

Worth your weight in gold?

The finance function can no longer rest on its laurels and assume that everyone in the business knows it's indispensable. **Sir Andrew Likierman** explains how financial managers can go about proving their value

Once upon a time, finance didn't have to discuss its own performance. The function was seen as essential, although the reasons why it was essential were understood only hazily by outsiders. But that's no longer the case. Inexorable cost pressures have exposed finance to increasing scrutiny and it is as much a potential target for cost-cutting as any other activity. Technology and outsourcing are often the most obvious way to achieve such savings.

Even without cost pressures, if finance fails to explain how it adds value, it will lose out in the competition for scarce resources. The whole business will suffer as a result, so good performance measures are essential weapons for those fighting for the right resources to do the job.

But first there must be a health warning. The finance core assumed here is private sector (overall lessons may also be relevant to the public sector), including external reporting, risk and compliance, treasury and tax, investor relations, transaction processing, costing, planning and control. But there are huge variations in the way departments are organised. It is a question not only of size – whether you have one part-time unqualified bookkeeper or hundreds of trained professionals – but also of the degree of centralisation and integration. The boundaries vary

greatly too, with IT, strategy, performance and other functions sometimes inside the finance department and sometimes outside it. This article therefore highlights ways to test existing practice and does not attempt to give one “answer”, regardless of the circumstances.

Getting there

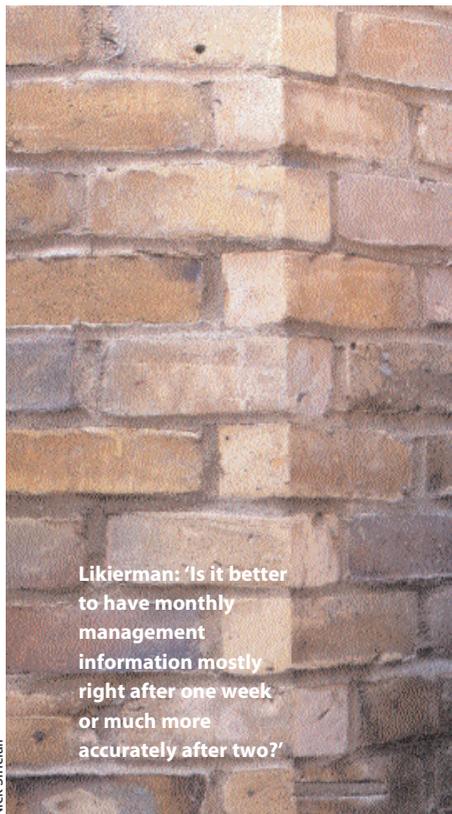
When first asked to measure performance, the understandable temptation for financial managers is to use their numerical skills to crack the problem. Popular measures include cost over the past five years, numbers employed compared with last year and the proportion of invoices paid on time. The advantage of these measures is that they are precise. The problem is that the bare numbers give only a partial picture. What about quality?

So next there are measures to plug gaps, including customer satisfaction questionnaires, the number of days it takes to provide financial information and, perhaps, a balanced scorecard. This gives better information, yet rarely provides an answer to the question “how well is finance doing?”

At this stage it is tempting to give up and simply say that everything is not only essential, but, because of IT and outsourcing, it is getting cheaper. Resist this temptation. It's vital to continue asking questions and helping the function to define its performance.

What should finance functions do? Before even thinking about measurement, they need to recognise the problems. These usually start with poor links to organisational objectives. There is no easy answer here and those outside the function rarely know enough to distinguish between what's optional and what's required. This applies as much to traditional activities such as budgeting as to newer ones such as risk. Then there's the thorny issue of measuring the results – outcomes rather than inputs. It's all very well to chant the mantra of the need to add value, but how would we know? The fact that the organisation has not gone bankrupt is hardly a knockout argument. Good relations with the bank and the external auditors may be a sign of strength, but they could also mean that the organisation is the loser in these key relationships. How would we measure this issue anyway?

Life isn't made easier by poor feedback. Unless they have recently worked elsewhere, most “customers” will not possess enough information to make judgments. Many long-serving managers lack wider experience to be clear about trade-offs, opportunity costs and risks. Is it better to have monthly management information mostly right after one week or much more accurately after two? It's often assumed that current practice is the only way to do things. It is only after you add non-



Likierman: 'Is it better to have monthly management information mostly right after one week or much more accurately after two?'

Nick Sinclair



financial measures, forward-looking information, charts, a really useful commentary and perhaps some colour that the board realises the good old system was in fact pretty terrible.

Lastly, because boundaries are so fluid, and responsibility for parts of the work is shared, it's often difficult to ascribe success or failure directly to finance. This measurement problem becomes worse the more the function embeds itself into line management.

Choosing measures

The implication of these problems is that it may be impossible to give an unambiguous

IN BRIEF

- 1 Connect your department's performance with the objectives of the organisation and management expectations.
- 2 Increase the sophistication of your measures and ensure that they focus on outcomes. Performance is about delivery, not effort.
- 3 Make comparisons wherever possible, using internal and external benchmarking.
- 4 Improve the quality of your feedback. Rather than rely on questionnaires, explore alternatives such as face-to-face contact and senior management appraisals.

answer to the question "how well is finance doing?" The good news is that there are many ways to use performance measures to provide solid evidence.

- Connect the performance of the function to objectives and constraints for the organisation as a whole, and to the expectations of its management. This needs to be done at least once a year at budget time, when the expectations – including trade-offs in cost and time – of line and senior management are formed. Two examples are understanding the disadvantages of an aggressive tax strategy and agreeing with the marketing and purchasing department the implications of managing working capital to its limits. These expectations should also be part of the targets that are set, perhaps in formal service agreements.
- Increase the sophistication of the measures and the way they are used. This should start by shifting the focus away from measuring cost and activity towards outcomes, signalling that performance is about delivery, not effort. Rather than using cost (or even no measure) for reporting, why not use a combination of financial and non-financial measures and commentary for external reporting, and customer feedback and comparisons for internal reporting and control?

The message should be reinforced by setting targets at levels defined by the organisation's objectives and customers, not by finance. Indeed, people outside the department should be used wherever possible. They could be from another function (such as HR), from another organisation ("I'll appraise yours if you'll appraise mine"), the auditors or an external consultant. All of these have disadvantages in terms of knowledge, independence and cost, but the most important benefit is that they have a fresh view on, for example, the extent to which the function initiates action.

- Use comparisons wherever possible. Best practice should involve a constant search, even by those who reckon they are among the leaders. The ideal, obviously, is to compare best practice in functions that are as similar as possible, but this may prove difficult. Where do you begin?

Large organisations with decentralised finance functions should start with intra-firm comparisons. Smaller organisations can look at other finance functions, perhaps through a benchmarking club. Also consider using other service functions in your organisation. When was the last time you talked about performance to HR or IT?

When making comparisons, the correct unit of analysis will be relevant individual

activities. For example, response times will vary for different activities, but you could discuss the approach with the IT department. Similarly, it may be worth discussing approaches for quantifying costs and benefits with research and development.

- Improve the quality of feedback provided to, and given by, finance. Customer satisfaction is a crucial indicator of successful outcomes, but this is tricky to measure because customer perceptions are dominated by current practice – they don't know what they don't know. You must not only determine whether customers are satisfied with what finance decides to provide; you must also help them to understand what is possible. For example, everyone may be used to a budgeting routine, but they may not see possible improvements from sharpening some processes and cutting others.

You should construct questionnaires with great care. Comparing what customers think with what finance thinks is more useful than simply asking: "Were you happy with the service (yes, no or quite)?" Indeed, questionnaires may not even be appropriate. Face-to-face feedback on questions sent out earlier, probably at budget time, give a better idea about what people really think. Such discussions allow you to try out new ideas as well as to find out whether other people think finance supports them.

You could also try using the head of finance's annual performance appraisal to discuss progress against objectives, changes to requirements and quality standards and trade-offs. How well was that unexpected hedging package put together? Overall, how did the treasury function cope with the unforeseen during the year?

Conclusion

As finance becomes more integrated into the rest of the organisation, as outsourcing becomes recognised as a permanent option, as the focus moves towards added value, so it becomes increasingly hard to define its success. Financial managers need to deal with these complexities by moving away from cost and activity measurement and towards closer links to objectives, more sophisticated measurement, better comparisons and improved feedback. Doing so will improve the ability of those in finance to identify their contribution, benefiting all who work in it and the organisation as a whole. FM

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