Whitepaper

The Role of Finance Reimagined: A Manifesto

Financial Performance Management

REVELWOOD®

Manifesto Highlights

- **The Technology Disruption**
- **The New Organizational Dynamic**
- **The Role of Finance**
- **Enabling Finance Transformation**

INTRODUCTION

The technological revolution of the early 21st century is transforming our global economy and the quality of life on this planet at a pace we've never seen before. Every part of our lives including what we eat, our health and wellness, how we get around, our housing, energy, communication, finance, entertainment, leisure—even fundamental social norms and basic human behavior—is affected.

Such transformation means organizations in every industry must learn to adapt in this new world or risk their very survival. New entrants are leveraging new technologies to introduce fundamentally new business models and upend entire industries. And, they're able to do so at orders of magnitude lower costs than in the past.

How must organizations think and act differently in order to survive? How can teams and individuals be equipped and empowered to make decisions a hundred times faster than they do today? What role does the office of finance play in this quest for survival and dominance in this new world?

Let's explore these questions and see what the answers look like.

THE TECHNOLOGY DISRUPTION

Our world is in the midst of a *transformative technological revolution* that is impacting every nation, industry, enterprise and human being on this planet. It is truly the stuff of science fiction. It is a revolution because it is radical and happening so fast. It is transformative because it is so pervasive and fundamentally changing the way we live.

"Today, if you're not disrupting yourself, someone else is; your fate is to be either the disrupter or the disrupted. There is no middle ground."

Salim Ismail
Executive Director
Singularity University

The reason we use words like "revolution" and "disruption" today is because of *rate of change*. Since the industrial revolution of the early 20th century, we have experienced change on a relatively linear curve. Today's technological revolution, however, has accelerated that rate of change to one that is exponential, thereby leading to disruption in the industries to which it is applied.

Gordon Moore, co-founder of Intel, famously stated in the 1960s that the number of transistors in a dense integrated circuit would double approximately every two years. Advancements in digital electronics are strongly linked to Moore's law: quality-adjusted microprocessor prices, memory capacity, sensors and even the number and size of pixels in digital cameras. However, the term *Moore's Law* has come to more broadly represent the rapid pace and driving force of technological and social change, productivity and economic growth.

Salim Ismail, executive director at Singularity University, states in his best-selling book, *Exponential Organizations: Why new organizations are ten times better, faster, cheaper than yours,* "Today, if you're not disrupting yourself, someone else is; your fate is to be either the disrupter or the disrupted. There is no middle ground."

Let's consider just a few of these technological advancements that are disrupting entire industries today.[1]

- Today's smartphone has more computational power than that of the entire U.S. government in the 1980s.
- Ten years ago, the Internet of Things (IoT) consisted of approximately 500 million connected devices. Today that number is 9 billion. At the end of this decade that number is projected to be 50 billion. And, not long after that? One trillion.
- The material world is based on a scarcity model. Companies manufacture products and sell them to consumers. Consider what happened to Kodak when that model shifted to a digital one. We went from taking one billion pictures a year to one billion a day. With no need for material goods, the concept of scarcity disappears. Some other examples:
  - Local Motors based in Arizona has developed a platform to be able to produce 3D printed cars, radically transforming the auto industry.
  - Entrepreneur Grace Choi has developed a home 3D printer for makeup that costs just $200. What does that mean for industry titans like Revlon?
  - The price/performance ratio of solar energy is being cut in half every year. At its current pace, 100% of the world's energy will be served by solar in less than 25 years. In 27 years that grows to 200%. And so on.

What happens to our economy when the marginal cost of physical products goes to zero and anything is available to anyone at any time? We shift from a scarcity model to an abundance model. The supply/demand curve is no longer relevant.

- Self-driving cars are no longer a dream. They're real and very close to becoming the standard. Did you ever consider Google a car company? It is projected that the soon-to-arrive proliferation of self-driving cars will increase the capacity of our roads and highways by a factor of 10-15 times. Imagine the impact on safety, quality of life… even real estate prices.

Think these changes only apply to industries that operate in the physical world? Think again. Entire business models are being disrupted.

- Crowdfunding means that institutional investors are no longer needed to fund startups. In fact, you can now validate new products without even creating them yet.
- The largest hotel company in the world—Airbnb—doesn't own a single hotel room. It has disrupted the business model by reducing both the cost of demand and supply to next-to-nothing.
- 50% of all business ground transportation costs in the U.S. are paid to Uber. And, it doesn't own a single vehicle.

[1]Many of these observations come from talks given by Salim Ismail, Executive Director at Singularity University.

"We can't be an industrial company anymore. We need to be more like Oracle. We need to be more like Microsoft. We want to treat analytics like it's as core to the company over the next 20 years as material science has been over the past 50 years."

Jeff Immelt
CEO
General Electric

- Physical forms of media are no longer needed. The way content is distributed has been radically transformed. Consider the newspaper and music industries.
- Walmart dominated the retail market for decades, and yet it is battling Amazon for its future.

Civics, politics, legal, healthcare, education, energy—our entire infrastructure was designed for a world that existed 200 years ago. Everything will need to be re-architected.

"We can't be an industrial company anymore," Jeff Immelt, CEO of GE, said in a recent interview with McKinsey and Company. "We need to be more like Oracle. We need to be more like Microsoft.… We want to treat analytics like it's as core to the company over the next 20 years as material science has been over the past 50 years. We can hire the talent. We can evolve our business model accordingly. We need to treat our service agreements to share outcomes with our customers the same way an IT company might approach that in the future. So, in order to do that, we have to add technology, we have to add people, we have to change our business models. We have to be willing to do all those things."

So, how can incumbents in an industry play catch-up to their start-up peers? One way to get there is to invest in or acquire innovative start-ups born of the new business models.

Airbus Ventures, the $150 million venture fund spin-off from the giant aerospace manufacturer, says its first investment is going to fund Local Motors. "Not since the space race has there been a bigger opportunity for aerospace innovation," states Tim Dombrowski, managing general partner of Airbus Ventures. The fund will take advantage of opportunities to "accelerate innovation in near ground, air and space flight."

Sound like a surprising investment for an aerospace company? In a recent article published in *Knowledge@Wharton*, a publication of the Wharton business school, the development model at Local Motors involves crowdsourcing engineering designs and then translating those designs into customizable products that are made on 3D printers through a distributed factory manufacturing system. In fact, GE is also an investor and partner with Local Motors. According to the Wharton article, "Speeding the time-to-market of any and all innovations, the partnership is leveraging advanced manufacturing processes using an open source model and a digital platform to deliver results for consumers and shareholders alike."

Another way incumbents in an industry can play catch-up is by transforming the business model:

- Start by examining the company's existing guiding principles, capital allocation patterns, processes, people and capabilities, and measurement systems.
- Question the core beliefs and underlying systems. Invert them to create an entirely new model.
- Test the new business model with customers, employees, suppliers and by observing new entrants in your industry.
- Apply the new model over time.[2]

[2]For more on this process, see http://knowledge.wharton.upenn.edu/article/industrial-firms-can-pivot-digital-business-models/?utm_source=kw_newsletter&utm_medium=email&utm_campaign=2016-07-28.

Responding to this technology disruption is not just about upending business models. There is a fundamental organizational transformation that must occur, as well. Consider the behavioral and social impacts of this technological disruption:

- *Connectedness* – expansion of your social sphere
- *Access* – a world of information at your fingertips
- *Productivity* – we can do so much, so quickly, and easily from our mobile devices
- *Openness* – we share much more of our lives
- *Democratization of power* – say what you want; influence the world
- *Self-service* – we have high expectations and make our own buying decisions; we prefer self-service over human contact

Humans think, behave and interact with each other and society differently today than in the past. So why do we think we can continue thriving with old world business models? Organizations are made up of human beings. Therefore, the organization of this new economy also needs to operate in a radically different way than in the past. It must recognize that traditional organizational business models are not reflective of how human beings behave today. It needs people at the fringes who are inherently hard to manage, yet have been given the opportunity to disrupt. Organizations must figure out how to embrace and leverage this disruption, rather than ignore or resist it at their own peril.

Let's further explore the new organizational dynamic of the 21st century.

THE NEW ORGANIZATIONAL DYNAMIC

In 2003, General Stanley McChrystal took command of the newly instituted Joint Special Operations Command, combining individual special ops forces like Delta Force, the Navy Seals and others into one coordinated unit.

However, he quickly realized that conventional military leadership approaches were not going to work against his 21st century enemy. As explained in McChrystal's 2015 book, *Team of Teams*, Al Qaeda in Iraq was a decentralized network that could move quickly, strike ruthlessly, and seemingly vanish into the local population. The allied forces had a huge advantage in numbers, equipment and training—but none of that seemed to matter. General McChrystal realized that to defeat such a dispersed, terrorist network, increased bureaucracy and rigidness was not the solution. His group would have to become as adaptable as the terrorist organization.

To defeat Al Qaeda in Iraq, McChrystal and his colleagues discarded a century of conventional wisdom and remade the task force, in the midst of a grueling war, into something new—a network that combined transparent communication with decentralized decision-making authority.

The walls between silos were torn down. Leaders looked at the best practices of the smallest units and found ways to extend them to thousands of people on three continents, using technology to establish a oneness that would have been impossible even a decade or two earlier. The task force became a "team of teams"—faster, flatter, more flexible—and beat back Al Qaeda.[3]

McChrystal's key realization was that the traditional command-and-control structure of the 20th century, supported by silos and hierarchies, was entirely outdated. That model embodied slow communication across the organization (or rather, "up and down"), lack of transparency and decision-making all the way up the chain of command. That being said, it was not so much the hierarchy itself that was the problem, but the way it was implemented.

According to Greg Satell in a 2015 *Harvard Business Review* article, *What Makes an Organization "Networked"?*, "We often hear about the need to 'break down silos' to create a networked organization, but this too is a misnomer. Silos are functional groups and they need a high degree of clustering to work effectively and efficiently. The real problem in most organizations is that path lengths are too great and information travels too slowly, resulting in a failure to adapt. The most efficient networks are small-world networks, which have the almost magical combination of high clustering and short path lengths. So silos aren't the issue—high clustering promotes effective collaboration—the trick is to connect the silos together effectively."

Satell continues, "General McChrystal's Special Forces command was still hierarchical and clustered into small operating groups. What changed is how they were interconnected. Rather than a collection of units, they became a synchronized organization that acted as one."

The need to adapt to this new type of interconnectedness is relevant to countless businesses, nonprofits and other organizations. The world is changing faster than ever, and the smartest response for those in charge is to give small groups the freedom to experiment, while driving everyone to share what they learn across the entire organization. The networked organization prioritizes its "soft structure" of relationships, networks, teams, groups and communities rather than reporting lines. People connect based on necessity, not based on their rank.

So, what is the new management model that strikes the ideal balance between structure and decentralized authority? That replaces centralized control and up-front planning with adaptability, transparency, open communication and front-line decision-making? Among various attempts to replace top-down management with a peer-to-peer model that balances hierarchy and collaboration is a "holacracy", a proven management system currently used by Zappos, Medium and hundreds of visionary organizations worldwide.

According to HolacracyOne co-founder Brian Robertson, "The social technology underpinning modern companies has become the primary constraint to their evolution and adaptability. Holacracy offers a new 'social technology' for governing and operating an organization—one that authentically distributes authority, and embeds flexibility and self-organization into the rules and processes through which the organization structures itself and goes about its business."

"Holacracy offers a new 'social technology' for governing and operating an organization—one that authentically distributes authority, and embeds flexibility and self-organization into the rules and processes through which the organization structures itself and goes about its business."

Brian Robertson
Co-founder
HolacracyOne

[3]From *Team of Teams, New Rules for Engagement for a Complex World*, by General Stanley McChrystal, ©2015. https://mcchrystalgroup.com/teamofteams/.

The biggest structural shift in a holacracy is that, as Jena McGregor writes in the *Washington Post*, "At its core, holacracy aims to organize a company around the work that needs to be done instead of around the people who do it." Therefore, the 'cells' of an organization in this model are not people, but roles, which people then fill.

Regardless of the new form of organization that companies adopt to survive the disruption of the 21st century, the message remains—adapt or die. And, it is not just organizational dynamics that must be considered. Additional factors include:

- The need for *speed*. Organizations must act much more quickly to keep up with market changes, technological innovation, customer demands and disruptive competition. The cost and time required for new entrants to launch and thrive in today's marketplace has been reduced exponentially.
- The need for *information*. No longer are labor or capital the currency of business. It is information and intellectual capital.
  - We need access to information in real time, and we must let it flow freely throughout the organization to enable rapid, front-line decision-making.
  - Maximizing intellectual assets is actually more important than maximizing financial assets. 94% of Microsoft's market value is intellectual capital. 96% of Coca Cola's is too!
  - We used to talk about translating data into information. But today, all information is data. It is unstructured (think text, social, audio, video, etc.) and coming at us ferociously at unprecedented volumes and velocity, exponentially greater than ever before.

Analytics becomes the new norm. Organizations must figure out how to leverage this data for competitive advantage. We must work smarter and faster. Furthermore, we can no longer rely on humans to process information to gain insight and make decisions. The speed and volume of the data "fire hose" requires that the process of analysis be relegated to machines. Not only is technology capable of understanding and processing tremendous volumes of data extremely fast, it is becoming self-learning. Our role as business leaders is to design these new systems of analysis and learning and apply them in creative ways to benefit our customers and markets.

Organizations should be investing in the following:

- Evolving towards a more experience-focused culture
- Capturing, merging and analyzing broader, more unstructured data
- Increasing teaming and collaboration across organizational functions and touchpoints
- Translating data into insights and leveraging those insights to operationalize value by creating recommendations and responses

THE ROLE OF FINANCE

What role must the Office of Finance play in the new, networked organization? How can it best support corporate strategy and operational effectiveness? How can Finance be viewed as a strategic partner to the business in its quest to disrupt itself and transform organizational behavior?

Ask ten people what the role of Finance is and you will get as many answers. This is because the term *Finance* is broad and includes a wide range of topics designed to support all aspects of the business. At its core, the role of Finance is to create and maximize value by providing individuals and teams throughout the organization with the tools they need to make smarter, faster decisions. Another primary role of Finance is to facilitate the availability of capital to enable the business to move forward. Finance is responsible for a whole host of other internal and external facing duties including reporting, compliance, transaction management, risk minimization, GAAP accounting, SOX, policies and procedures, general decision support for the business, and many other tasks.

All of these roles and responsibilities require us to constantly pivot and change direction based on the latest intelligence available to us at the time. Nowhere in that definition is there a requirement to blindly follow a fixed expense forecast regardless of what is happening in the real world. Unfortunately, that is exactly what traditional budgeting—the staple of most finance organizations—does. The budget process is a relic of the old command-and-control style of management and robs the organization of its true potential to succeed. Companies that insist on sticking to their rigid budget processes will simply not be effective in today's market and risk decline and eventual collapse.

According to Jack Welch, former CEO of GE and one of the most well-respected leaders of 20th century business, "Not to beat around the bush, but the budgeting process at most companies has to be the most ineffective practice in management. It sucks the energy, time, fun, and big dreams out of an organization. It hides opportunity and stunts growth. It brings out the most unproductive behaviors in an organization, from sandbagging to settling for mediocrity. In fact, when companies win, in most cases it is despite their budgets, not because of them."

"The budgeting process at most companies has to be the most ineffective practice in management. It sucks the energy, time, fun, and big dreams out of an organization."

Jack Welch
Former CEO
General Electric

Fundamentally, the budget is an antiquated, counterproductive tool. That is not to say that financial planning is no longer needed. On the contrary, it is critical to the decision-making process of an organization. It simply must be approached in a way that is relevant to the networked organization of the 21st century.

Why is the traditional budgeting process flawed? Consider its many attributes:

- It's time consuming and costly.
- It's quickly irrelevant and outdated.
- It's a purely financial process largely disconnected from specific drivers.
- It's principled upon negotiating and gamesmanship.

- It triggers unnecessary spending.
- It creates an inflexible performance contract against absolute targets.
- It drives the wrong behavior.
- It's based on a "push" system of trying to forecast customer needs and allocating resources accordingly, versus a "pull" based on customer demand.
- It does not empower front-line workers to think, be proactive and quickly react to changing business conditions.

"Increasingly, even finance people question the value of budgeting. One published report says nine out of ten think it is cumbersome and unreliable."

Jeremy Hope and Robin Fraser

Co-directors

Beyond Budgeting Round Table

Jeremy Hope and Robin Fraser, co-directors of the Beyond Budgeting Round Table (BBRT), an international research consortium, state, "Increasingly, even finance people question the value of budgeting. One published report says nine out of ten think it is cumbersome and unreliable. Among their complaints: it takes time away from activities that add greater value, such as supplying managers with the information they need to make decisions. According to a global best-practices study of finance organizations, finance personnel spent only 21% of their time analyzing and interpreting the numbers; they spent the rest doing 'lower-value-added activities' such as gathering and processing data, often for budget-related discussions."[4]

Hope and Fraser go on to indicate that studies have shown that on average global companies invest more than 25,000 person-days per $1 billion of revenue in the planning and performance-measurement processes. And the process absorbs up to 30% of management's time. Ford Motor Company is reported to have figured that its total cost at one time amounted to $1.2 billion per year.

So, what's the alternative? How can organizations measure performance, optimize behavior and facilitate planning and real time decision-making without budgets? The answer is three-fold:

1. ***Eliminate Incentives Against Fixed Targets*** – We need to move away from the flawed practice of linking incentive targets to our annual budgets. Gregory Milano shared his thoughts in the January 2014 CFO article, *Ugh! It's Budget Approval Time*. He said, "Whoever first decided to link performance measurement to budgets may have done more damage to business effectiveness than anyone else in history." This creates an environment where employees can make decisions that are in their own best interests, yet contradictory to the true interests of the organization. It is simply human nature to maximize personal benefit. The trick is to create an incentive plan which ensures that while maximizing my benefit, the company is rewarded as well. As it stands today, budgets basically turn into a game. The more fluff I can "sneak" into my expenses, the better chance I have to exceed my target, thus increasing my bonus. It leads to sandbagging, gamesmanship, sometimes combative negotiations, and the illusion of transparency and value. There is a belief that budgets must be a good basis for incentive compensation since so much of management's time went into completing and approving them. Break the link. Once we stop using our budgets for ancillary activities, the process can become streamlined and more of a value-added exercise.

[4] From *Who Needs Budgets?* by Jeremy Hope and Robin Fraser, published in the Harvard Business Review. https://hbr.org/2003/02/who-needs-budgets.

2. ***Move to Relative Performance Measurement*** – Instead of adopting fixed annual targets, business units set longer-term goals based on benchmarks such as return on capital. The elements or factors measured are key performance indicators (KPIs) such as profits, cash flows, cost ratios, customer satisfaction, time to market and quality. Such KPIs are both financial and non-financial. The criteria of measurement are the performance of internal or external peer groups and the results in prior periods. We therefore shift from absolute to relative measurement.

3. ***Institute Rolling Forecasts*** – Companies move away from budgets to driver-based rolling forecasts that typically look out 12-24 months and are updated quarterly or even monthly. Because these forecasts are regularly revised, they support a manager's ability to fashion strategies that continuously adapt to market conditions. Rolling forecasts differ from budgets in several ways:[5]

   - They don't envision a "finish line" at the end of the fiscal year whereby business effectively concludes and then restarts again.
   - They are constantly refreshed by the latest estimates of economic trends and customer demand and by emerging data from the most recent quarter, which makes them more accurate than the budget's stale targets.
   - They can be developed relatively quickly because they include only a few key drivers which then calculate a myriad of operational and financial impacts. Only the drivers and variable assumptions need to be reviewed and updated.
   - No one has a reason to manipulate or spin the numbers in a rolling forecast, because there are no fixed profit targets, or penalties for missing them.

Again, according to Hope and Fraser, "In an empowered organization, people are free to make mistakes and equally free to fix them. Managers have wide discretion in making decisions; as a result, they can obtain resources more quickly than in traditional companies and without having to document the need quite so elaborately, partly because they are accountable for the profitability of their units and can therefore be expected to shed any excess in the event that demand falls. In such a system, the "spend it or lose it" philosophy that's at work in traditional organizations has no meaning."

ENABLING FINANCE TRANSFORMATION

So, how do we evolve from traditional budgeting methods that support 20th century command-and-control management structures when the world moved more slowly, to real-time analytics and financial modeling that facilitate rapid decision-making in the networked organization?

[5]As interpreted from the Beyond Budgeting Roundtable (www.bbrt.org).

1. ***People*** – Make sure you've redefined culture, organizational structure and roles, and that you retrain or acquire the right people who are ready to think differently. Remember that in some cases, your team's skillsets have been centered around flawed, disjointed processes and systems. They spend lots of time gathering data from multiple source systems and ticking and tying that data. Your future state does not have as much of a need for this. You need to determine whether or not your current team has the ability to plug into that new world and be successful.

2. ***Process*** – Redefine processes to be more open, collaborative and transparent. Strengthen the interconnectedness across silos. Rethink everything that you do today. Remember that every function and process in the Office of Finance should support value creation in one way or another. Evolve from traditional budgets and fixed targets to more adaptive planning techniques.

3. ***Technology*** – Disrupt yourself. Leverage sophisticated analytic and machine learning tools to make decision-making smarter and faster.

So, what kinds of tools are needed to support analytics, planning and the overall performance management process?

At the heart of a successful FP&A process is a technology platform that is robust, fast, collaborative, scalable, intuitive and innovative. Unfortunately, most finance organizations today still use Excel as their primary planning and reporting tool, whether they realize and admit it, or not. Not that there's anything wrong with that! Excel is an extremely effective tool for analytics and reporting. However, Excel by itself cannot handle the rigors of today's sophisticated planning and reporting requirements. Using it in conjunction with the right underlying platform, however, can mean the difference between success and failure.

Let's further explore the key requirements of a good FP&A technology platform:

1. ***Robust*** – It must have an extensive set of capabilities that allow business analysts and other knowledge workers to plan, report and analyze. Sophisticated features such as multidimensional analysis, financial modeling, scenario exploration and tight Excel integration are a must.

2. ***Fast*** – It must be able to process data, calculate and produce results at or near real time. Analysts cannot wait for batch processes to run every time they run new scenarios or update model structures.

3. ***Collaborative*** – It must be able to work across individuals, teams and the entire enterprise. It should support a "single version of the truth" and allow users to collaborate and share data, information, reports and insights without creating redundancies.

4. ***Scalable*** – Data volumes are growing in form and number at exponential rates. The platform needs to be able to scale to meet the needs of growing businesses—both in terms of number of users, sources and types of data and size/complexity of models.

5. ***Intuitive*** – The toolset should be easy to learn and use for all users—from developers to analysts to executives. It should be designed for business users, not sophisticated technologists.

6. ***Innovative*** – The platform vendor should have the means to demonstrate significant investment in the tool to leverage newer technologies such as predictive analytics, natural language query and adaptive learning.

As organizations shift from traditional budgeting to real-time analytics, perpetual planning (i.e. rolling forecasts) and financial modeling, they need a platform that can evolve with them through that process. It must support the ability to create traditional budgets, extend those budgets to roll forward for longer time horizons, incorporate driver-based calculations and what-if scenarios, and then eliminate the annual fixed budget when the time is right.

CONCLUSION

Our discussion began with the recognition that technology is disrupting our world at an exponential rate, affecting virtually every business in every industry. Human behavior has changed, as has organizational dynamics. The new, "networked" organization must think and act much faster than ever before, leveraging increasing volumes of structured and unstructured data through analytics. Facilitating that decision-making process is the role of finance, which provides the necessary tools and insights into market activity, company performance, strategy and planning. Finance and executive management must recognize the detrimental impact that traditional budgets have on corporate success and evolve the organization to new methods of planning and performance measurement. Finally, that evolution must be supported by disruptive analytic technology that outthinks traditional tools and embraces the new normal—continual, exponential change. Organizations that don't recognize or acknowledge the reality of fundamental transformations taking place in their markets risk their own survival. Adapt or die.

ABOUT REVELWOOD

For more than 20 years, Revelwood has helped organizations grow revenue and profits through the use of data and analytics. We leverage the best analytics technology to optimize financial results and operational performance. Offering products, services, training and support, we combine analytics software with best practices and pre-configured, out-of-the-box applications to help businesses achieve their full potential. Hundreds of successful implementations and proven ROI for Fortune 1000 and mid-market companies are just a few reasons companies turn to Revelwood.

Financial Performance Management | Data Science | Business Intelligence

CONTACT INFORMATION

Revelwood
14 Walsh Drive
Parsippany, NJ 07054

201.984.3030

info@revelwood.com
www.revelwood.com

Revelwood Inc
14 Walsh Drive
Parsippany, NJ 07054
www.revelwood.com