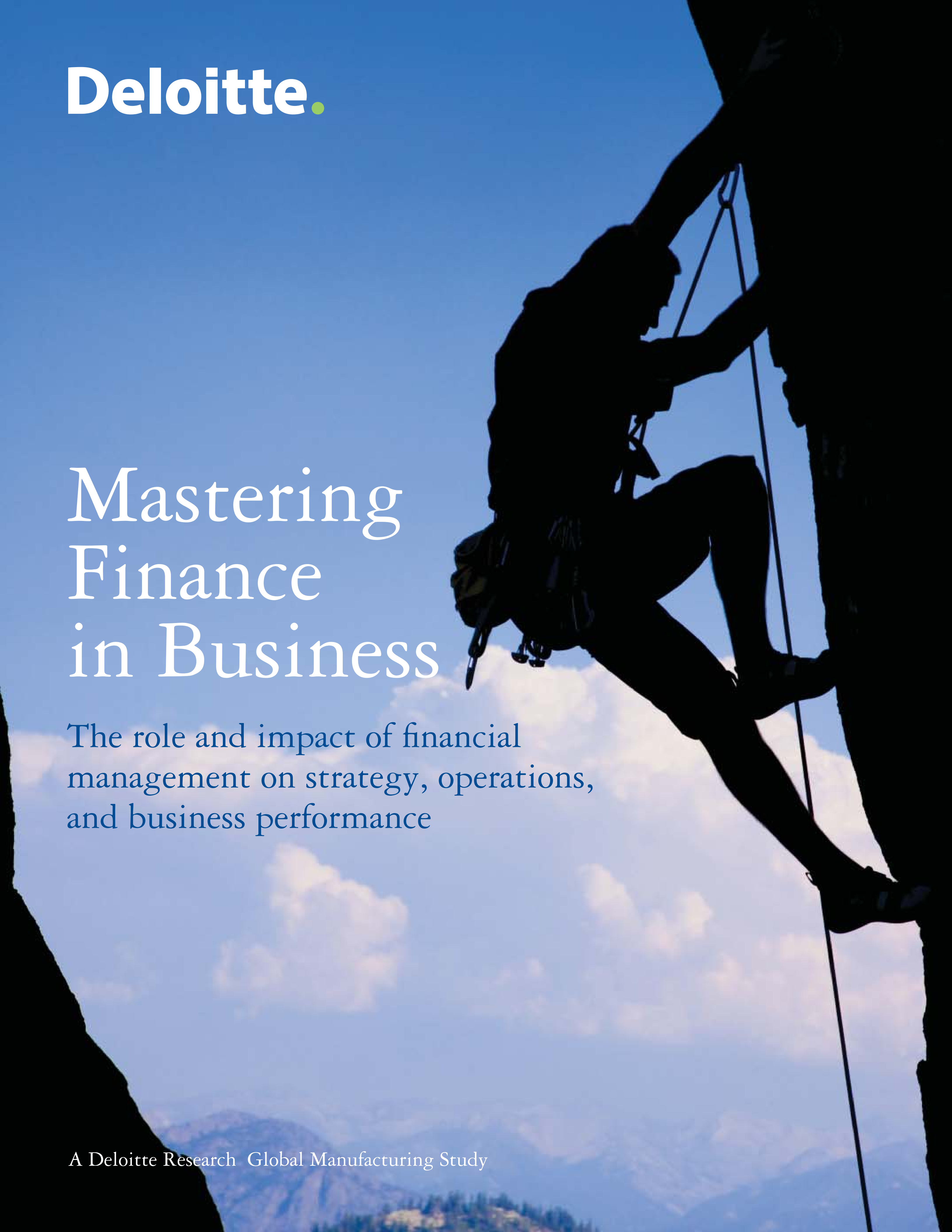

Deloitte.

Mastering Finance in Business

The role and impact of financial management on strategy, operations, and business performance

A Deloitte Research Global Manufacturing Study

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About Deloitte Research

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Introduction

From mining in South Africa and commodity production in Asia to sales and service networks in North America, the business operations of some of the world's largest and most sophisticated industrial enterprises are experiencing a quiet revolution. It is led by finance.

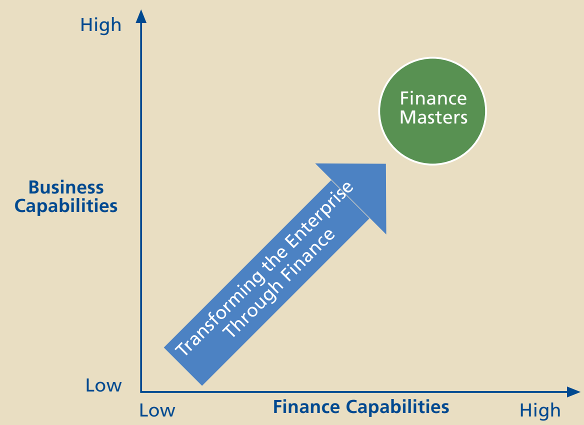
With their complex webs of production facilities and distribution centers, customers and suppliers, and the resulting flows of products, services, finance, and information, global manufacturers find tracking financial performance hard enough; to many, *mastering* finance may seem like a pipe dream. Yet, a number of the world's leading companies are increasingly turning to finance as a lever for transforming their enterprises and driving business — with impressive results.

Findings from our ongoing benchmark study around how manufacturing companies are using finance to transform their companies are dramatic. Among the companies analyzed to date, the group we called "finance masters" — companies with the strongest finance capabilities to support business transformation — are leading the pack with superior business performance. The research not only links the transformation of finance and business to performance, it also shows how finance masters differentiate themselves from the competition.

While many companies have pursued business transformations over the last decade or more,[1] the results remain mixed. Our research suggests that to effectively transform the entire enterprise toward a more successful and sustainable path, companies need to integrate business and finance transformation. Companies that combine the transformation of both business and finance operations — finance masters — are far more likely than their competitors to succeed in their industry (figure 1).

Over the last five years, we have benchmarked the global strategies, financial and operational capabilities, and business performances of more than 1,100 manufacturing companies across the Americas, Asia Pacific, Europe, the Middle East, and Africa.

Figure 1. Transforming the Enterprise Through Finance



Source: Deloitte Research

To develop a deeper perspective on how companies can build and leverage financial management capabilities to help improve and even transform business strategy and operations and drive performance, we have initiated a multi-year benchmark study specifically focused on how companies are transforming their enterprises through finance. So far, more than 70 companies have participated in this specific finance and business benchmark research around the world. Seventy-five percent of respondents have corporate revenues higher than US$1 billion. Industries represented include aerospace and defense, automotive and commercial vehicles, consumer products, diversified industrial products and services, process and chemicals, high technology and telecommunications equipment, and life sciences and other industries. (See appendix for further details.)

According to our research, many companies are indeed struggling, despite large-scale investments in global expansion, new product development, production facilities, and information systems. Shortcomings in performance management, alignment of organizational structures and incentives, and decision-making support for business investments and execution create barriers to improve and sustain business performance. Companies often fail to overcome these obstacles because they lack the financial management capabilities to remove, or at least reduce, these barriers to profitable growth.[2]

The Challenge of Business and Finance Transformation

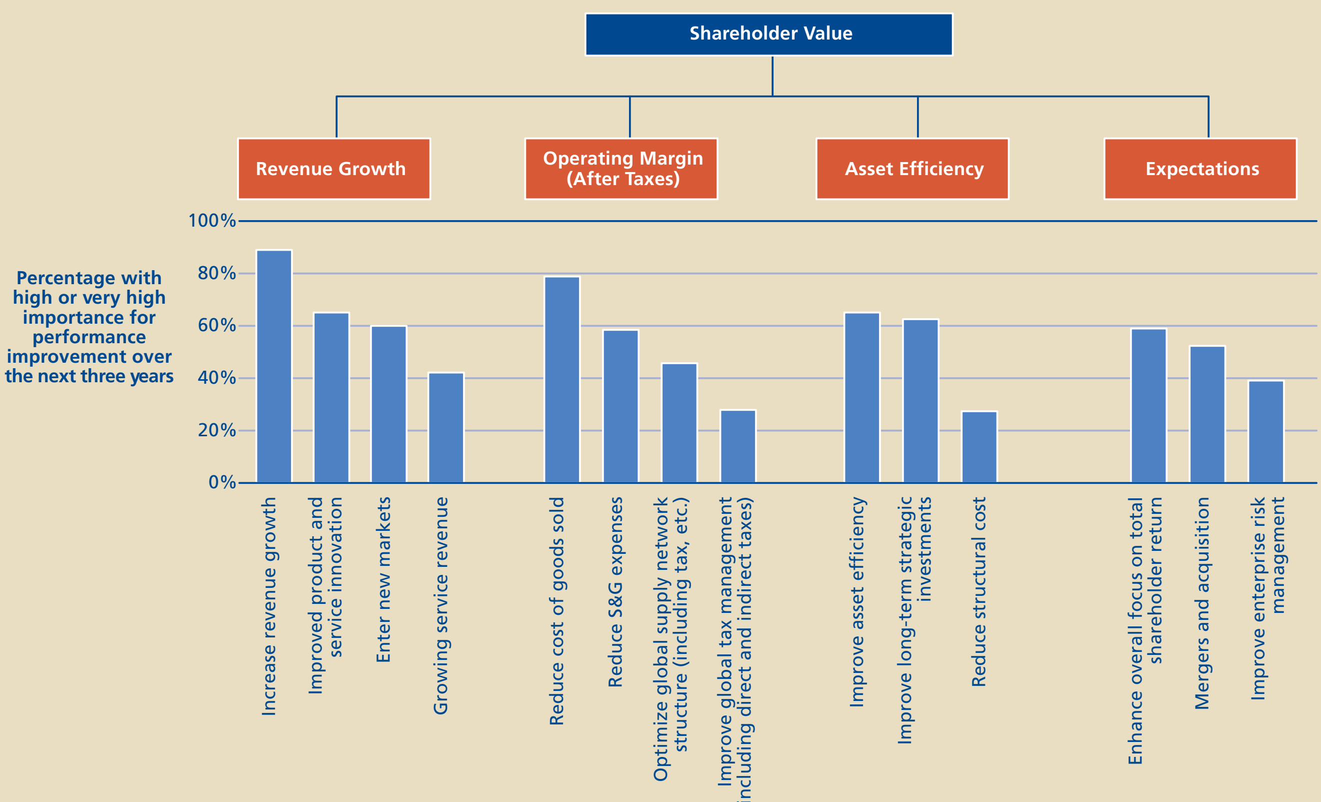
The list of obstacles and opportunities facing manufacturers seems endless, including globalization and expansion into new markets; low-cost country sourcing; pursuit of growth through innovation; product proliferation; service competition; going green; the war for talent; mergers, acquisitions, and divestitures; enterprise risk management, and compliance requirements. Addressing each of these areas presents an enormous challenge to manufacturers in their own right; taken together, the task is mind-boggling. Beating the competition and driving profitable growth to exceed investor expectations in this context is a daunting task.[3]

Raising the bar

Yet, despite challenging business environments, ambitions remain very high for most companies benchmarked.

1. Revenue growth tops the agenda, with 89 percent of the companies considering it important or very important over the next three years (figure 2). Such companies tend to focus on growth through product and service innovation (65 percent), new-market entry (60 percent), and service sales growth (40 percent).

Figure 2. Ambitious Goals
Many companies have ambitious goals for improving business performance



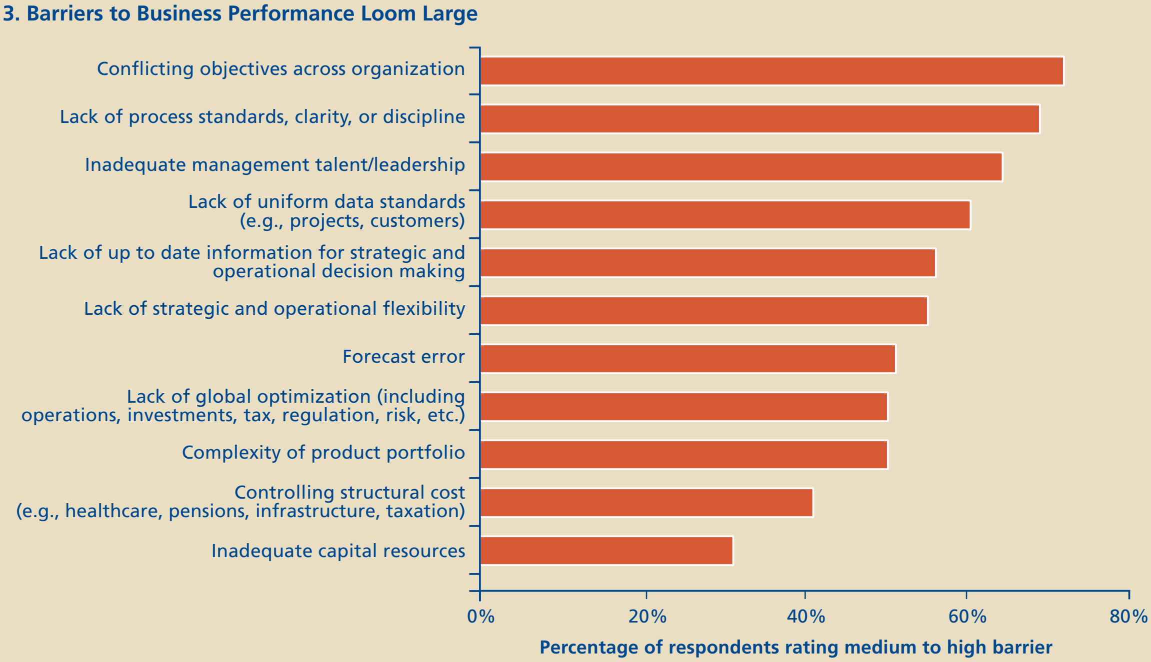
Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

2. Cutting costs and boosting margins represents another major priority. Among surveyed companies, 78 percent are planning to reduce cost of the goods they sell; 59 percent are striving to reduce selling, general, and administrative expenses; 46 percent are aiming to optimize their global supply-network structures; and 27 percent are aspiring to improve their global tax management.
3. Managing structural costs and improving asset efficiency is a priority for 63 percent of participating companies. Sixty-two percent of companies plan to improve asset efficiency by improving long-term strategic investments in R&D, human capital, and alliances, among others. Twenty-seven percent plan to reduce structural costs like healthcare, pension, infrastructure and taxation cost.
4. Finally, the expectations held by a company's investor community are a major factor in driving enterprise value. This "future value" — essentially, the expected value of a company's future investments — is a large part of the enterprise valuations, with 80–90 percent of the total enterprise value of top-performing companies typically attributed to future expectations. Increasing those expectations means improving the valuation of the company.[4] A number of companies are focused on developing prospects through new sources of supply (48 percent), mergers and acquisitions (43 percent), divestitures (11 percent), better communications to the external marketplace and investors (47 percent), and better management of enterprise risks (39 percent).

While these targets in themselves are worthy pursuits, many of them come at the cost of more complexity and greater risk, which few companies are feeling prepared to manage effectively. Our research reveals three primary barriers to business performance (figure 3):

1. **Alignment:** A key barrier is insufficient alignment between strategic and operational decision making and lack of talent to support it. Seventy-two percent of organizations call conflicting objectives across the organization a medium to high barrier; 55 percent report lack of strategic and operational flexibility; and 50 percent face lack of global optimization in operations, investments, tax regulation, risk, and so on. While improving asset efficiency is a priority for more than 60 percent of companies studied, 41 percent consider their inability to control structural costs a barrier. Innovation in new products and services is at the top of the revenue-growth agenda for many companies, but 50 percent report that the complexity of their product portfolio prevents them from improving business performance. Thus, the very same areas in which companies see the greatest opportunities to boost performance also contain the biggest barriers blocking their growth. Adding to their woes, 64 percent of respondents do not believe they have adequate capabilities for talent management and leadership development.

Figure 3. Barriers to Business Performance Loom Large



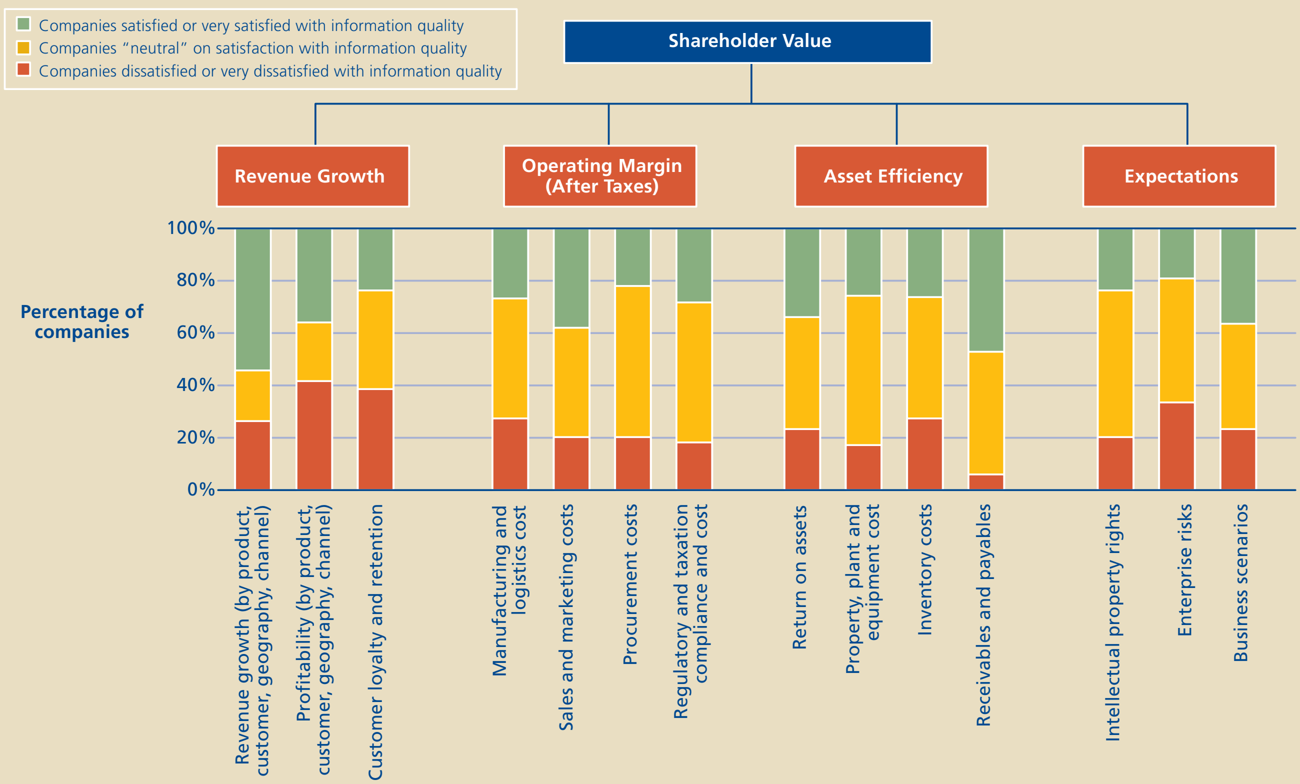
Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

2. **Information:** Lack of up-to-date information for strategic and operational purposes is hampering the pursuit of business improvements. Insufficient visibility into key areas of business strategy and operations is a fundamental problem for most companies. Even worse, many companies are also not satisfied with the quality of information on the very metrics they want to improve. For example, companies want to improve revenue growth, but 25 percent of them are either dissatisfied or very dissatisfied with the quality of information available around revenue growth by product, customer, geography, and channel, among others (figure 4). Forty percent of the respondents are not satisfied with the profitability information available for those categories. Thus, companies have a limited understanding of where to focus investments to achieve revenue growth and profitability targets.
3. **Standardization:** Inadequate process and data standards is an underlying problem for a majority of the companies studied. Nearly seven out of ten companies rate the lack of process standards, clarity, or discipline as a high to very high barrier to improving business performance (figure 3). Shortage of uniform data standards (for example, on products and customer relationships) is a high or very high barrier to improving business performance, according to about three out of five companies.

Common among these barriers to improving business performance is a general lack of financial management competencies necessary for driving business performance. Indeed, many of the executives indicate that they need to make significant enhancements to their finance capabilities over the next three years.

To uncover the role and impact of finance on business transformation and performance in more detail, we analyze and rate the companies participating in the research along four dimensions of finance and business-capability maturity.[5] (See appendix for further details.) The following four key roles of finance reveal an organization's ability to enable and drive enterprise transformation (figure 5).

Figure 4. Low Visibility
Few companies have high information quality across key business areas



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Finance capabilities:

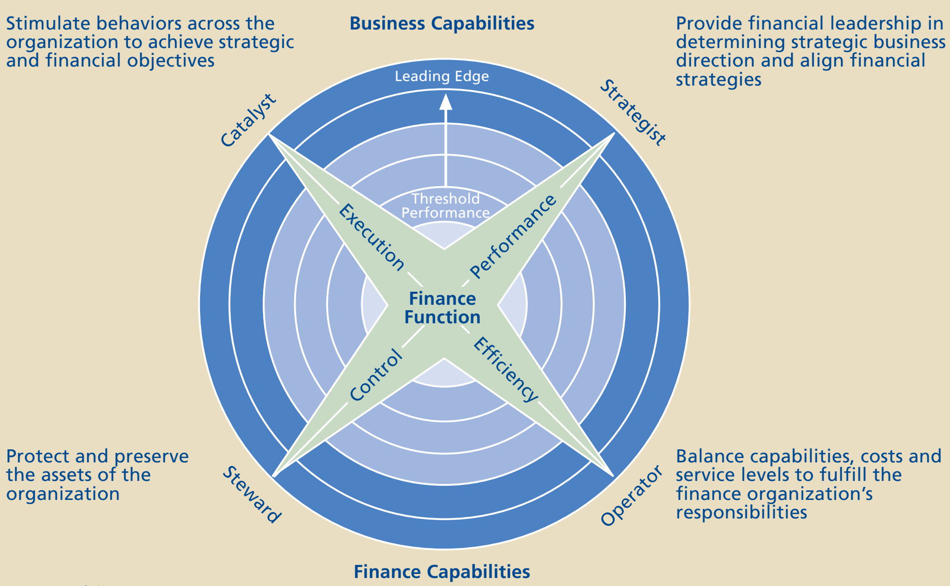
- **Steward:** Ensuring company-wide compliance with financial reporting and control requirements, managing risk, and providing high-quality business and operational information across the enterprise
- **Operator:** Defining and adapting the operating model to balance efficiency and service levels in financial processes and ensuring the availability of highly skilled talent for financial management

Business capabilities:

- **Strategist:** Supporting business-strategy development through robust decision-making processes and performance management
- **Catalyst:** Partnering with business executives to change organizational behavior and drive disciplined execution of strategic choices across the enterprise

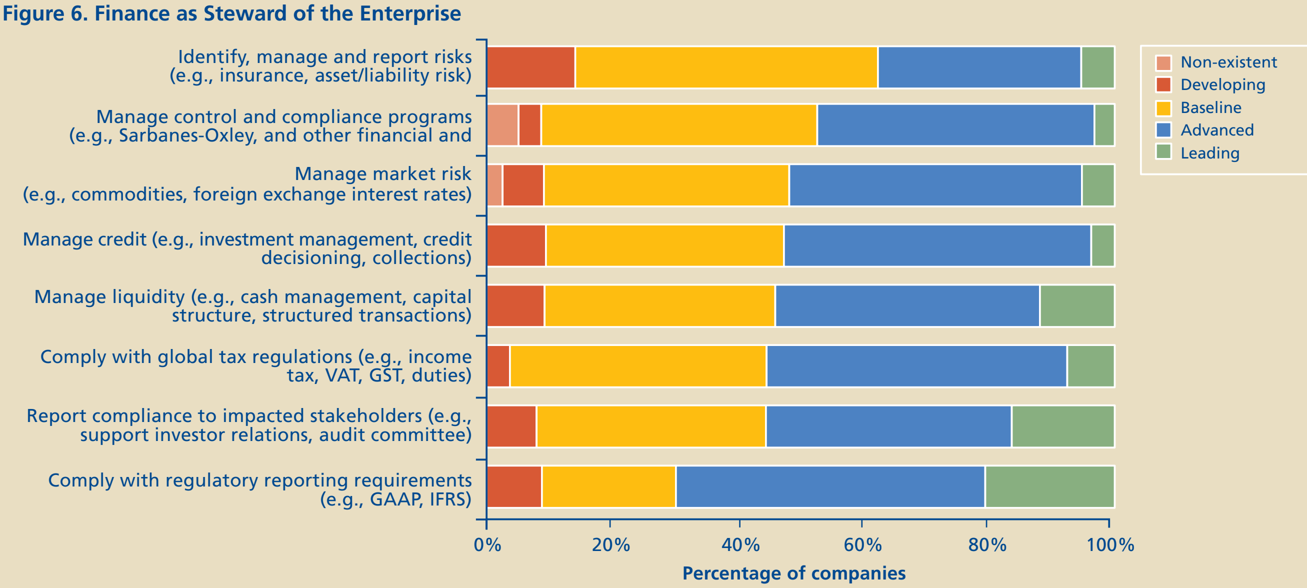
Many companies demonstrate great strides in building core finance capabilities around the stewardship role, while some are still struggling in improving the efficiency of finance operations (the operator role). This is no surprise since key aspects of the finance stewardship role are mandated by governments and financial markets. Indeed, a significant share of the companies studied have advanced and leading finance capabilities in areas related to regulatory reporting (GAAP, IFRS, Sarbanes-Oxley), environmental reporting, tax compliance, and credit management (figure 6).

Figure 5. The Four Faces of Finance



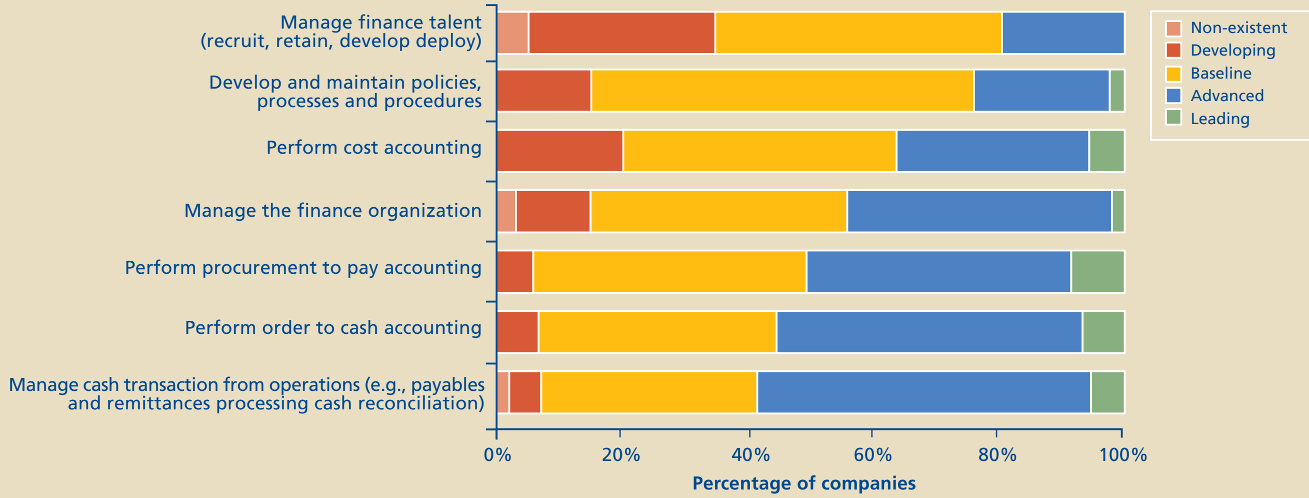
Source: Deloitte

Figure 6. Finance as Steward of the Enterprise



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Figure 7. Finance as Operator: Driving efficiency and effectiveness



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

To improve finance operations, most responding companies prioritize better management of people, processes and technologies. The need is obvious. Many companies are facing incomplete, inefficient or ineffective processes and a hodgepodge of hardware, software and systems. Weaker areas include cost accounting to support business strategy formulation and execution as well as talent management, which is a particularly challenging area (figure 7).[6] While many are still pursuing improvements in these areas, the majority are confident in their order-to-cash and procure-to-pay processes.

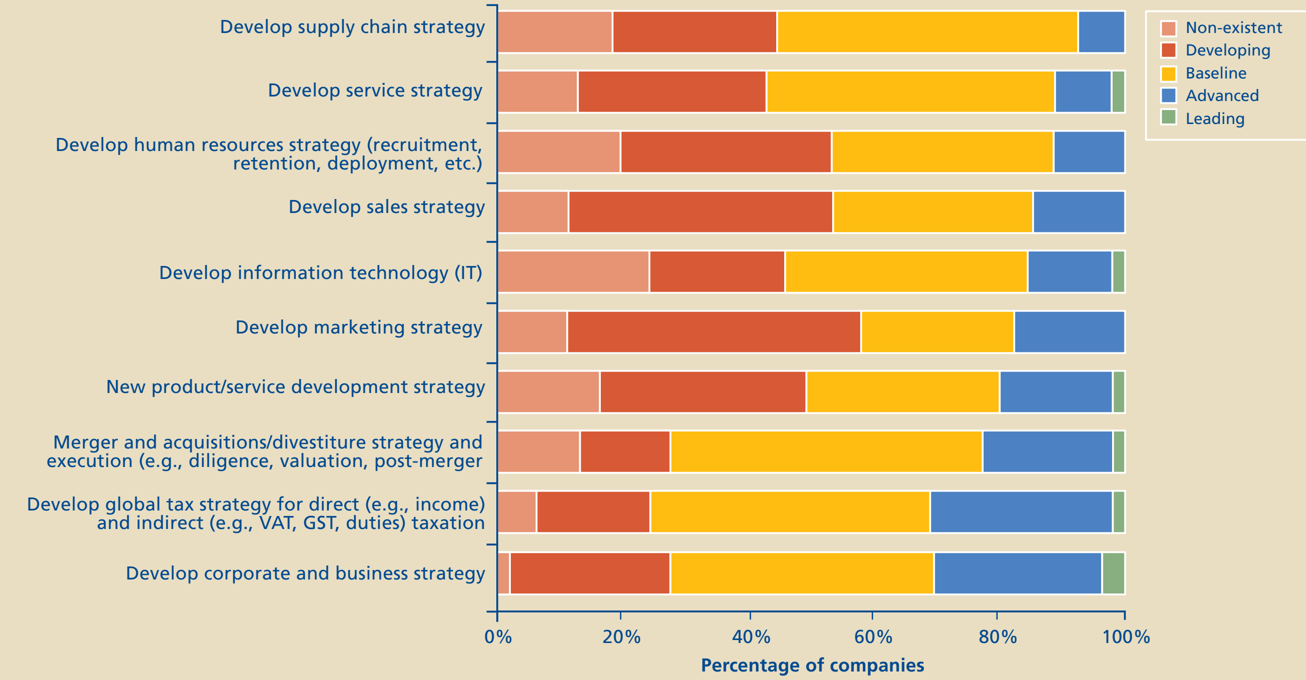
While core finance operations — the steward and operator roles — are challenging for many, the vast majority of companies struggle in making finance matter to developing and executing business strategy — the strategist and catalyst roles.

Indeed, the business roles of finance are among the weakest areas of financial management today. For example, financial planning and analysis remain under-developed capabilities (figure 8 and 9). Even in more operational areas, such as optimizing investments in plant and equipment assets, a significant number of companies struggle to build finance capabilities. More than 70 percent of respondents have either baseline or less-than-baseline capabilities in preparing budgetary business plans and preparing forecasts.[7] And, while companies' valuations increasingly consist of intangibles like brand, goodwill, and intellectual property, few companies excel in evaluating and optimizing those assets.[8]

In supporting decision-making around investment allocations, mergers and acquisitions, and spin-offs, less than 32 percent of companies think they have the skills needed to succeed. The weakest areas, with less than 20 percent of organizations having leading or advanced capabilities, are integrated business performance and risk management. The limited impact of finance becomes even more pronounced beyond corporate headquarters, to business units and functions like marketing, sales, supply chain, and IT.

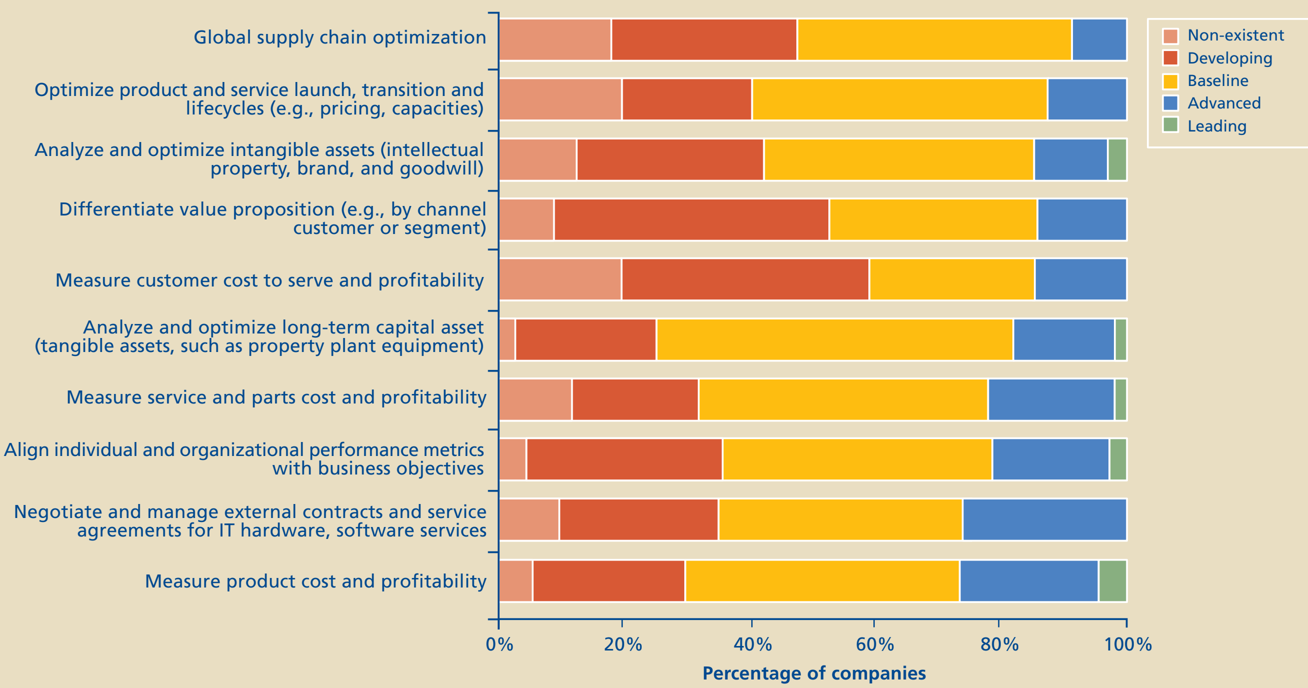
Many might ask what finance can really do to help the myriad challenges facing manufacturers. Does finance matter to driving enterprise performance? Do investments in better financial-management capabilities pay off, and how do companies leverage finance to outperform their competition? What are the key areas of finance — and the key links between finance and business — that leading companies are improving, and in some cases, perfecting? The following will provide insights and answers to these questions.

Figure 8. Finance as Strategist Supporting the Business



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Figure 9. Finance as a Catalyst for Change and Execution



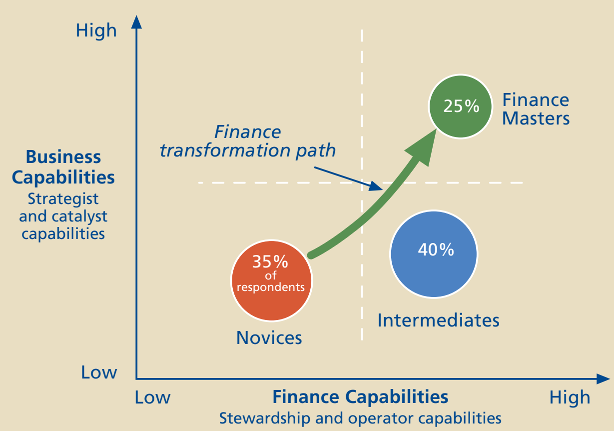
Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Finance Transformation Drives Business Performance

Investing in financial management capabilities and underlying processes, tools, and technologies can pay off. Our research shows a strong linkage between the maturity of finance capabilities and business performance. It suggests that companies need to go beyond the core finance capabilities of steward and operator to leverage finance capabilities as strategist and catalysts. In fact, the strongest link between finance capabilities and business performance is the role of finance as a strategist and a catalyst. Only where finance effectively supports strategy and operations is there a significant impact on business performance, according to our research.

Finance masters are leading the pack with superior financial performance and shareholder value creation relative to their peers.[9] These companies have not only built a strong foundation in their capabilities for being capable financial stewards and operators for their companies, they have gone much further by building and leveraging finance and business capabilities as strategists and catalysts across the enterprise (figure 10).

Figure 10. Defining Finance Masters:
The finance and business capability quadrant



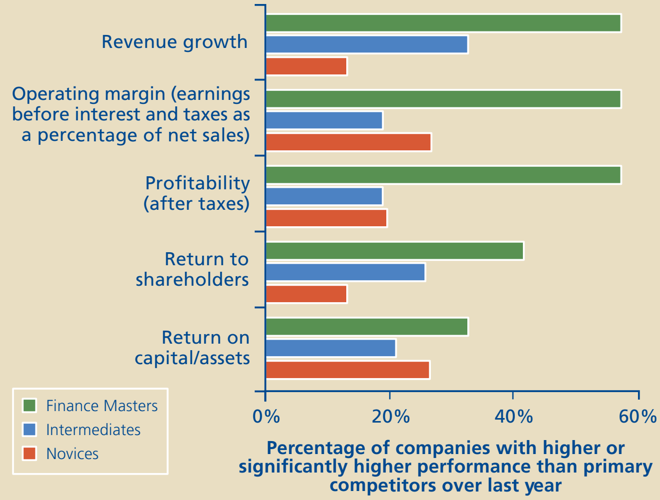
Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Among the companies benchmarked to date, about 35 percent have limited capabilities for finance stewardship and operations, and they also have limited capabilities as strategists and catalysts for the enterprises. We call these companies "novices." (See lower-left quadrant of figure 10.) Another 40 percent of companies have made great inroads in building their capabilities as stewards and operators, but they have yet to effectively build capabilities as strategists and catalysts. These companies are labeled "intermediates." (See lower-right quadrant.) Significantly, no companies with high capabilities for transforming business reported low capabilities for transforming finance. (See upper-left quadrant.)

Finally, about 25 percent of companies have not only invested in strong capabilities as stewards and operators, they have gone further by building much better capabilities as strategists and catalysts to support business improvement and transformation. We have labeled these companies "finance masters" (see upper-right quadrant). While they are not flawless, they have charted a finance transformation path that sets them apart from their peers with significantly higher performance in terms of profitability, returns on assets, and shareholder value (figure 11).[10]

The path to finance excellence is built on finance stewardship and operations. As mentioned above, there is no company yet participating in our research that has been able to master strategist and catalyst capabilities without a strong foundation in stewardship and operator capabilities. In many cases, the finance masters have stronger stewardship and operator capabilities than the intermediates. Thus, mastering finance as strategists and catalysts does not mean that stewardship and operator capabilities are neglected. In fact, our research indicates that stewardship and operator capabilities provide a crucial underpinning for successful business transformation. For finance masters, those capabilities are typically stronger than those of other groups studied.

Figure 11. Finance Masters Outperform



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

How It Works: Finance as a Foundation for Business Transformation

Finding a pathway for transforming the enterprise through finance

Building financial management capabilities to support strategy and execution across the enterprise provides a competitive edge. Getting there is the hard part. Our benchmark research provides some insights into how companies can become finance masters. Three lessons help guide our analysis for the remainder of the study:

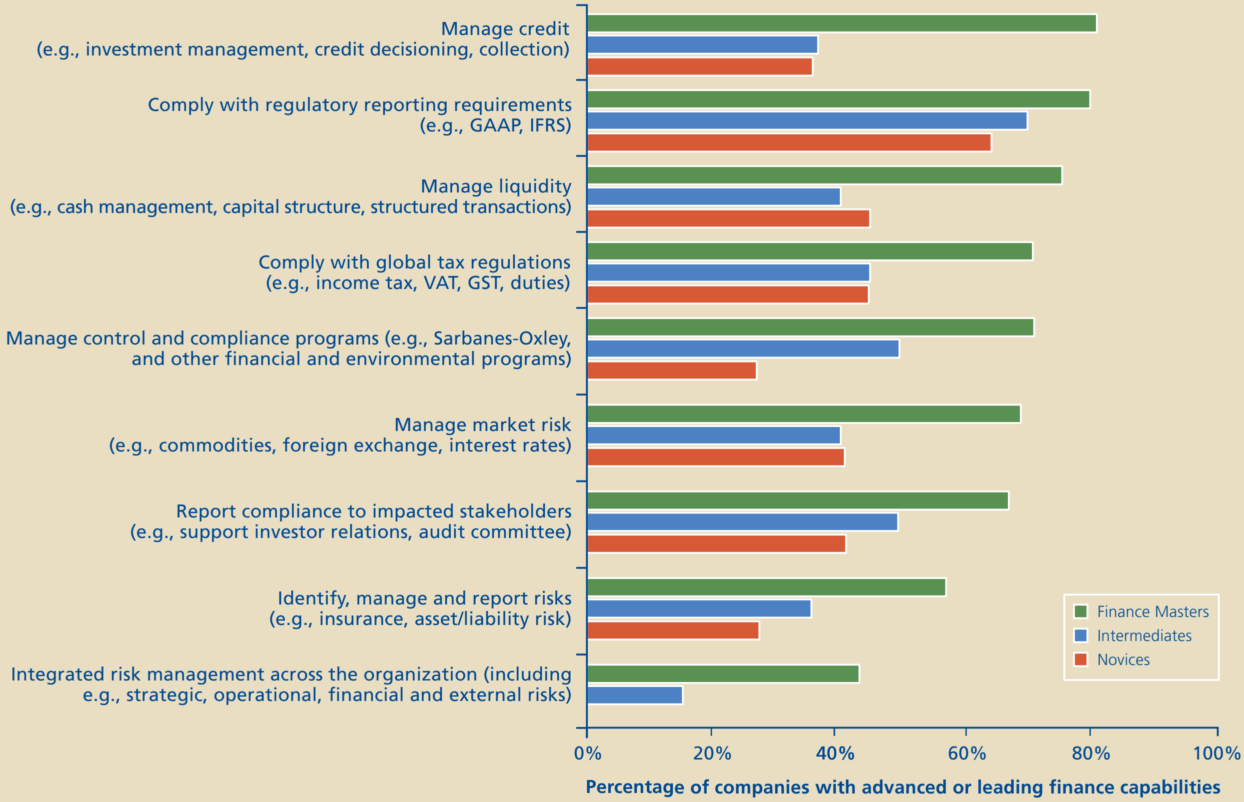
1. **Design: Invest in finance from a business perspective.** Goals and plans for improving finance capabilities should be decided from the perspective of business strategy and performance management instead of the single pursuit of finance-process efficiency or compliance requirements. It sounds straightforward, but many companies who have built strong finance processes and still lack capabilities for supporting business transformation do so with less-than-stellar results. Even if investing in finance for compliance purposes is the top priority, use those investments to augment strategic finance capabilities. For example, some companies investing in Sarbanes-Oxley compliance requirements have used the opportunity to improve their overall finance capabilities. This also means that finance should work closely with the business to identify the finance-transformation path. Without a business perspective on investments in the finance function, much of those investments are likely to be less valuable, and precious time may be lost while pursuing lower-priority initiatives.
2. **Develop: Lay a finance foundation for enterprise transformation.** Without solid reporting and compliance capabilities, finance is unlikely to gain the trust of business managers. No company participating in our research to date has attained finance mastery without strong core finance capabilities. Furthermore, without reliable finance operations (think financial processes, such as order-to-delivery and procure-to-pay), pursuing a role as strategist and catalyst will be built on quick sand. For example, Owens-Illinois (O-I) is taking this approach in its efforts to transform the business. Based on an overall assessment of the top priorities for finance and business transformation, O-I, the world's largest manufacturer of glass containers, is developing policies, standards, and operating and competency models for a globally integrated finance organization. This foundation will enable O-I to focus on using finance to transform the business, including aligning operational strategies and investments with overall drivers of business performance.[11]
3. **Exploit: Identify and prioritize high-impact areas of the business to improve first.** For example, if eroding product margins is the major strategic challenge for the company, consider key areas of pricing, costing, and supply chain for improvement from a finance and business perspective. Often, the solution lies in stronger financial management support for better decision making and execution in those areas. Again, taking a business perspective on finance transformation will help prioritize what matters most. But it requires solid visibility into the business. In many of the underperforming companies we have studied, the weakest areas of company operations, with the least visibility, were often the ones where finance had had the least impact.

Finance masters have laid a stronger foundation than most. For example, they have developed stronger capabilities than other companies even in the core steward functions of compliance and reporting (figure 12). While risk management is one of the weakest areas across the companies studied, finance masters have made great strides in this area with 40–70 percent reporting advanced or leading capabilities for various aspects of risk management ahead of most of their competitors.

Avoiding unnecessary risk and exploiting profitable ones can hedge and sometimes even augment operational returns, as Porsche AG has shown (see box on page 11).

In core operator functions, such as managing cash transactions and developing and maintaining policies, processes and procedures, finance masters have also taken a lead (figure 13). The reason is that many of these processes provide the underpinnings for effectively supporting business transformation and ongoing business operations – areas in which finance masters excel.

Figure 12. Laying a Foundation for Mastering Finance: Finance as a steward of the enterprise



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

How It Works: Finance and Global Risk Management

Due to the volatility of currencies against the Euro (especially the U.S. dollar and the Chinese yuan) and other risk parameters (for example, regulation around fleet fuel consumption and carbon dioxide discharge) for luxury sports cars, Porsche has become an astute user of financial hedging instruments. Its largest single market is in the United States, and with no production facilities in the country, Porsche is using currency hedging to guard against declines in the U.S. Dollar versus the Euro. Porsche believes it is reaping the benefits of using risk management and financial hedging tools like this. In the latest fiscal year, the company reported pre-tax earnings of Euro 5.9 billion, more than 50 percent of which were due to returns on financial hedging and financial investments (especially income from its 30.6 percent stake Volkswagen AG).

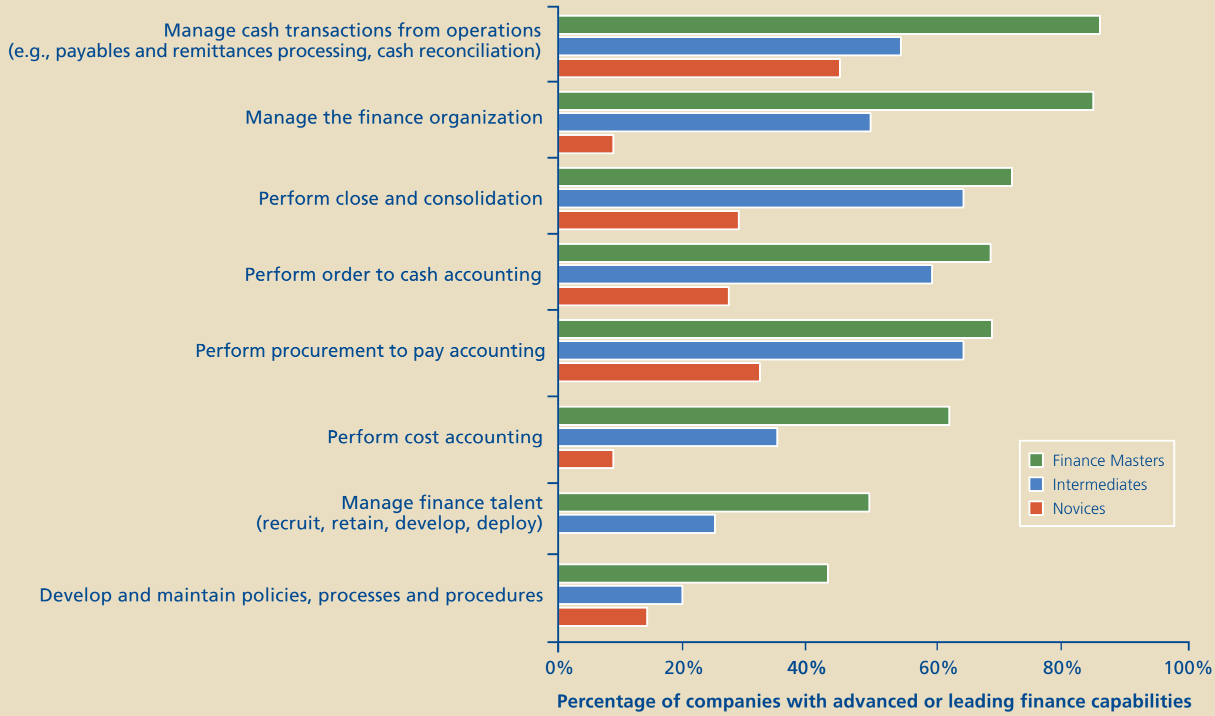
The ability to hedge currencies in a holistic way was accomplished by Porsche's centralization of treasury functions across its many operations around the world. This, in effect, reduced currency risk-management responsibility from country operations, which is now invoiced in local currencies, and allowed Porsche's corporate finance function to manage and optimize currency risk exposure for the global company. On the importance of using financial risk management instruments to hedge against currency swings, Holger Haerter, CFO of Porsche AG, said: "We are in the middle of a paradigm shift. Globalization will certainly lead to a change in the traditional currency cycles of old over the longer term and we as a company need to be ready for that."[12] The company has also applied the use of financial instruments in its recent purchase of stock in Volkswagen AG to reduce the risk of share-price increases as it started to acquire shares in the giant automaker.[13]

Finance and information technology

Information technology (IT) is another area in need of stronger finance support, according to our benchmark research. With IT accounting for a large share of investments by most companies, providing support for effectively managing those investments should be a top priority for finance. But in many of the companies we have studied, finance involvement in IT is still emerging.

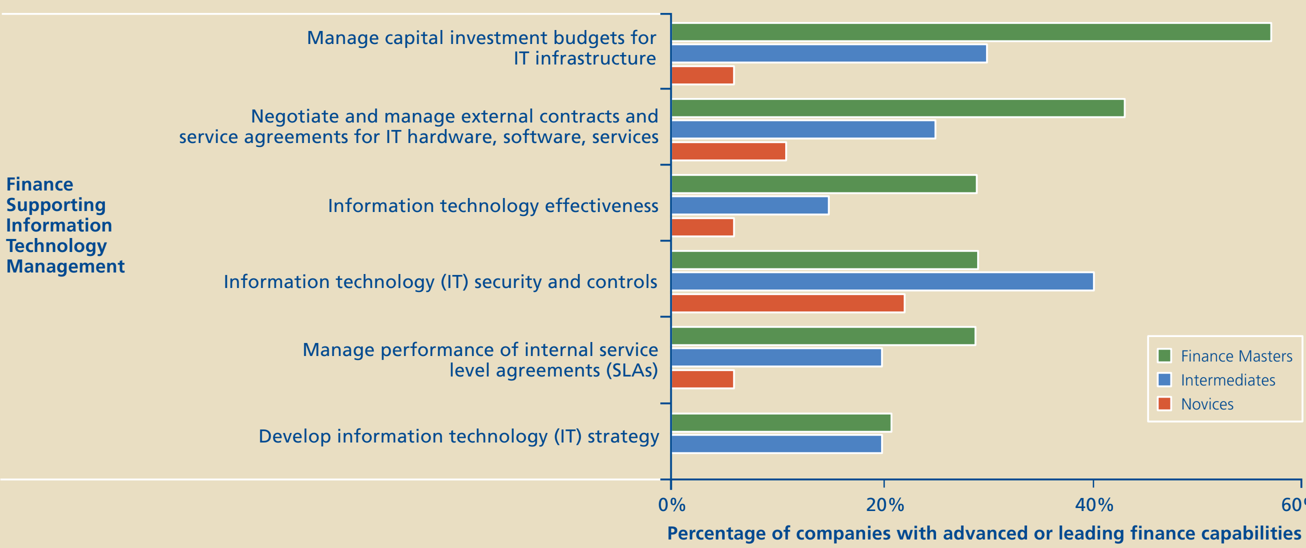
While some think information technology doesn't matter,[14] finance masters beg to differ. They are actively supporting IT functions with managing capital budgets and external service level agreements to ensure the efficiency and effectiveness of their IT investments (figure 14).

Figure 13. Mastering Finance Operations Processes



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Figure 14. Finance Supporting Information Technology Management

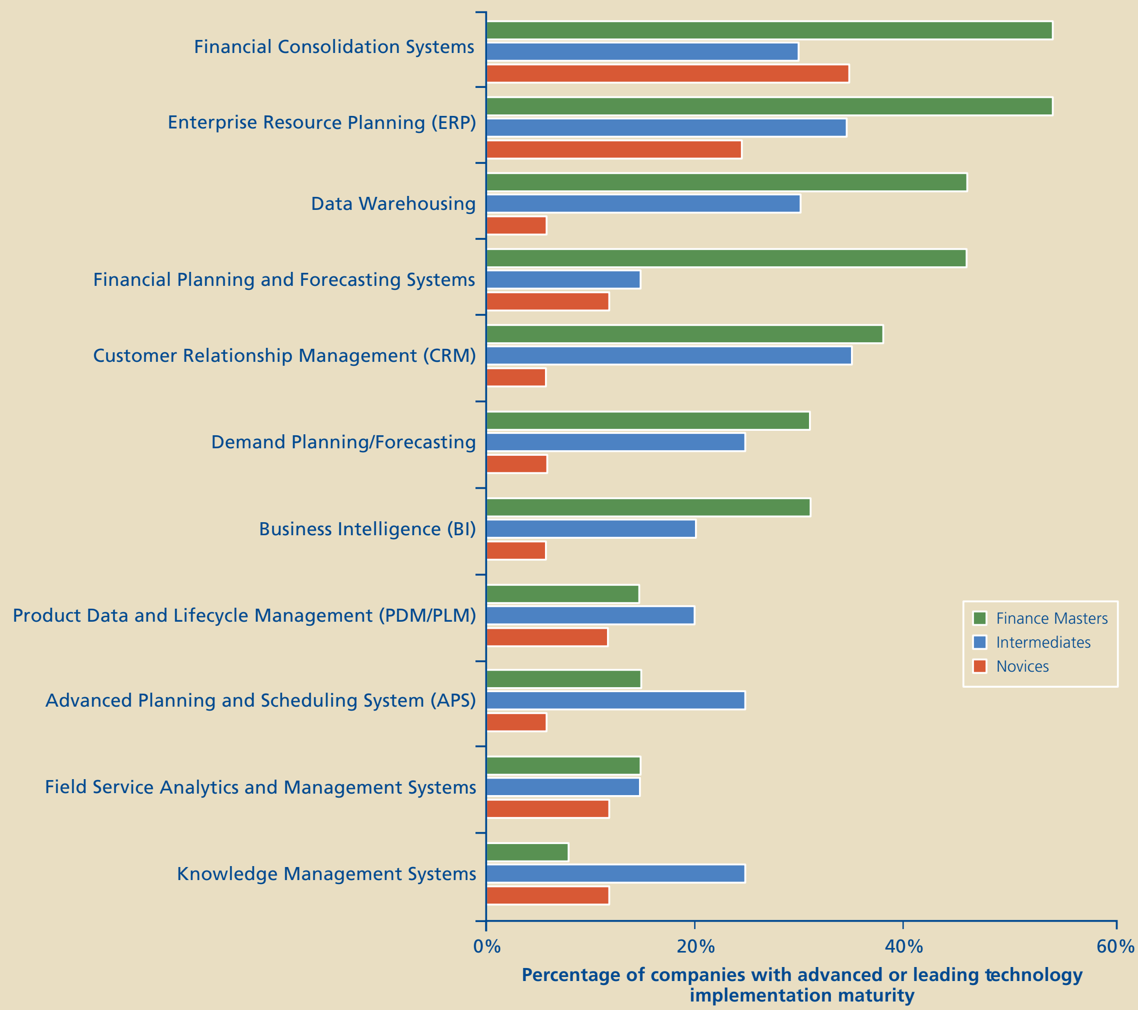


Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Finance involvement in IT, however, does not mean automatic cost reduction and red tape in getting new IT investments approved. In fact, finance masters are far ahead of many other companies in adopting both core financial information systems like enterprise resource planning (ERP), financial planning and forecasting, financial consolidation, business intelligence, and data warehousing (figure 15). They are also taking a lead in implementing leading-edge applications for customer relationship management (CRM), field service, demand planning and forecasting, advanced planning and scheduling (APS), product data and lifecycle management (PDM/PLM), and knowledge management.

Henkel Loctite is a good example of a company that focuses on leveraging technology for improving financial management capabilities. In a multi-billion dollar business, cost planning is vital but work-intensive. Henkel's central controlling department faced a huge workload every year when the planning figures had to be prepared. Plans and data from more than 250 cost centers were provided in multiple formats followed by manual data entry and analysis. The process was both costly and time-consuming. To improve efficiency, Henkel-Loctite implemented a system to allow decentralized and user-friendly cost planning and management. This enabled cost managers to have direct influence on their figures and allowed the controlling department to more effectively process and analyze the data.

Figure 15. Finance Masters Ahead in Adopting Information Technology



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Finance and human capital

Attracting and engaging talent is one of the top challenges for manufacturing companies in both mature and emerging markets. Finance can play an important role in figuring out how to invest profitably in talent management. This includes not only core areas of workforce compensation and benefits management, but also issues around measuring labor productivity and cost and alignment of individual and company performance objectives. Most observers believe these are key issues for companies, but few have the needed capabilities to succeed.[15] Not surprisingly, finance masters have made more progress than most other companies in addressing these challenges, although they have much more ground to cover in coming years (figure 16).

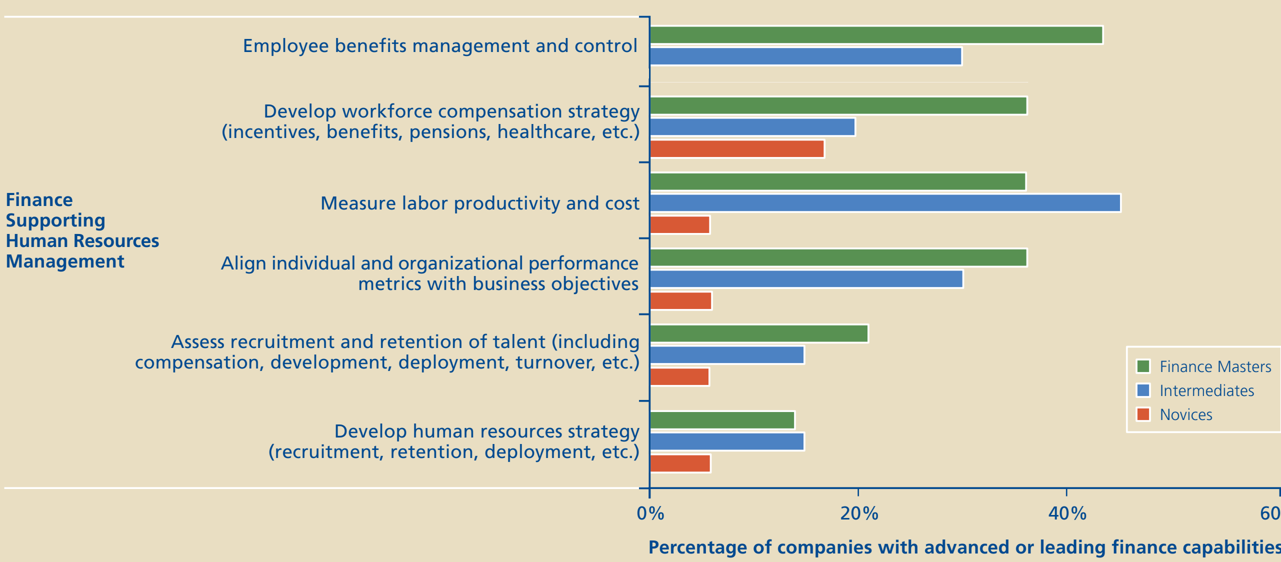
While finance involvement in more mundane areas such as compensation strategy and incentive alignment are natural choices for leading manufacturers, some, such as Harmony Gold, go much further by applying finance to critical areas of managing operations (see box).

How It Works: Finance and Human Capital Management

Harmony Gold, the world's fifth-largest producer of gold with mining operations in some of the most inaccessible areas of the world, has been an astute user of finance in driving decision-making around strategic mining investments and operations (such as mine closures and shaft mining prioritizations). Its prowess in finance, however, has come to the ultimate test as the company is trying to survive and manage a health and human capital crisis of gigantic proportions. By 2005, an estimated 30 percent of its labor force was infected by HIV/AIDS with projected annual cost of R212 million, which included medical cost, paid sick leave, lost productivity, funeral leave, training and replacement, disability processing, and cost of treatment programs.[16] In addition, the associated risk premium to the company's stock had a significant negative effect on enterprise valuation by capital markets.

The situation may have seemed quite hopeless, but Harmony Gold is applying the tools of financial management to the crisis. Detailed analysis of mining operations, worker scheduling, and treatment processes is giving the company insight into the financial cost and opportunity of improved treatment programs and worker participation in those programs. Analysis of drug sourcing is providing a view to help optimizing the global drug sourcing cost and financial risks like rising prices, and currency movements. By applying the principles of financial-portfolio optimization, the company is taking a holistic approach to resolving the HIV crisis. This includes creating portfolios of possible HIV treatment programs — the thousands of combinations of drugs, services, treatment locations, service providers, etc. — and calculating the cost and benefits associated with each portfolio over time in terms of both productivity and revenue, and the risks and returns. The key is to pick the portfolio with the highest returns given an acceptable level of risk. Harmony Gold's approach is expected to reduce treatment cost in pilot programs by 30–40 percent over a two-year period, while significantly increasing participation in the treatment program and reducing absenteeism.[17]

Figure 16. Finance and Human Capital



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

The Journey to Mastering Finance and Business

The journey to mastering finance is not easy, but it can be very rewarding. By leveraging finance to help drive strategy and execution at the corporate and business unit level, companies have a real opportunity to help business transformation and improve results.

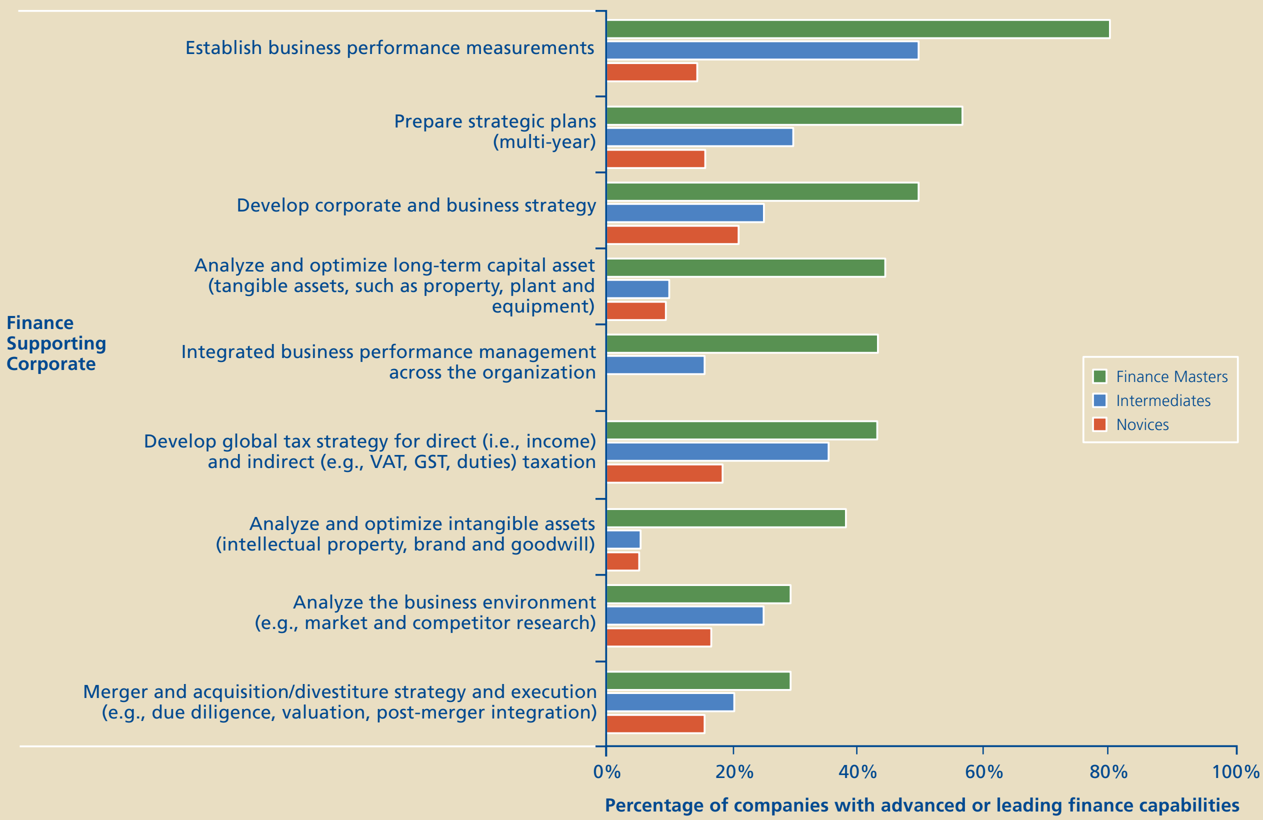
Integrated performance management across the enterprise

About 80 percent of the finance masters have advanced or leading finance capabilities for supporting the establishment of business performance measurements, and about 50–60 percent claim similar capabilities for developing corporate and business strategy and preparing strategic plans (figure 17). They are far out in front of the competition. About 40 percent of the finance masters report advanced or leading capabilities for integrated performance management across their organizations; ahead of most other companies studied.

As noted earlier, a common weak spot for companies is around optimizing total tangible as well as intangible assets, including property, plant, and equipment, intellectual property, brand, and goodwill. But finance masters are making progress; around 4 out of 10 believe they have advanced or leading capabilities in those areas.

Incitec-Pivot Ltd (IPL), a leading producer of fertilizers, is showing that finance can drive strategic and operational change and catalyze business transformation with impressive results (see box).[18]

Figure 17. Corporate and Finance: Finance masters focused on strategic planning, performance management and execution



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

How It Works: Finance and Performance Management

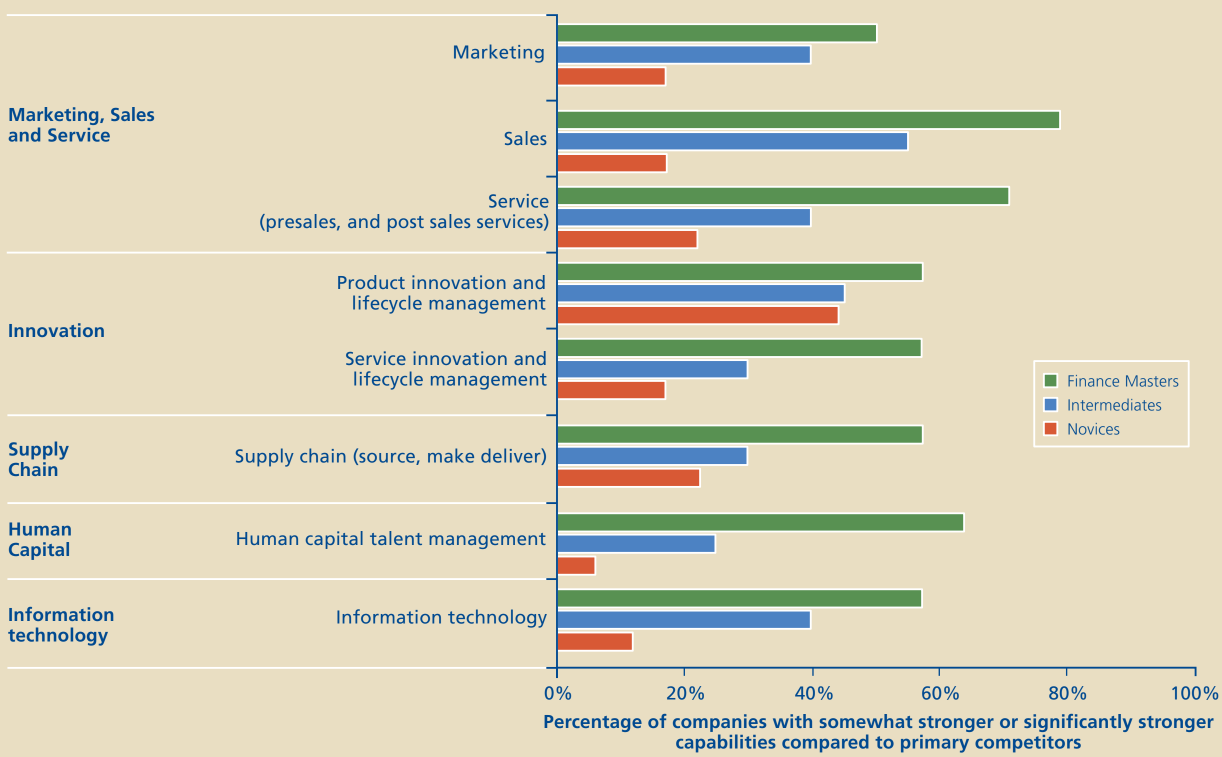
IPL, created through spin-off from Orica and an acquisition from BHP Billiton is operating in one of the most commoditized parts of the chemical process industry. Indeed, the company was an unlikely candidate for finance mastery, but IPL's executive leadership team had a different mindset. They recognized early on that finance helps create a performance culture capable of breaking down silos that stymie growth and enable new ventures and innovation. As a result, IPL has become one of the best performing companies listed on the Australian stock exchange over the last year.

The transformation tone was set at the top. To get away from a previous single-minded focus on market share or volume gains, IPL's executive team changed to a value-based management system. Based on targets for return on net assets (RONA) of 18 percent, which is expected to deliver shareholder returns around 15-16 percent, IPL's leadership team is able to evaluate investments and performance targets in terms of the gap to market expectations. To enable effective performance management, finance actively monitors performance of each part of the business with full profit and loss (P&L) statements as well as balance sheets produced every month.

Finance has spread its wings across the entire company. Every part of the business — including supply chain, manufacturing, R&D, and sales — has a finance team that works closely with corporate management. For example, the manufacturing finance team reports to the company CFO, sits in the operations meetings that set targets, monitor performance, and approve investment funding. The impact from the transformation is profound. By integrating finance with the supply chain team, IPL is improving forecasting, sales and operations planning, manufacturing and sourcing decisions (such as whether to import or produce locally), and inventory management, with dramatic cost savings as a result. Furthermore, by looking at the full cost to service customers and fully understanding customer and product profitability, the sales force is no longer simply pushing products to unprofitable customers.

Innovation through finance is yet another area in which IPL is making inroads. To serve customers better, IPL is extending credits for fertilizer purchases until after the harvest season. This allows farmers a better cash flow, which they are willing to pay for in terms of carried interest payments. For IPL, however, this credit extension is a big item on the balance sheet, which makes it difficult for the company to meet investor expectations in terms of capital returns. It is removing these debts from the balance sheet by selling the loans to banks on a non-recourse basis. Farmers get easy access to credit, and IPL's reduces its risk exposure and capital invested with higher RONA as a result.

Figure 18. Business Capabilities of Finance Masters Strong



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

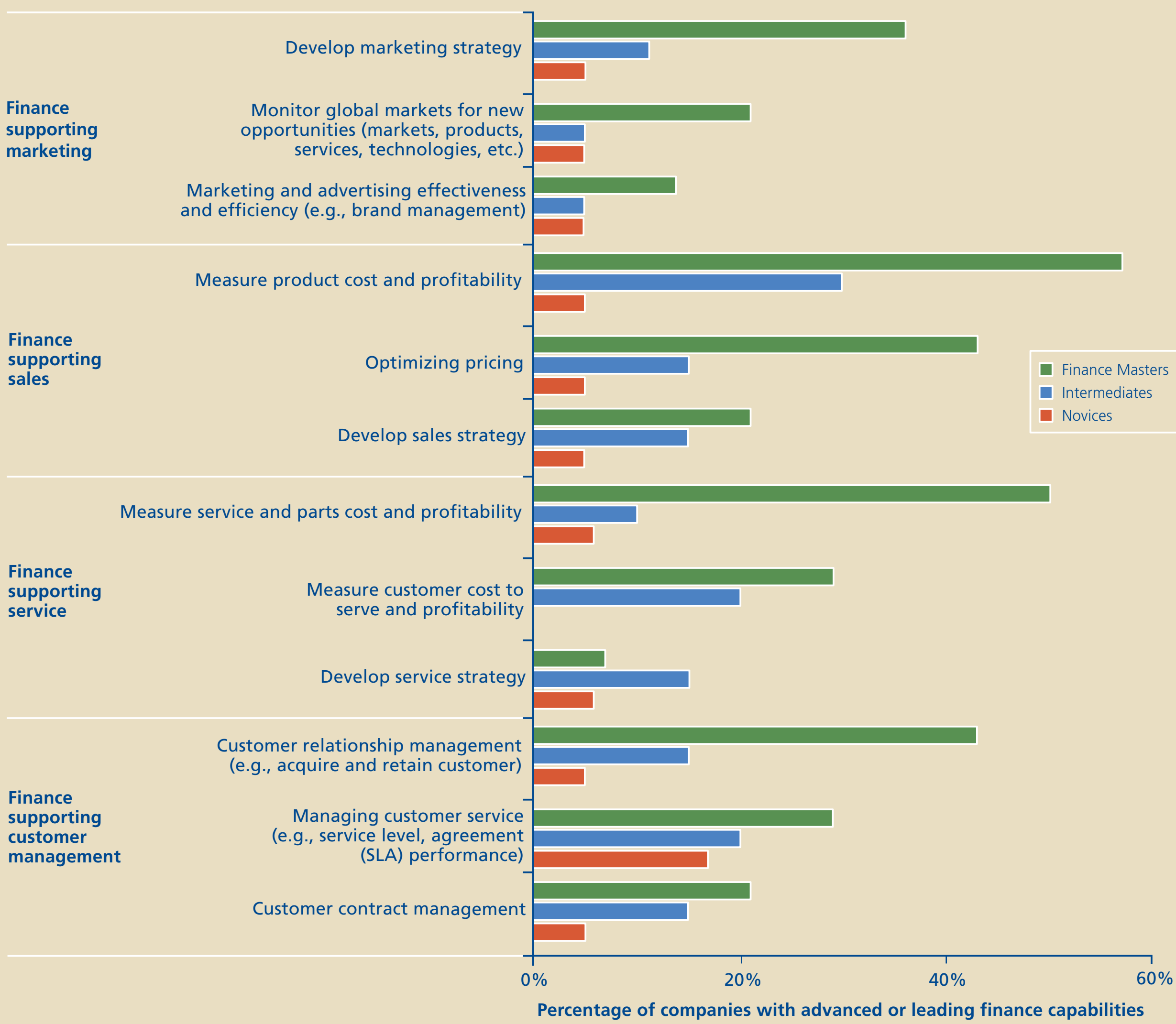
As the case of IPL illustrates, the advantage of leveraging finance for business transformation can be considerable. Among the companies we have benchmarked, finance masters have developed the strongest business capabilities in marketing, sales, service, innovation, supply chain, human resources, and information technology (figure 18). As we show in the following sections, the ability of finance to support these business functions is significantly more advanced among finance masters than other companies studied.

Finance and customer operations — marketing, sales, and service

Across the key areas in which companies' financial management capabilities play important roles as strategists and catalysts in the business, the support for marketing, sales, and services — the areas that arguably matter most to customers — is among the weakest. Yet, these areas are also the ones in which the differentiation by finance masters is the greatest.

Overall, fewer than 15 percent of companies have leading or advanced capabilities in finance supporting the marketing function in developing marketing strategy, providing differentiated value proposition, monitoring global markets for new opportunities, and ensuring effectiveness of marketing and advertising (figure 19). Similarly, less than 30 percent of companies have such capabilities in supporting the sales function. Given that most companies lack strategic information like on profitability by different segments, it is not surprising that the finance function in only 27 percent of companies benchmarked has been able to develop leading or advanced capabilities in measuring product cost and profitability. Similarly, only 10 percent of companies have leading or advanced capabilities in customer contract management and in ensuring sales efficiency and effectiveness. While finance can play a strategic role in setting the right metrics for measuring sales effectiveness and focusing attention on profitable customer segments, in the majority of the companies studied, there is only minimal coordination between finance and the sales, marketing, and service functions.

Figure 19. Finance masters far ahead of competition in applying financial management to marketing, sales and service



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

In most of these areas, finance masters have differentiated themselves. They are far ahead in applying finance to marketing areas such as marketing strategy. More than 35 percent of finance masters have advanced or leading capabilities for finance supporting marketing strategy versus 11 percent for other companies. In sales, 57 percent of finance masters report advanced or leading finance capabilities for supporting the measurement of product cost and profitability — a key part of the foundation for effective sales management. Similarly, 43 percent of finance masters have advanced or leading finance capabilities for optimizing pricing.

Many companies are looking to service sales for revenue growth, but very few of them — even the finance masters — have managed to leverage the finance function in developing services strategy.[19] However, finance masters have laid the groundwork. They are far more likely to have strong capabilities for measuring service and parts cost and profitability and have made the most inroads in developing finance capabilities for helping to measure customer costs to serve customers and profitability.

Finance in combination with marketing, sales, and service can create powerful synergies; finance introduces analytical insights to the evaluation of new strategic opportunities and market sizing for products and services. This includes developing suitable metrics for measuring marketing and advertising effectiveness, improving sales and service effectiveness in driving customer satisfaction, loyalty, growth, and profitability. Toyota illustrates the power of finance in supporting marketing, sales and service (see box).

How It Works: Finance and Customer Management

While most observers commend the legendary Toyota Production System (TPS) for its emphasis on creating lean manufacturing and assembly operations with few defects, a key component of TPS is the customer-facing operations. Without measured efforts to effectively manage demand, many supply chains could easily run into trouble. Unpredictable demand can create havoc with even the greatest supply chains. Toyota understands this very well.[20]

In North America, Toyota Motor Sales NA (TMS) is managing and coordinating sales, service, and parts for 1200 Toyota dealers and 210 Lexus dealers across the region. Going from success to success in sales has created a high bar for improvement. The challenge for TMS is to grow while keeping operational costs as low as possible. With more than US$50 billion in sales, the challenge is enormous.

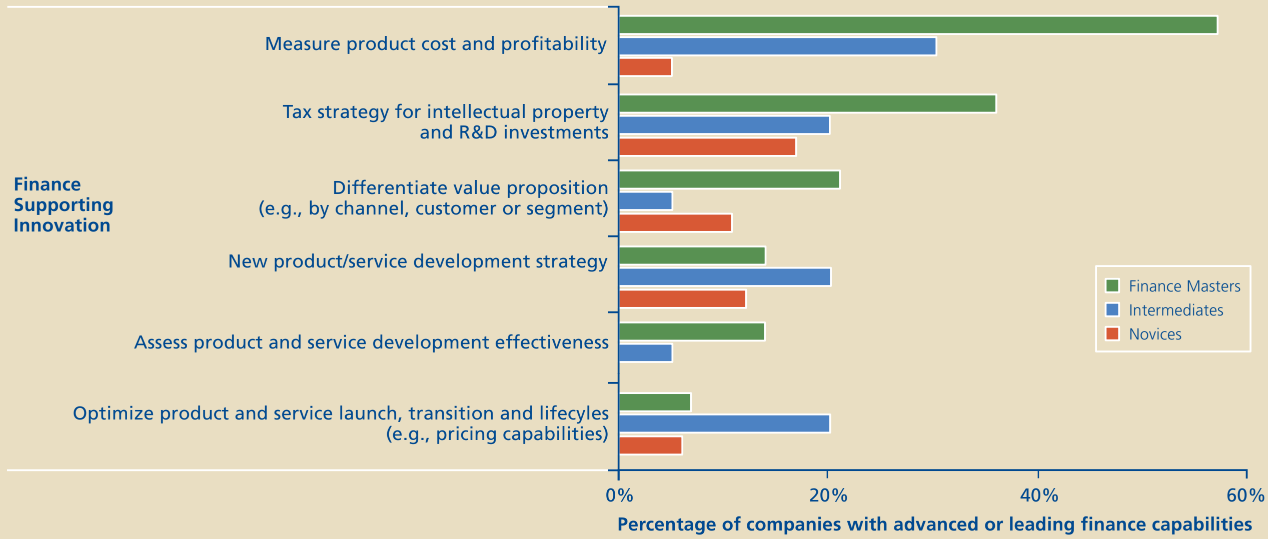
A pilot finance transformation project called “Driving for Higher Performance” was launched to simplify business processes, align the finance function with internal customer needs (including dealers), and provide decision support to those customers to enable growth.[21] To lay the groundwork, TMS finance personnel were trained in Kaizen principles for continuous improvement and encouraged to find better ways of doing their work, supported by upgraded finance information systems. Lean accounting techniques were employed to organize financial data by profit center. This would also allow easy identification of major deviations from the plan and potential forecast improvements. Furthermore, finance managers were aligned to the different business units (such as the Lexus division) to better understand and support decision-making around business planning, budgeting, forecasting, and strategic projects.

After a strong foundation was created for finance transformation at Toyota Motor Sales, it was time to take it to the next level. As part of an initiative to enhance finance capabilities, finance started providing assurance from the corporate center in areas such as tax, treasury and accounting. Using transactional data, executive dashboards were created to help the divisional management identify future investment opportunities and the risks associated with them.

The results have been remarkable. In the core finance areas, monthly close times are down to less than three days, cost per transaction processed has been reduced by 40 percent, and time spent on reporting to corporate headquarters in Japan has been reduced by 40 percent.

Says Tracey Doi, group vice president and CFO of Toyota Motor Sales North America, “My top mission is helping our executives and business partners see where the opportunities for profitable growth are” [22] TMS also ensures that performance indicators are chosen in such a way that balances short and long term objectives. “We must continue to increase our efficiencies and allocate the right resources to support sustainable, profitable growth. The human capital, engineering, manufacturing, sales and marketing, IT, and capital investments all need to be integrated to ensure a successful outcome. I strive for finance to be a strategic business partner,” says Doi.[23]

Figure 20. Finance and Innovation: Finance masters are discovering the missing link



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Finance and innovation — new products and services

Innovation gets all the attention from top management that is looking for growth opportunities through new and better products, services, and even business models. Yet, our research shows that most companies struggle to link innovation spending to reliable returns.[24] This may seem obvious to most observers of innovation over the last decades, but it is nevertheless an expensive problem in nearly all enterprises.

The finance function has yet to play a strategic role in driving innovation in most organizations that we have studied. For example, only 22 percent of companies have leading or advanced capabilities in developing tax strategy for R&D investments. Less than 10 percent of companies have such capabilities in optimizing product and service launch, reducing time to market, and assessing product and service development.

Our research shows that finance masters have made the most headway in supporting innovation — particularly around cost and profitability measurement, intellectual property tax strategy, and developing a differentiated value proposition (figure 20). In other areas, such as supporting innovation strategy and lifecycle management, finance masters, along with their peers, still have a long way to go.[25]

One can argue that nowhere is the demand for innovation higher than in the fast-moving consumer products industry. There is no greater opportunity for finance to play a role in making R&D work. Despite being recognized as an innovation leader in the industry, Hershey — the iconic maker of Hershey's chocolates and other branded products — has recognized that too much time and resources were spent by R&D and marketing teams to evaluate costs and opportunities of new product ideas early in the innovation lifecycle.[26] While Hershey's finance team was already heavily involved in new product development stage-gate processes, it was not enough. To improve the speed and efficiency of innovation, Hershey's finance organization helped develop analytical tools to assist marketing and R&D in evaluating new product concepts. Key aspects of this work included new criteria for evaluating products, setting goals, developing analytical tools, and training brand teams in different aspects of financial analysis. "It is not enough for the Finance team to track performance; we need to be involved in the innovation process at the very beginning," says Bert Alfonso, CFO at Hershey. "We view Finance as integral to the new product development and innovation process at Hershey. Finance aids the business in allocating investment resources, evaluating concepts at different stages in the development and launch process, and providing performance analytics which underpin decision-making." [27]

Finance and supply chain operations — plan, source, make, and deliver

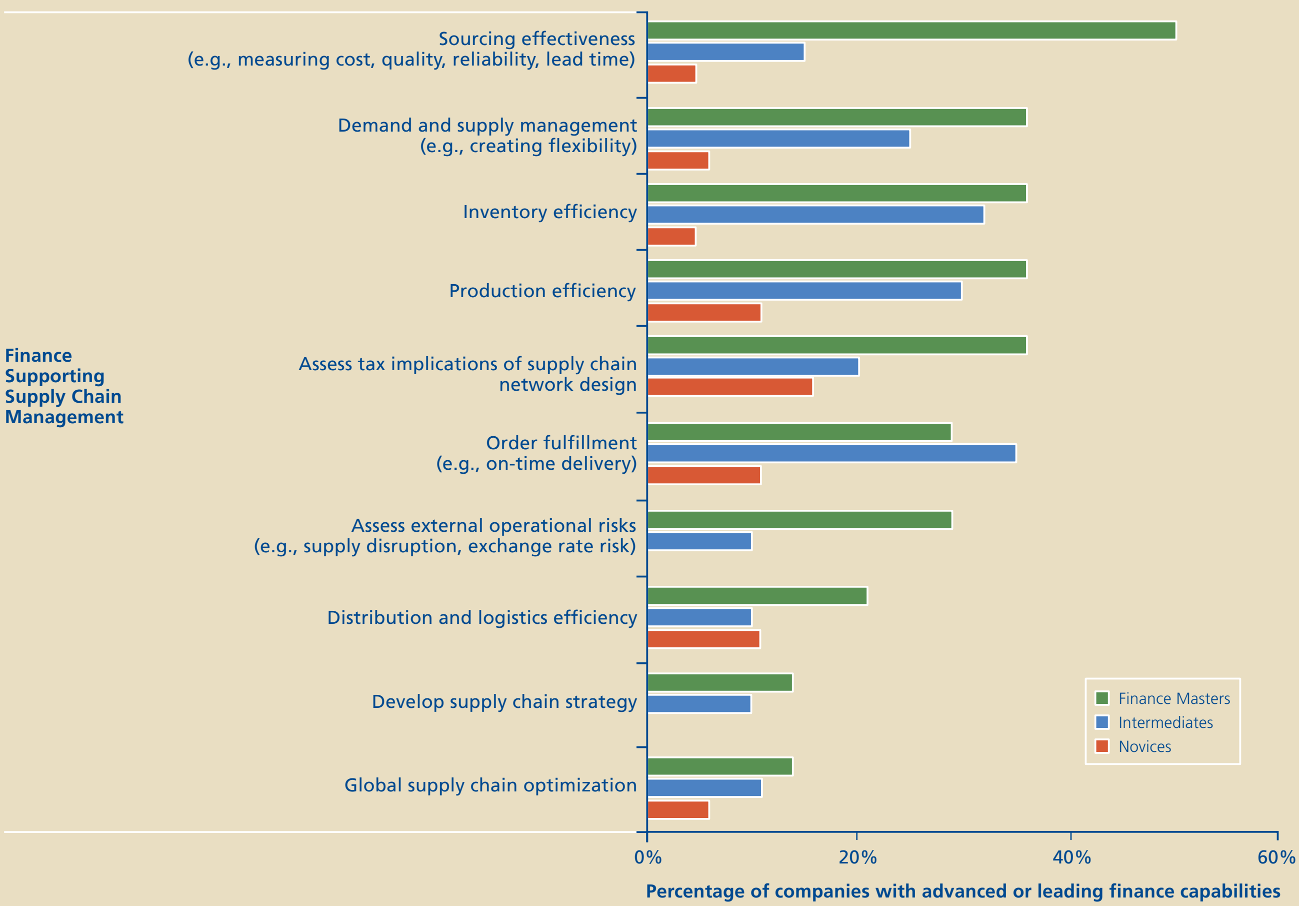
The efficiency and effectiveness of the supply chain (or *network*, as many are starting to call it due to the complex supply networks of many global manufacturers) often determines the success or failure of an enterprise. Without effective supply chain management to reduce the cost of goods sold, help speed time to market for new products, and avoid disruptions in delivery, profit margins and shareholder value can quickly evaporate.[28]

One would think that this would always get the attention of top management and finance executives. Yet, our research shows that the vast majority of companies have yet to pursue the great opportunities for supply-chain improvements across the global manufacturing sectors. Involvement of finance in supporting supply-chain decision making is still at a nascent stage. Only around 25 percent of surveyed companies have developed leading or advanced finance capabilities to support order fulfillment and inventory optimization. Less than 10 percent have achieved similar finance capabilities for assessing external risks, optimizing the global supply chain, and developing supply chain strategy.

The reasons for the low adoption of finance capabilities for supply chain management include lack of visibility into the true challenges and opportunities for improvement, lack of capabilities for improving the supply chains, and a lack of awareness of the cost and risk of doing nothing. Troubles due to increased supply chain complexity, supply disruptions, and product failures have made headlines the world over and punished companies through negative customer reactions and lower share prices. Understanding and managing the risks and opportunities of global supply chains through the application of financial management processes and tools is an important area for companies to explore.[29]

In most areas of the supply chain, however, finance masters have taken a lead (figure 21). For example, they are ahead in applying finance capabilities to areas such as sourcing and supply chain risk management — two areas getting full attention by news media and business executives in recent years as companies have continued to increase outsourcing of the their parts and product assemblies to lower-cost emerging markets. Getting the supply chain strategy and operational model right in an increasingly complex environment is a daunting task, but it is one where finance can provide a crucial contribution.

Figure 21. How Finance Masters Help Drive Supply Chain Performance



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Conclusion

Financial management is often viewed too narrowly when managing global companies. Many traditionally consider it important for budgeting and reporting, but less-than-optimally applied to business strategy and operations. This is changing. Leading companies are starting to apply finance to business in a much more comprehensive, consistent and analytical way. Our research demonstrates that finance can lead, rather than lag, business transformation. It can provide the crucial underpinning to improving strategy and business operations in key areas like supply chain, sales, and services, with remarkable results. The companies furthest ahead on this path for transformation (the finance masters) are by no means perfect — all of them have significant room for improvement — but by breaking out of the pack they are enjoying the benefits and reporting significantly higher growth, profitability, and shareholder value than other companies in our benchmark database.

While companies will have a hard time catching up to these finance masters, the good news is that many of the lagging companies have invested significantly in the foundations for mastering finance and business. This includes investments in better processes and technologies for managing cash flows, financial and operational performance, and other enabling capabilities. Our research shows that these capabilities provide a vital foundation for transforming the enterprise through finance.

Appendix: Research Methodology and Company Profile

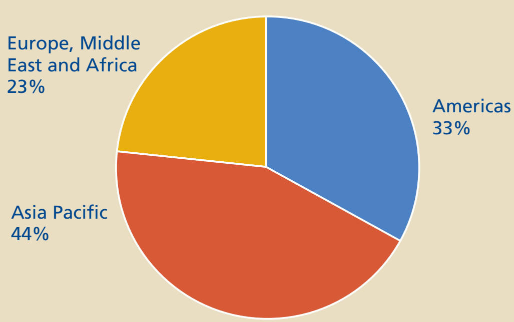
This study is based in part on the ongoing *Deloitte Global Survey on Transforming the Enterprise through Finance* with more than 70 companies and business units participating to date across the Americas, Asia Pacific, and Europe, Middle East and Africa (EMEA).

Of all reporting companies, about one-third have corporate headquarters in the Americas, 44 percent in Asia Pacific, and about one-quarter in EMEA. Seventy-five percent of respondents have corporate revenues higher than US$1 billion and 16 percent have corporate revenues higher than US$25 billion.

Industries represented include aerospace and defense, automotive and commercial vehicles, consumer products, diversified industrial products and services, high technology and telecommunications equipment, life sciences, process and chemicals, and other industries.

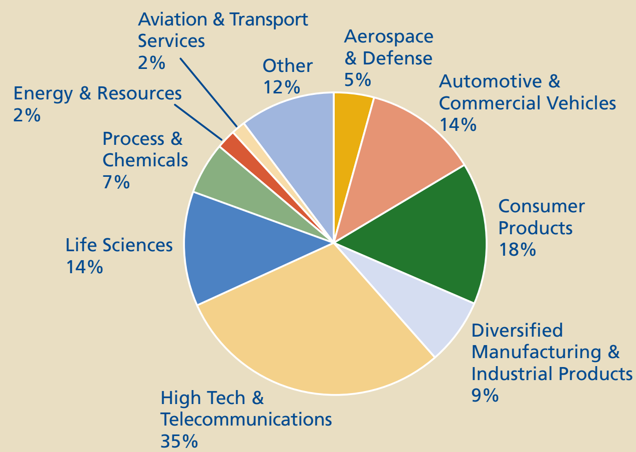
The scale for finance capability maturity level, used to rate companies in this study, is described in Figure C.

Figure A. Geographic Profile of Companies



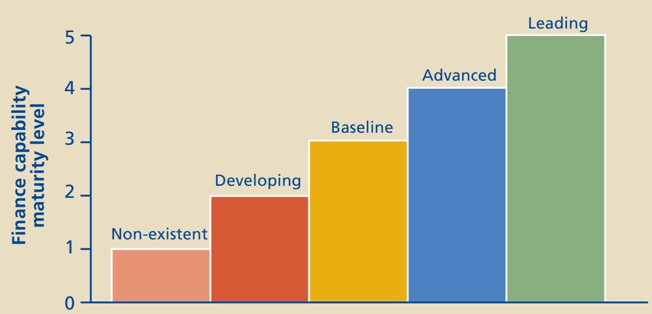
Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Figure B. Industry Profile of Companies



Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Figure C. Scale for Finance Capability Maturity Model



Finance Capability Maturity Level	Description
5: Leading	Leading practices thoroughly embedded in processes and tools. Integration of internal and external data to support processes. Real time information.
4: Advanced	Leading practices introduced. Enterprise integration of processes and internal data. Widespread automation.
3: Baseline	Standardized process. Some integration across the enterprise. Moderate amount of manual effort.
2: Developing	Process capability partially defined. Different approaches used in the organization.
1: Non-existent	Capability not in place in any structured sense.

Source: Deloitte Research, based on the Deloitte Global Survey on Transforming the Enterprise Through Finance

Endnotes

[1] Business transformation is often described as an initiative aimed at improving the alignment of people, process, and technology with business strategy and often includes changing organization design, product and market strategies, and large-scale implementation of performance improvement initiatives, such as six sigma and lean manufacturing, and new processes and systems for enterprise resource planning (ERP).

[2] For a detailed analysis of why financial management and finance transformation can play a key role in resolving these major problems of global manufacturing industries, see Deloitte Research, *Why Finance Transformation Matters in Global Manufacturing* (New York, 2007).

[3] For further details on the challenges (and opportunities) across global manufacturing industries see e.g., Deloitte Research, *Why Finance Transformation Matters in Global Manufacturing* (New York, 2007); Deloitte Research, *Managing the Talent Crisis in Global Manufacturing: Strategies to Attract and Engage Generation Y* (New York, 2006); Deloitte Research, *The Service Revolution in Global Manufacturing Industries* (New York, 2006); Deloitte Research, *Unlocking the Value of Globalization: Profiting from Continuous Optimization* (London and New York, 2005); Deloitte Research, *Mastering Innovation: Exploiting Ideas for Profitable Growth* (New York, 2004); and Deloitte Research, *Mastering Complexity in Global Manufacturing: Powering Profits and Growth through Value Chain Synchronization* (London and New York, 2003).

[4] For more on the concept of "future value," see Deloitte Research, *Why Finance Transformation Matters in Global Manufacturing* (New York, 2007); Deloitte Research, *Global Manufacturing 100* (New York, 2002), and *Performance Amid Uncertainty in Global Manufacturing: Competing Today and Positioning for Tomorrow* (New York, 2002).

[5] In our finance capability maturity model, a rating of 1 equals "non-existent," 2 equals "developing," 3 equals "baseline," 4 equals "leading," and 5 equals "advanced." Each company participating in the research is requested to use this rating system to assess its current capability and the capability it will need in three years. See appendix for further details on the finance capability maturity model ratings.

[6] See e.g. Deloitte Touche Tohmatsu and Economist Intelligence Unit, *The Finance Talent Challenge: How Leading CFOs Are Taking Charge* (New York, 2007).

[7] See Appendix for details on the ratings.

[8] For more on intellectual property valuation, protection and exploitation, see Deloitte Research, *Value, Protect, Exploit: Managing Intellectual Property to Build and Sustain Competitive Advantage* (New York, 2007).

[9] For the purposes of this analysis, "finance masters" are defined as those scoring in the top quartile on their strategist and catalyst maturity level. See Appendix for further details.

[10] The performance of finance masters is significantly higher than those of the other groups studied. Using a rating by respondent based on performance relative to primary competitors, finance masters rate significantly higher than other groups studied across a range of metrics including revenue growth, operating margin (earnings before interest and taxes as a percentage of sales), profitability (after taxes), return to shareholders, and returns on capital/assets. For example, a combined score across these metrics is significantly higher for finance masters than the other groups studied (significant at 93 percent level and higher). Similarly, finance masters rate significantly higher than other groups studied on their level of business capabilities (strategist and catalyst dimensions) in our framework (significant at 95 percent level and higher).While many studies around financial management and its impact on business performance have been conducted over the years, few, if any, have been able to establish a connection between the maturity of financial management capabilities, business capabilities and business performance. Much of the quantitative, statistical research around the benefits of finance transformation has been focused on the cost and efficiency of finance and accounting processes. While this is an important aspect, our research shows that the impact of finance on business improvement and transformation can be a much larger lever for driving performance. For a review of recent studies, see for example Jeremy Hope, *Reinventing the CFO: How Financial Managers Can Transform Their Roles and Add Greater Value* (Boston, MA: Harvard Business School Press, 2006).

[11] See also Deloitte Research, *Why Finance Transformation Matters in Global Manufacturing* (New York, 2007).

[12] See Porsche Group Financial Statement. See also Richard Milne, "Porsche profits by CFO's hedges," *Financial Times*, 29 November 2007.

[13] See Richard Milne, "Porsche chief defends Euros 70m salary after profits increase," *Financial Times*, November 29, 2007. On Porsche's use of strategic and operational hedging to create strategic and operational flexibility, see the case on Porsche's Boxster model in Deloitte Research, *Performing Amid Uncertainty: Competing Today and Positioning for Tomorrow* (New York, 2002); and the case on Porsche's Cayenne model in Deloitte Research, *Mastering Complexity in Global Manufacturing: Powering Profits and Growth through Value Chain Synchronization* (New York, 2003); and Deloitte Research, *Mastering Innovation: Exploiting Ideas for Profitable Growth* (New York, 2004).

[14] See e.g. Nicholas Carr, "IT doesn't matter," *Harvard Business Review,* May 2003. See also, "Does IT Matter: An HBR Debate," *Harvard Business Review,* June 2003.

[15] See Deloitte Research, *Managing the Talent Crisis in Global Manufacturing* (New York, 2007).

[16] See Harmony Gold, *Sustainable Development Report 2007.* In some of the most extreme cases in the mining industry, infection rates can reach 90 percent in some locations and the lifetime cost of treatment US$400,000 to US$900,000 per person. See Mergen Reddy and Boete Swanepoel, "Cutting the Cost of HIV," *Harvard Business Review*, September 2006.

[17] Based on interview with Boetie Swanepoel, CEO of e.com institute (Pty) Ltd., and former senior executive in charge of finance operations, Harmony Gold. See also Mergen Reddy and Boetie Swanepoel, "Cutting the Cost of HIV," *Harvard Business Review*, September 2006.

[18] Based on interview with Chris Furnell, Executive Manager, Corporate Finance, in charge of acquisitions and mergers, treasury and funding, Incitec Pivot Ltd.

[19] For more on services, see Deloitte Research, *The Service Revolution in Global Manufacturing* (New York, 2006), and J. Glueck, P. Koudal and W. Vaessen, "The service revolution: manufacturing's missing crown jewel," *Deloitte Review,* 2008.

[20] See J.P. Womack, Daniel T. Jones and Daniel Roos, *The Machine that Changed the World: The Story of Lean Production (New York: Rawson Associates,* 1990). For evidence of the power of marketing, sales, service, customer satisfaction and loyalty on supply chain efficiency, see also Deloitte Research, *Making Customer Loyalty Real: Lessons from Leading Manufacturers* (New York, 1999).

[21] See e.g. Anne Ozzimo, "Powering the Finance Transformation," *Profit*, May 2006.

[22] See Anne Ozzimo, "Powering the Finance Transformation," *Profit, May 2006.* See also Anne Ozzimo, "Driving Value Creation at Toyota Motor Sales", May 2006.

[23] See Molly Rose Teuke, "2007 Profit Innovation Awards", *Profit*, February 2007.

[24] See e.g. Deloitte Research, *Mastering Innovation: Exploiting Ideas for Profitable Growth* (New York, 2004).

[25] For more on innovation, see Deloitte Research, *Mastering Innovation: Exploiting Ideas for Profitable Growth* (New York: 2005). See also Deloitte Research, *Why Finance Transformation Matters in Global Manufacturing* (New York, 2007).

[26] See "Company CFOs Who Promote Innovation," *Financial Executive,* October 1, 2007

[27] See "Company CFOs Who Promote Innovation," *Financial Executive,* October 1, 2007.

[28] See Deloitte Research, *Disarming the Value Killers: A Risk Management Study* (Boston, MA, 2006).

[29] For examples of expensive mistakes in managing global supply chains, see Deloitte Research, *Unlocking the Value of Globalization: Profiting from Continuous Optimization* (New York, 2005); and Deloitte Research, *Disarming the Value Killers: A Risk Management Study* (Boston, MA, 2006). See also Yossi Sheffi, The Resilient Enterprise—Overcoming Vulnerability for Competitive Advantage (Cambridge, MA: The MIT Press, 2005).

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