

Value

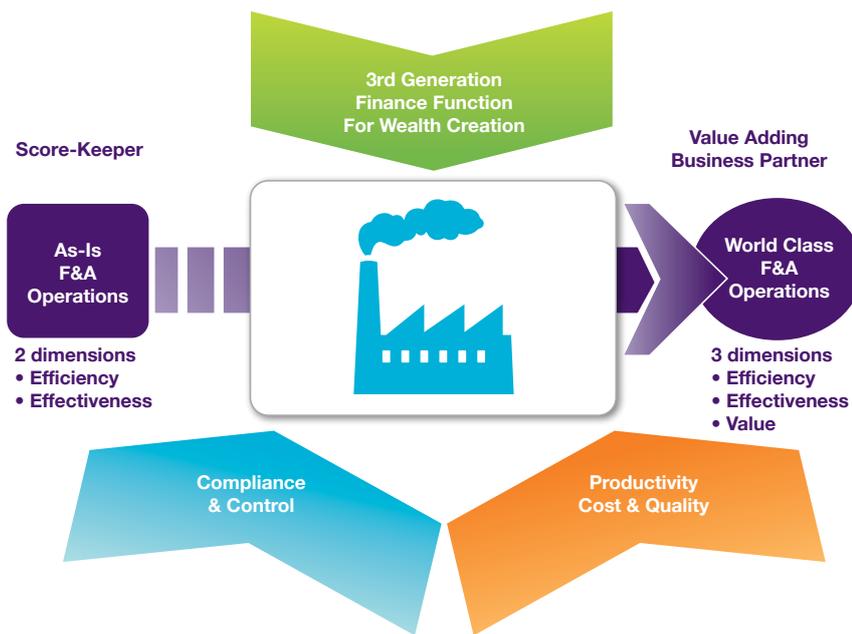
... the missing 3rd dimension to help
CFO's navigate the journey to world class
Finance and Accounting

A Capgemini White Paper



Summary

Steering a course through best economic cost to serve and highest quality whilst simultaneously adding value in the journey to World Class F&A.



CFO's and back office operations are now well past the initial impact post Enron and after being somewhat taken up with a focus on compliance and control they can now refocus back onto the long term goal of World Class Finance & Accounting. But the economic climate has also moved on and the pursuit of world class is in the context of an ever more competitive and aggressive commercial environment and in the relentless spot light of accountability post SOX legislation. It is incumbent upon all CFO's to be rigorous in their pursuit of control and compliance. In addition they are being asked to contribute to both operational excellence and lowest cost to serve as well as adding value and wealth to the business. This is quite some juggling act and requires, amongst many other things, a comprehensive measurement set and "dashboard" to maintain control.

The focus on wealth and value add has been described as the 3rd

Generation Finance Function (3G FF). To achieve this in an environment with increasing focus on operational efficiency and productivity is driving more and more CFO's to shared services and the use of outsourcing models such as BPO. The combination of pressures makes the measurement of progress and identifying success more complex. Balancing cost, timeliness and now value means looking again at the measures used to navigate the journey to world class. Conventional measures for operational excellence have historically been 2 dimensional in the areas of Efficiency (quantitative) and Effectiveness (qualitative). The 3G FF model cries out for a focus on value to fully support the aspiration for world class.

Using this new combination of 3 measures ensures that the end result is not just best economic cost to serve and highest quality (most efficient and most effective) but also achieving this whilst adding value to the

business. This maintains the finance departments alignment with corporate objectives and contributes to Investor wealth and value creation.

A key benefit to the business that a 3 dimensional approach brings is a balanced measurement and monitoring "dashboard" to guide the organisation to the attainment of World Class Finance & Accounting. Ensuring the achievement is benchmarkable against the best of the clients peers from a point of view of operational excellence but also simultaneously maintaining the link to corporate values and business objectives. Benefits of the "value" measure will essentially accrue in one of three areas: Corporate Alignment (ensuring the finance department is driven operationally in line with corporate values and objectives), Market Position (ensuring finance operations is contributing to areas that will lever market positioning such as brand reputation) and Value Creation (finding leverage in finance operations to influence top line growth).

Since Capgemini BPO F&A Services role is to provide World Class F&A services to our clients back offices we have built into our BPO deliver excellence program, transition implementation frameworks and operational delivery methodologies a three dimensional measurement process which incorporates "Value" as the essential 3rd dimension to World Class F&A measurement. This drives our back office services and therefore the clients businesses we serve inexorably towards World Class by ensuring Value Creation is at the heart of the journey. This paper discusses in more detail the introduction of that 3rd "Value" dimension.

The 3rd Generation Finance Function

The evolution of the finance function has been tracked in studies over the last 10 years from ‘scorekeeper’ to ‘valued business partner’.

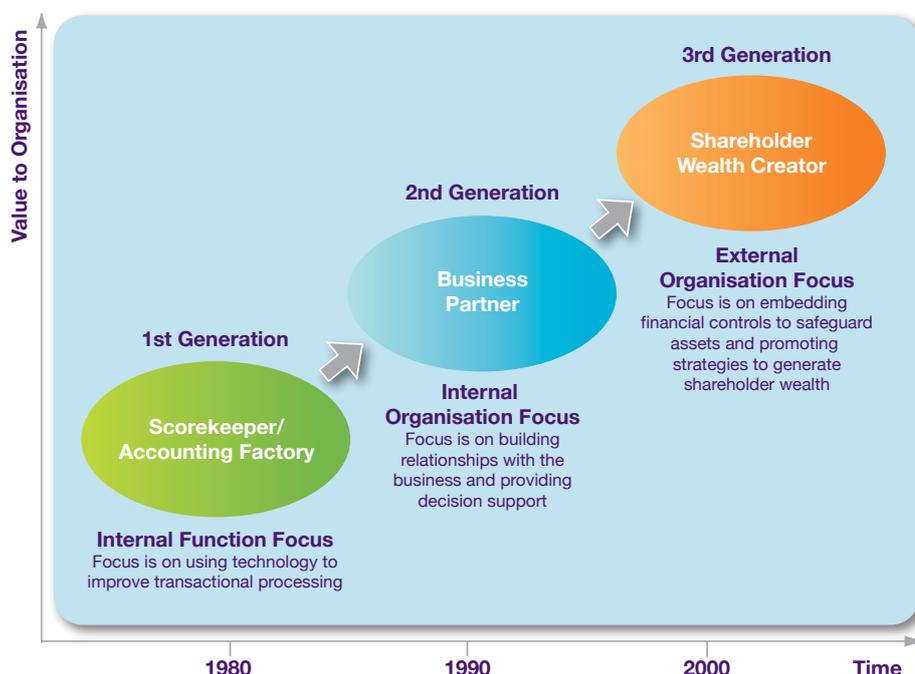
The valued business partner

The principles of gaining efficiencies through technology and exploiting the benefits of shared services have become the foundations of the 20th century finance function. But several years ago the “post Enron” fall out shifted the focus back to basics. Compliance and control became the watch words. As a result the last few years has seen a realignment of the finance function with the twin priorities of robust internal controls to meet regulatory requirements and producing transparent financial reporting to rebuild investor trust and confidence.

There was a risk, of course, that these dramatic increases in regulatory reporting responsibilities could distract CFOs from more strategic areas and for a time this was true and indeed was necessary. But increasing numbers of organisations have now

gone through the implementation of compliance programs and are at a stage of maturity where compliance processes are established as a repeatable and annual continuum rather than a one off implementation. The residual problem is that they are costly and often inefficient.

Forward thinking CFO’s are looking for the most cost effective solution. As BPO business models have matured those CFO’s are already outsourcing the repetitive annual “transactional” elements of the compliance process. Indeed Capgemini’s own BPO business has an offshore Assurance Services team delivering cost effective SOX compliance support services. So with the back of compliance broken those same CFOs are starting to ask “where do we go from here, how do we start adding value again?” The answer to that question is... back on the road to “valued business partner” with a target of World Class Finance & Accounting centred in the cross hairs. This means engaging fully with the 3rd Generation Finance Function.



How do you measure performance in 3rd Generation F&A?

John Coombe, CFO, GlaxoSmithKline, has said,

“It is more than just about defining profit & loss, it is establishing product profitability, the effectiveness of research and development, manufacturing efficiency, and the value to patients of the medicines we create.”

Area of Organisation		Potential Value Driver
Operations		Sales growth rate Tax rate Operating profit margin
Investments		Working Capital investment Fixed Capital investment
Financing		Weighted Average Cost of Capital (WACC)
Value Measure		Explanation
Market Based	Total Shareholder Return (TSR)	Annual % return to shareholders in a period
	Market Value Added (MVA)	Total value of company less the total capital invested
	Economic Profit (EP)	Adjusted net operating profit less a capital charge
Business Based	Cash Flow Return on Investment (CFRoI)	Internal rate of return for the business divided by the normal life of its assets
	Risk Adjusted Return on Capital (RARoC)	The return on either fixed or working capital adjusted for the appropriate degree of risk

Translating Shareholder Value into Simple Actions

So how does the 3G FF translate creating investor value into simple actions that can be embedded within the heart of the organisation? The key is to understand what value means for the individual organisation and what are the drivers of this value. More and more CFOs believe that their challenge will be to find better ways of using numerical expertise to quantify drivers of value. John Coombe, CFO, GlaxoSmithKline, has said, “It is more than just about defining profit & loss, it is establishing product profitability, the effectiveness of research and development, manufacturing efficiency, and the value to patients of the medicines we create.”

(source: Capgemini Point of View: 3G Finance, the next generation finance function)

Leading organisations are using proven value measurement systems such as SVA & EVA (Shareholder Value Analysis & Economic Value Analysis) to steer performance in the 3G Finance Function model. Put simply this approach to value analysis sees the finance function asking the organisation to answer some fundamental business questions:

- How do we define value e.g. brand recognition, shareholder returns, share price?
- How do we create value e.g. sales growth, investments, operating margins?
- How do we measure value, i.e. market based vs internal business measures?

Defining value at the highest corporate level will, in part, be unique to every organisation but there are some common value drivers and measurements that can be used across different companies.

Some examples are in the figure opposite but these measures don't provide the detailed linkage to the operational "shop floor" of the finance department that is needed to drive sub-process level activities towards World Class. But we know a core element of the 3G FF is striving for world class and so it's essential that the finance back office is driven consistently in the same direction and aligned with the finance strategy and also the objectives of the overall business. For example, if "brand value" is core to the business how do we link that into the operational controls and measures driving the back office services in the finance department.

On the face of it there is a potential for a measurement failure at this point. Clearly measuring value performance at the top end of the business must use measures aligned to the corporation. But how to translate that down to the "shop floor" of the finance departments operations on an industrialised day to day basis consistent with industry process standards.

It's our contention and indeed Capgemini BPO's own internal benchmarking across more than 20 F&A clients bears this out, that as you move down the organisation from the corporate strategic level it is possible for the value measures to become less company specific and at the operational and horizontal

processing level in the back office it is possible to assign value measures which are consistent from business to business and if selected with Business Insight into the clients operations, will allow alignment with corporate goals. This means that it is possible to facilitate navigation on the world class journey whilst incorporating value into the process measurement mix alongside efficiency and effectiveness. This will allow a more industrial and standardised view of managing the journey and make it possible, through consistent measures, to benchmark attainment of value against internal dashboards and external peers.



Adding the 3rd Dimension

Value alongside Effectiveness & Efficiency

Our good friends at Hackett Group (the global benchmarking company) tell us that world-class finance organisations report the cost of finance at 0.67 percent of revenue and that this is 45% lower than most typical companies, where the average costs are 1.22 percent of revenue. Also Richard Roth, Hackett's Chief Research Officer has been reported saying: "Our benchmark analysis shows that typical companies are just beginning to recover from the compliance efforts which consumed much of their attention over the past

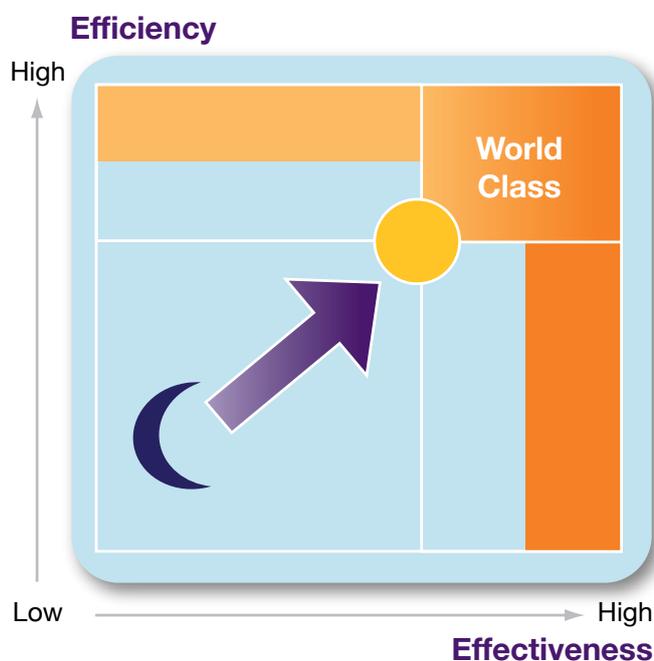
two years." "Most companies are now resuming their focus on improving other areas of finance operations. Meanwhile world-class finance organisations continue to improve at a more rapid pace. Their streamlined operations, with lower complexity, more standardisation, better use of technology, and greater use of shared services have made compliance a comparatively painless process. They are able to literally 'have their cake and eat it too,' and have continued to make improvements in cash and cost while at the same time increasing service and reducing risk."

(source: DM Review article, 20th Nov. '06)

Another Hackett Senior Advisor, John McMahan, has said: "While many typical companies still view the finance function as a cost center responsible simply for measuring and monitoring the financial health of the company, world-class CFOs understand that finance can produce significant business value in its own right."

(source: DM Review article, 20th Nov. '06)

Key measures in benchmarking and steering operational excellence on the path to world class F&A can be summed up in two classes: Efficiency and Effectiveness. But as we have said earlier in this paper the leading F&A operations are refocusing on becoming "a value adding business partner". This means we need to add a "value" indicator onto the F&A world class dashboard which compliments the key measures of efficiency and effectiveness.



(Source: Hackett Group 2006)

3 Dimensional World Class F&A Measures

- Value** - the Enterprise measure
- Efficiency** - the Quantitative Cost measure
- Effectiveness** - the Qualitative & Timeliness measure

There may be a trade off when balancing the measurement choices and emphasis between Efficiency, Effectiveness and Value. From the outset of the World Class Program the “as-is” assessment and “to be” targets will need to lay out what the definition of world class will be for this organisation. Whether the organisation is leaning towards cost efficiencies, or towards effectiveness benefits such as “straight through processing” or towards less tangible areas such as “reputation”.

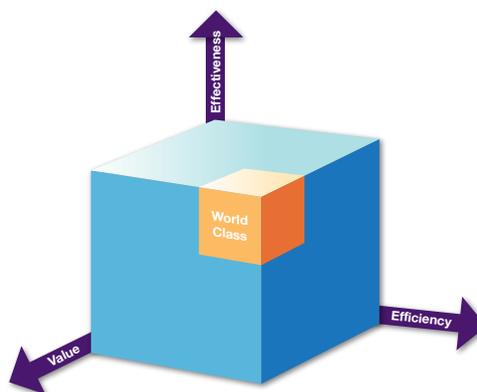
Value orientated measures bring benefits to the business in essentially one of three areas: Corporate Alignment (ensuring the finance department is driven operationally in line with corporate values and objectives), Market Position (ensuring finance operations are contributing to areas that will leverage market positioning such as brand reputation) and Value Creation (finding leverage in finance operations to influence top line growth). For example: one of Capgemini’s clients has seen the direct impact of finding value from conventional BPO workflow as a result of us using analytics on the billing data to highlight areas where customer retention strategies can be deployed and thereby directly positively impacting their top line.

When selecting quantitative and qualitative performance measures for Effectiveness and Efficiency we need to consider factors such as:

- **Balanced** - is the measure focused on one axis or does the measure provide the right balance between efficiency, effectiveness, and value?
- **Consistent** - can the measure be defined in a common way to ensure broad applicability and consistency?
- **Relevant** - why is the measure of value to the business what does it reveal?
- **Reach** - does the measure help provide a balanced picture of the full range of current operations?

The same criteria are relevant to the design of the value measures but with the additional caveat of

- **Alignment** - is the measure aligned to our corporate values and objectives?



The Benefit of the Value Measure

The advantage of including a focus on value measures into the steering KPI's for a world class program means we can navigate the finance departments operational performance simultaneously with maintaining alignment to corporate aspiration, objectives and values.

Value measures can be used to drive behaviour and results in areas that will influence for example:

- brand image
- customer reputation
- supplier reputation
- fraud reduction
- revenue enhancement
- customer satisfaction
- customer retention

Capgemini's 3 dimensional approach to measuring progress on the journey to World Class F&A.

To achieve world class the finance function needs to be excellent in all facets. So in the transformation program from the "as-is" base line to world class aspiration each area requires a set of measurement criteria that encompasses all 3 dimensions. Efficiency, Effectiveness and Value. A simplified view of the F&A department would normally span all of the areas highlighted in this figure opposite. Each process sub-set is an area where a set of performance measures is needed to drive behaviour

and operations keeping the focus on the path to world class. The areas in green are those one might typically find in a shared services or business process outsourcing environment.

In the same way as efficiency and effectiveness measures are built into the KPI dashboard at the process level "value" must also be baked in at this level. Also these measures must be embedded in the governance frameworks for transparency and accountability to ensure value measurement is a regular component of reporting and monitoring.





Our unique position as a leading F&A BPO provider with a wide base of complex F&A clients means we have our own sample database for benchmarking performance criteria. Capgemini BPO delivery excellence teams have built 3 dimensional measurement matrices for all the primary process in the back office such as Accounts Payable and Accounts Receivable.



Example of A/P & A/R Efficiency & Effectiveness Measures

Conventional efficiency and effectiveness measures to drive world class metrics in some of the sub-process areas in A/P and A/R might include the following examples:

- Management cost as a % of total finance cost
- Ave. # of days/month to reconcile intercompany accounts
- Ave. # of intercompany accounts in error
- % of overall finance key controls operating with deficiencies
- Record-to-report process cost per FTE

From Capgemini's growing F&A BPO global client base we have built a comprehensive data base of benchmark measures and World Class attainment levels by applying our 3 dimensional measurement criteria across this global BPO sample of finance departments.

It would not be in our competitive interest to list out and illustrate our full measurement matrix set in this white paper. However, by way of example, to illustrate the three dimensions relative to each other here are a couple of sub-process examples from A/P and A/R.

Illustrative Examples of 3 Dimensional World Class Measurements for AP Master Data and AR Reporting

Sub-Process	Measure 1	Measure 2	Indicator	Value
AP Master Data				
Efficiency	Number of master file changes	Total time spent	Time per charge	
Effectiveness	Number of master file changes	Number of documents processed accurately	% of documents processed accurately	
Value	Number of master file entries in accordance with group policy	Total number of master file entries	% compliance	<ul style="list-style-type: none"> • reduced fraud • lower cost • protect reputation
AR Reporting				
Efficiency	Number of reports issued	Total time spent	Time per report	
Effectiveness	Number of reports issued	Number of reports issued on time	% of reports issued on time	
Value	Number of "insight" reports	Total number of reports	% insight	<ul style="list-style-type: none"> • improved margin • competitive advantage

The comprehensive efficiency and effectiveness measures in each of the sub-process areas ensures that navigation on the journey to World Class encompasses all of the key operational targets that will position the business competitively in a class of its peers. The addition of the 3rd dimension for "Value" links in corporate goals, objectives and market positioning aspirations ensuring that the finance department is contributing to wealth creation and investor value. Thus ensuring that all aspects of the 3G FF are measured to steer a course of transformation from "scorekeeper" to "value adding business partner".

Conclusion

The commercial environment is relentless in its competitiveness and unforgiving of operational inefficiencies. Post Enron circumstances have left a permanent spotlight on accountability and transparency. It is incumbent upon all CFO's to be rigorous in their pursuit of control and compliance. But in addition the continuous pressure of the market requires the finance function to contribute both to operational excellence as well as adding value and wealth to the business.

Adoption of the 3rd Generation Finance Function model refocuses attention on value and wealth creation. This is driving finance departments to strive for world class performance levels. Conventional measures for operational excellence have historically been 2 dimensional. A 3rd dimension of "Value" completes the set to fully support the 3rd generation finance function aspiration in its pursuit for world class.



Using this combination of 3 measures ensures that the end result is not just the best economic cost to serve and highest quality but also that finance is adding value to the business whilst simultaneously ensuring the department is aligned with corporate objectives and is assisting in Investor wealth and value creation.

Capgemini has built into its BPO deliver excellence program, transition implementation frameworks and operational delivery methodologies such a three dimensional measurement matrix to incorporate value. This drives our BPO back office services and therefore the clients businesses that we serve towards World Class ensuring Value Creation is at the heart of the journey in the shift from “scorekeeper” to “value adding business partner”.

We have explained the rationale behind our thinking on 3 dimensional measurement for F&A transformation programs. Briefly illustrating some of the value measures associated with the core transaction processing areas we deploy in Capgemini’s BPO F&A delivery operations. If you would like to discuss the Capgemini approach to 3 dimensional measurement in world class Finance & Accounting and learn more detail on how our clients have benefited from this and other innovations in F&A Business Process Outsourcing please contact Capgemini at www.capgemini.com

A Capgemini White Paper

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