below is the example of transformation of decentralized treasury where each company of the group is taking care of its' own funds requirements. Neither they have visibility of other companies of the group nor any tool for intercompany coordination to help each other.

Decentralized Treasury (Losing US$12m)

Company	Balance (M US$)	Interest Rate	Interest (M US$)
A	800	2%	16
B	(600)	5%	(30)
C	100	2%	2
Total	300		(12)

Now after centralization of treasury, Head office has 'Birds-Eye View' on all the companies and meets cash deficits of one company by cash surplus of other group company without any external support. Under this concept, Central Treasury works like an inhouse bank who pays the interest on deposits and recovers interest on overdrawn accounts.

This concept has resulted in huge monetary savings. Earlier the organization was losing US$12m prior to centralization, now gaining US$ 6m i.e. the difference of US$18m.

Centralized Treasury Function (Gaining US$ 6m)

Company	Balance (M US$)	Funds used in Other Group companies	Balance	Interest Rate	Interest (M US$)
A	800	800	-	2%	0
B	(600)	(600)	-	5%	0
C	100	100	-	2%	0
Total	300		300	2%	6

In addition to that there are some indirect benefits:

- Instant funding to group company in case of cash deficits and invest net surplus to money market.
- Minimizing the cost of administration of current accounts.
- Settlement of suppliers' invoices and collections through single window will increase the efficiency and reduce the cost and turnaround time.
- Negotiate larger facility at group level at low cost with minimal efforts.

Role of Internal Audit

Internal audit can play a significant role to support this project by utilizing their audit skills e.g. Internal control, Testing, Independent Reviews, Vetting, Cost benefit Analysis and Feedback.

Conclusion: Each organization could be at different stage of its' development depending on the location, maturity level of the organization & country and availability of skilled manpower. At the scale of 1-10, if an organization is currently working at 2, it may not reach at scale 10 in one go. Even if it achieves scale of 5 or 6 in its' 1st phase of transformation, it would be a great achievement. Therefore, the meaning of transformation may not be the same for all.

About the author: *Author is Chartered Accountant from India with 24 years of experience in finance, internal audit and commercial in diversified business including mining & metals, defense, audit & consultancy.*
Currently working as Head of Finance in Siham Al Khaleej Technology LLC (An Italian Joint Venture in Defense sector) and can be contacted on:
kamal-agarwal@outlook.com