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Continuous Improvement and Shared Services

Driving Continuous Improvement

"The Aggregation of Marginal Gains"

Dan French, CEO – Consider Solutions

Accounting Shared Services are a central plank of any finance transformation targeting a world class finance capability. They are a key finance tool for efficiency and enabler for strategic flexibility, but achieving the process standardization required to drive the desired cost efficiencies is a difficult business in practice. It is easy to see process standardization at a high level but the devil is in the detail. Getting thisright is delicate surgery. We need to ensure we are cutting the waste and not impacting productive business effort. Benchmarks show the range of cost efficiencies for organizations using Shared Services are as wide as for those that do not. This paper illustrates the reasons for this, discusses Shared Services efficiency and value creation, explores the new wave of continuous improvement and shares the role of continuous monitoring and exception analytics with examples.

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World Class Finance, Transformation and Shared Services

In today's globally interconnected economy, CFOs face increasing challenges fromshareholder expectations, regulatory pressures, advances in technology, globalization, changes to accounting standards and fast moving business operations.

Finance leadersare working hard to evolve an optimized model for finance that helps both drive and support overall business performance. In the drive for increased efficiency and flexibility, leading organizations are striving towards a world class finance vision. The cost of a world classfinance function is approaching 0.5% of revenue according to The Hackett Group, down from as much as 2 or 3% a few years ago. Finance productivity increased by nearly 10% in the three years to 2012 and the demand for more is relentless. However, structural changes in business and the emergence of both stand-alone shared transaction services and global business services is challenging some of these benchmarks as the effort and costs involved, and thus comparisons between them, become less transparent.

The 'world class' finance function needs to drive down cost of operations while providing heightened levels of services as a true 'business partner' delivering the following key services;

- Stewardship & Reporting
- Accounting & Finance Operations
- Business & Management Support

CFO magazine offers us a kind of 'Balanced Scorecard' for the finance function when they describe the four pillars or dimensions of financial management, namely;

- Efficiency: continually improve process efficiency, speed, and quality
- Effectiveness: effective financial stewardship, risk management, control and compliance
- Relevance: provide analytical insight that decision-makers need
- Influence: proactively drive the business toward superior outcomes

Shared Services most commonly targets accounting and finance operations although we are seeing extensions into other classic 'back office' functions. Today, the most common financial process under Shared Services stewardship is accounts payable, lagged somewhat by general accounting, fixed assets, T&E management and accounts receivable.

Driving business value from Shared Services

Industry research indicates that significant benefits from finance transformation and the shift to shared services have been realized. The same research shows greater opportunities in the future to drive further business performance and business value. Anecdotal evidence however, indicates that the benefits of transformation and shared services may be less in direct cost savings and more in the areas of strategic flexibility, scalability, enabling balancing of effort across all markets in different stages of the economic cycle and enabling faster, lower cost new market entry.

Research also indicates that the sheer scale of investment in new process, technology and change management has been significantly higher than planned for many organizations

Shared services are clearly here to stay, whether implemented as a specific tactic to improve finance operations or as a catalyst to transform the business as a whole, often breaking down historical regional and country based silos of operationalactivity. The common refrain that 'transformation is a journey not a destination', is a claim that cynics regard as a tacit confirmation that direct efficiency gains and cost savings are not all they are cracked up to be. That being said, perhaps ironically, the primary initial objective is always cost reduction. The longer term goal is typically to improve the business 'outcomes' of finance.

As finance and business service leaders focus on measurement there is an increasing realization that a full set of quantitative indicators reading 'positive' does not necessarily mean the client is happy. This is a lesson learnt by many an open market service provider, and as always, creates some shades of grey in assessing the new model operation. It is nothing new to learn that performance indicators tend to give rise to unanticipated consequences.

AQPC recently published some interesting benchmarks on the cost of accounting illustrated below. In interpreting this data, I tend to assume the 'bottom performers' are not genuinely bottom of the market as an awareness and desire to benchmark and complete the detailed questionnaires demonstrates some aspiration towards process improvement at the very least. But even taking this data at face value, it is fascinating to observe that the performance gap between top and bottom performers in shared services is 8-fold. In fact, the spectrum of efficiency achievement is nearly twice as wide for organizations deploying shared services compared to those where accounting services are distributed in local operations (i.e. the 'old world' model). If nothing else (and of course the statistics are on a limited sample and there may be other variances in the assumptions), this chart illustrates there is something else significant that drives efficiency beyond simple centralization of common services. Simplification, standardization and automation are obviously key to this but this is where the 'devil in the detail' starts to get interesting. AQPC comment that large volumes of manual journal entries represent one area of the 'productivity gap'.Our own experience also shows large amounts of redundant effort in supposedly standard Purchase to Payable and Order to Cash processes that can be eliminated. Practical experience is starting to shed some light here.

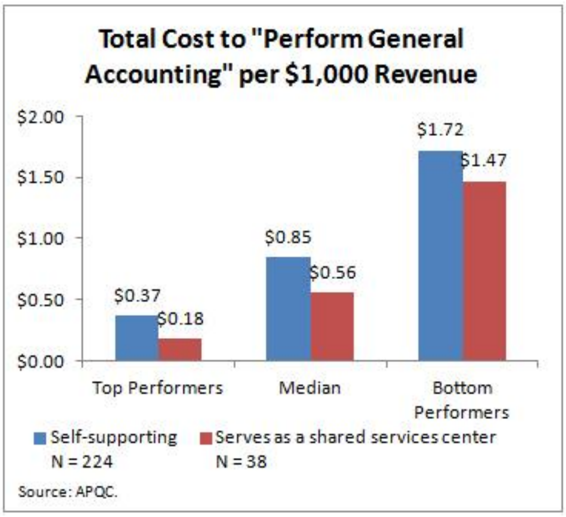


Figure 1

Of course, not all observers are completely convinced by the arguments for shared services. Management thinkerProfessor John Seddon, for example, is wary of evidence claimed for the economic benefits as much of this evidence comes from sources with a vested interest. He sees the argument for economies of scale as a 'flawed theory' and believes there is little hard data supporting predicted or claimed savings.

There are also reported unanticipated 'favourable outcomes' of Shared Services especially with regard to control and compliance. Deloitte report that 85% of their 2011 survey respondents experienced positive impact on their level of control and oversight.

Shared Services Evolution – The Third Wave

According to many commentators we are entering the third wave of shared services evolution. The first was transactional consolidation where the organizations strove to realise benefits through centralising activities and consolidating systems. These vary from 'Big Bang' transformations where process, technology and organization are tackled in one phase, with the associated change management headaches, through to the 'Lift and Shift' phased approach which many have credited with easing the transition. This phase was also often associated with the initial drive to business process outsourcing.

The second wave came in the form of a concerted focus on process efficiency and flexibility though process standardization. There has been considerable effort expended on this with new process designs and associated new system implementations. Simplification and standardization has had a massive focus and is often regarded as the 'nirvana' of Shared Services. Key questions have emerged, however, such as 'how do we know when we have got there?'. How do we measure progress towards standardization? How do we identify what is non-standard?

The third wave is focussed on continuous improvement and the drive for increased business value. There is considerable discussion on finding ways to exploit and analyze data to these ends. This is allclosely aligned with the move to end to end process ownership that reaches across Shared Services and beyondseeking out and exploiting best practice and ensuring global implementation.

To summarize, theprimary drivers of shared services value are;

- Less is more - Efficient management of common resources. Consolidation of managers, workforce, IT systems, facilities etc drives more efficient use of resources and reduces cost by more efficient use, i.e. you use less in total than you did in a distributed world. This ignores of course the efficiency 'drag' of removing such functions and relationships from local operations, but that is a separate discussion. This was the primary benefit of the early waves of the shared services concept.

- Simplification & Standardization – A common process and IT system enforcing a single way of working reduces re-work, error, ambiguity, effort, customer misunderstanding etc. Ultimately, thisreduces cost and improves cash flow and enables strategic flexibility and scalability. Additionally the re-engineering of processes in Shared Services becomes a catalyst for the re-engineering of the affected end to end processes across the organization.

We know from many disciplines that standardization drives efficiency and flexibility. But we also know that we don't get true process standardizationby publishing new process definitions, implementing a new system or forcing standardization of inputs and outputs. Human behaviourand initiative is very adaptable!

Standardization, Processes and Systems

The common ERP technology platform has been both an enabler for end to end process integration and globally shared services and occasionally an inhibitor to operational acceptance. It appears that technology is sometimes also used as an inanimate target of frustration with the change process.

However, it is reported that approaching 50% of shared services organizations now run on a single ERP instance. This should surely help standardization especially as a new system implementation is where the 'rubber hits the road' - the vision of common process meets the reality of operational momentum and necessity.

The real challenge is that despite their power, ERP systems or any other administrative system do not enforce business processes, they only enforce the process for data entry and capture. This subtle difference gives rise to a large gap between 'achievable' standardization and 'achieved' standardization and associated cost reduction. However, we know that when true standardization is achieved it also drives better information access and visibility which itself increases efficiency and reduces costs further.

Just consider a simple accounts payable process. To initiate an efficient automated payment we need a system to match an authorized PO, a confirmation of goods receipt and corresponding invoice. This simple three way match is designed to ensure we only pay for what we plan on, expect and receive. However our systems can only control the sequence of data entry not the actual business process.Have you ever considered what PO's created on the same day as invoice postings or goods receipts might mean? In most cases it means the standard 'process' was never followed at all and the first evidence of the order was either a delivery or an invoice receipt. In this example we create apparent standardization and the automated process lulls us into a false sense of security.

To take another common indicator of divergence from standardized process, it is common to see a high degree of change on both purchase orders and sales orders through their life-cycle as the operational teams struggle to match the realities of their business demands with the control exerted by the new common system. Orders get created with nominal values to get through system controls, and to start approval processes, get updated to reflect the desired detail later, and often demonstrate multiple price changes during the process. In addition to exposing financial planning and forecasting risk, this causes a great deal of duplication of effort where no value is added.

When provided with the evidence and information on these 'multi-touch' orders for example, it is easier for process owners and transformation specialists to explore and understand what is causing the wasteful activity. In many cases, this gives rise to a very healthy conversation about the realities of customer or vendor engagement and helps the process owners understand that the 'real' process is not quite as anticipated, and sometimes with good reason. This allows a genuine collaborative process improvement dialogue to develop.

So how can we better understand this ‘divergence’ from expected outcomes?

Think of the car park barrier in the image below as the 'control' that enforces a standard process for access and use of the car park. The automatic gate opens only when you swipe your employee badge on the reader and it only lets one car through at a time. This way, it is clear that only authorized people can use the facility and that a record is kept of each visit. The automated process works perfectly and as designed. There is even a regular testing and maintenance cycle of the barrier!

The tyre tracks on the snow, however, tell us whether this process is really working as expected.

Obviously not !

The tyre tracks show us deviation or exception from the standard and should stimulate us to understand how often it is happening, why the exceptions happen and refine the process accordingly.

This illustrates clearly why we need analysis of process exceptions so we can understand them and take action. It is important to validate our ERP system is doing what is expected of it, but it is even more important to analyze the 'tyre tracks' of business process exceptions. The tyre tracks tell us what is actually happening and the level to which our desired standardization is happening in practice. They also help us diagnose root causes.

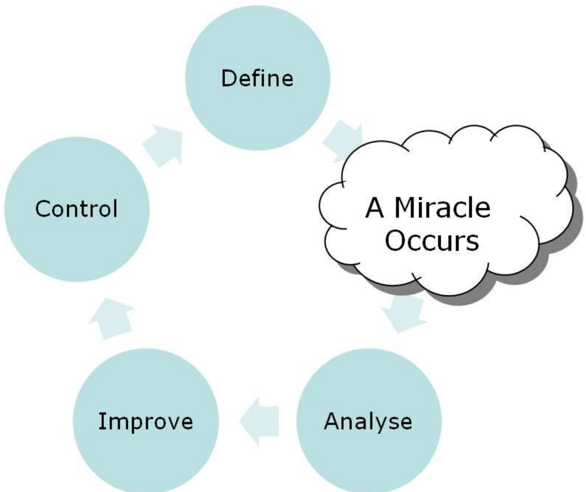
What is needed is a better ability to measure, compare, diagnose, resolve and drive action on detailed exceptions at key points in the process.

Exception Analytics - The need for better diagnostics to guide action

We need a better process for driving continuous improvement. Performance measures or Key Performance Indicators (KPIs) are a good start but common practice is to drive improvement by identifying deviance from aggregate performance indicators, such as Days Sales Outstanding (DSO) or Average Cost per Invoice Processed. To identify the root cause of such a general deviation is tricky, and symptoms can often be mistaken for causes. Say, for example, the DSO performance measure is 41 days, whatever happens to individual receivables the flag is only raised when the aggregate DSO exceeds 41 days. This has some serious implications. Firstly, it is a very lagging indicator and by the time DSO hits 42 or 43, working capital is already hurting. Secondly, the indicator tells you nothing about the cause – is it a general deterioration or a couple of very large receivables or certain customers with specific issues? Thirdly, this approach does nothing to help predict or avoid the scenario of deteriorating DSO. Advocates of this approach claim that continuous improvement specialists should be always ahead of the curve talking to accounts receivable and

credit control staff to understand latent issues. However, in a large organisation this is like looking for needles in very large haystacks. Perhaps it s not surprising that although continuous improvement ranks highly as a priority in surveys of Shared Services leaders, it also reports a lower level of success than desired. Whether you adopt the 'Plan, Do, Check, Act' continuous improvement philosophy or a Lean approach to eliminate non-value added activities with a 'Define, Measure, Analyse, Improve, Control' cycle, the challenge remains measuring and analysing with a level of detail and precision.

The cycle below illustrates the problem in the typical cycle of continuous improvement with the need for 'miraculous' intervention to identify root causes . . .

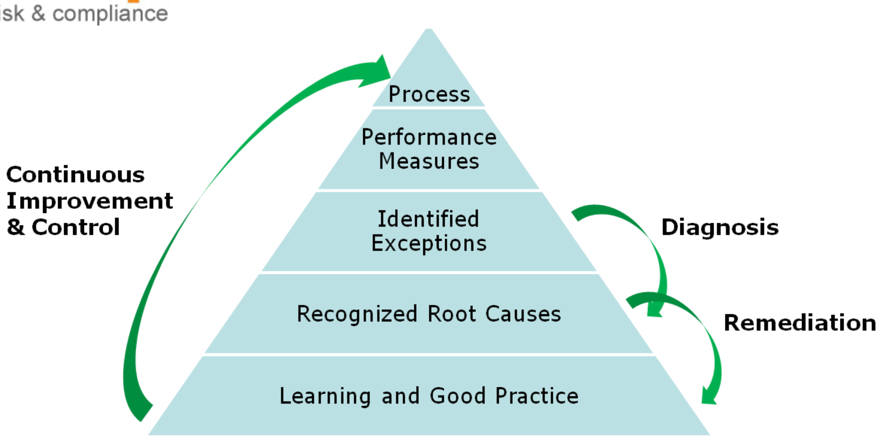


We can measure at the KPI level, as we have discussed, but we need a sharper instrument.

To solve this problem we need to create some leading indicators that give a better idea of what might go wrong that would later result in damaging a lagging KPI.

When we know 'what bad looks like', we can keep a (virtual) eye out for it, address it early and avoid major impact on our key KPIs as well as overall financial performance.

Identifying 'what bad looks like' is about defining exception conditions for critical elements of the business process . When we know these exception conditions, we are halfway to a much more coherent and holistic continuous improvement process. We can now automatically monitor for these process exceptions at a point in time for benchmarking purposes or continuously as the fuel to drive continuous improvement. The role of this exception identification, diagnosis and remediation is shown in a more effective Continuous Improvement cycle below.



What can go wrong in the Purchase to Pay/Accounts Payable cycle to damage the lagging KPI of 'Total Cost Per Invoice? Here are some of the culprits;

- 'Multi-touch' POs and invoices
- Lack of purchase order
- Invoices not clearing three way match
- Inconsistency between purchase order and purchase requisition
- Invoice dispute - mismatch between agreed/expected terms and vendor master data
- Duplicate invoices
- Blocked invoices
- Differences in quantity or value between receipt and invoice and purchase order
- Invoices with no goods receipt

In one organisation 9% of indirect purchase orders were undergoing price changes after creation generating considerable downstream effort of no value to the business and 2% were undergoing payment term changes. 5% of purchase orders had payment terms different to those agreed and held in vendor master data.

On the revenue side of the business, what can go wrong in the Order to Cash process that might result in damage to the 'Days Sales Outstanding' (DSO) KPI? This is not always measured in Shared Services but of great concern to the Controller and CFO. There are many but some good examples include;

- Lack of agreed terms or no terms defined
- Mismatch between agreed/expected terms and customer master data
- Lack of credit checks vs outstanding credit balance
- Mismatch between our sales process and customers purchasing process (missing a PO for example)
- Lack of confirmation of delivery, receipt, acceptance by customer
- Invoicing the requestor or goods recipient rather than the accounts payable centre
- Billing errors due to missing or incomplete customer data
- Late invoicing and late or missing reminders
- Lack of sharp follow-up as invoices become due
- Lack of escalation process in case of dispute or customer communication issues

Finance executives at one firm were alerted to a massive 16% of sales orders subject to late changes, which drove excessive value-sapping effort as well as create a receivables problem damaging DSO targets. 3% of sales orders were subject to changes to payment terms after the fact, also damaging DSO.

In these examples, clear and precise information on the nature of these exceptions enabled management to diagnose the root causes and implement changes to processes, policies and training to eliminate wasteful effort and reduce costs and cycle time.

Continuous improvement is about the "the aggregation of marginal gains" popularized by Team GB's cycling team director of performance Dave Brailsford after that team's tremendous success at the 2012 Olympics. Dave proved that constant monitoring and a succession of apparently small adjustments in many areas can make a huge difference to overall performance. If we apply the same thinking to the elements of our key processes, finding the exceptions and outliers, understanding why they occur, then make adjustments by eliminating, refining or standardizing them, we too can benefit from the aggregation of marginal gains.

Looking Ahead

The current burst of research and commentindicates three main themes emerging from leading practitioners;

From Cost Reduction to Added Value– There has long been an argument that finance transformation and shared services as a tool are more than just efficiency drivers for the finance function. Advocates refer to their role in re-shaping broader business strategy and changing the role of finance. However, caution suggests that perhaps the current levels of achieved cost reduction are not sufficient to justify the substantial capital investments in these major transformation programs. There is a substantial industry that needs to justify itself. Is this a case of changing the measures to justify an existing strategy? Either way, we know the efficiency drive must continue and greater standardization in Shared Services provides a great catalyst for improvement across the end to end process.

Continuous Improvement is the new wave **–** As the big bang transformation programs complete, continuous improvement is becoming the common agenda. Organisations are building structures, responsibility and accountability for global process leadership and the new focus is the end to end process that spans the business functions of sales and purchasing through the SSC and back around.

New processes and technologies are emerging here to support this. It is possible that this is very closely aligned to the first observation above. It may be that the payoff for the grand transformation programs has not fully materialized driving business leaders to look for new areas of benefit.

*From Accounting Shared Services to Global Business Services***–** Many companies are broadening their vision of shared services to encompass all general business services such as HR, IT, Procurement as well as accounting. There is no clear best practice emerging yet, but if you accept the economies of scale and strategic flexibility/scalability arguments, then this seems a logical next step. However, it is still early days in assessing the true cost and value . . .

But some big questions continue to be asked . . .

1. As businesses continue to seek operating efficiency, how do we drive further savings?
2. What is the optimal role for shared services and how do we maximize their value?
3. What is the mechanism to drive continuous improvement and how do we use data analytics to identify exceptions?

These questions all revolve around this issue of continuous improvement. The key is the continual drive for simplification and standardization, not just at the big picture level but down at the detail of process execution. What are the best practices? How do we get the information on exceptions to start diagnosis? Which exceptions should we start with? How do we benchmark variances to the operating standard by region?

Tools and techniques exist. There are now low cost non-disruptive ways to capture and analyze the process performance exception data, on a one-off assessment basis or on a continuous basis as part of 'business as usual'. The first step is to perform an assessment on a key process for one or two key areas of the business to start the process of diagnosis and action planning.

However you define 'finance transformation', it is generally agreed that that it targets cost reduction, efficiency and effectiveness, flexibility, scalability (agility for expansion), accelerating new market entry, easier assimilation of M&A activities and greater operational visibility. That visibility needs to extend into performance norms and exceptions so that we can genuinely drive continuous improvement. If we can broaden our knowledge of thepotential approaches and options, start simply and drive rapid value, perhaps we can tackle this particular 'elephant in the room.'

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About the author

Dan French is CEO of Consider Solutions,a firm specialising in advancing the state of the art in performance & risk exception monitoring. Dan has run the firm for 11 years and has a background of 25 years in general management, performance improvement, process change and technology. Dan advisesorganisations in Europe, US and Asia on strategies for continuousmonitoring and exception analytics. Dan claims to live in London despite his travel schedule. He can occasionally be observed playing blues guitar or sampling fine red wines, but rarely at the same time for reasons of practicality rather than preference. Dan can be contacted at dfrench@consider.biz

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