Drive Financially Sound Operational Decisions

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Position finance business partners as decision experts

Gartner

Introduction

Many finance organizations have invested in building and improving finance business partnering capabilities, but few can claim success at consistently supporting business decisions in a way that delivers tangible business value. In fact, at most companies, poor operational decision making compromises upwards of 3% of profits.

The good news is that a simple change to the finance business partnering approach can yield the tremendous business benefits companies seek. Read this report to learn why and how finance business partners must transform from business generalists to decision experts.

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CHAPTER 1

The Staggering Cost of Bad Decisions

How many operational decisions does your organization make every year?

Not the strategic business decisions made by senior management, but the decisions with financial implications made by midlevel managers. Decisions that determine when and by how much to discount prices, which IT vendors to select, how much and which inventory to hold, how much equipment overtime to run, or what types of marketing campaigns to use.

How many? 100? 300? 3,000?

If you said 3,000, you might be underestimating. Operational decisions are increasing in speed, volume and complexity — creating a challenge for finance, whose job it is to make sure those decisions are financially sound. Many CFOs already align finance business partners (FBPs) to discrete operating units to support decision makers, but few FBPs maximize their impact — and the leakage from poor decisions costs businesses millions, even billions, every year.

To stem this tide, progressive CFOs are modernizing their FBP approach, adopting a decision expert model that better leverages the acumen of finance — and exerts that influence earlier in the decision-making process. The result is scalable decision support and an opportunity to create value in a way that's not possible for business generalists.

Our research basis

- Surveyed 469 business decision makers and 128 finance executives across 20 industries and all regions
- Interviewed finance executives at more than 70 companies across the globe
- Interviewed a range of executives: chief financial officers, business unit CFOs, VPs of finance transformation, VPs of finance business partnering
- Proprietary 2018 Gartner Decision-Making Model, using regression and relative weights methodology to assess the effectiveness of different approaches in driving financially informed decisions

How bad is it?

Is the operational decision environment really that big of an issue?

Absolutely, according to our survey of 469 business decision makers and 128 finance executives, and interviews with finance executives at more than 70 companies.

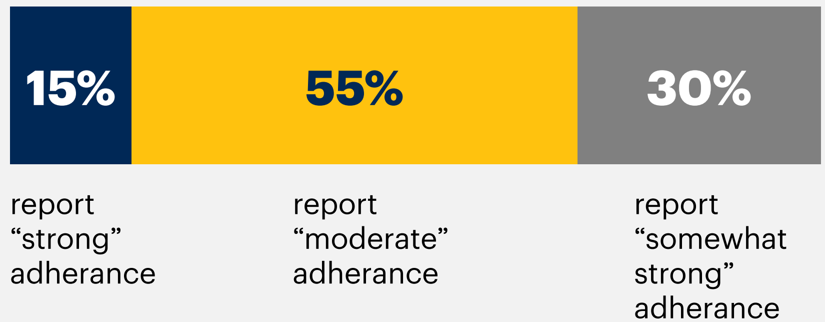
61% Sixty-one percent of business decision makers report an increase in the volume of operational decisions in the last three years, primarily due to geographic expansion, the impact of increasing merger and acquisition activity and/or new business models.

57% Fifty-seven percent say operational decisions materially impact profitability, as decisions now impact more staff and customers, and are copied/replicated faster across the enterprise. Faster propagation of risk also makes decisions harder to reverse.

Business managers are also expected to make operational decisions that are financially sound — but they often use the flexibility inherent in decision guidelines to justify exceptions.

How well do your operational decision makers adhere to your rules?

We asked finance executives, and:



Costs from bad decisions accumulate

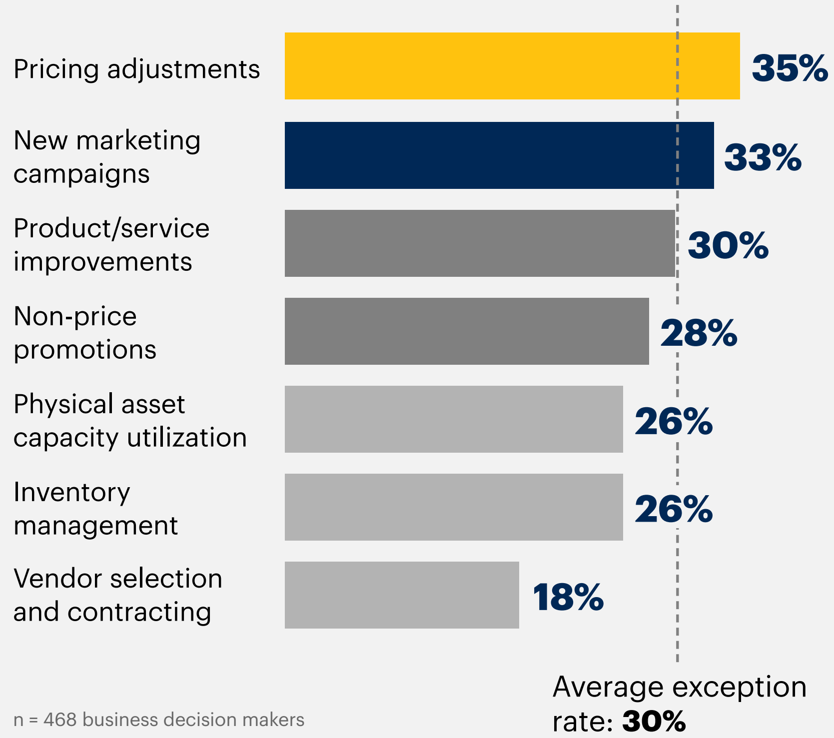
Of the seven main types of operating decision types (see figure at right), exceptions occur most often in pricing adjustments (35% of the time). Across all seven, exceptions occur 30% of the time, on average.

Business managers also tend to make operational decisions in a vacuum:

22% Twenty-two percent don't consider a single financial implication. The primary consideration is revenue — the "any business is good business" attitude that fails to account, for example, for the opportunity cost of foregone alternatives.

34% Thirty-four percent don't consider two of the six considerations we consider critical to making financially sound decisions — those that take proper account of the organization's broad strategic and financial objectives.

Frequency of Exceptions to Operational Decision Rules



n = 468 business decision makers
Source: Gartner Decision-Making Model

What makes an operational decision financially sound?

For operational decisions to be financially sound, they must take full account of:

- Full economic impact
- Impact beyond profit and loss (e.g., balance sheet)
- Relationship between various available levers (e.g., pricing vs. market share)
- Opportunity cost of foregone alternatives
- Link to broader strategic/financial goals of the company
- Strict adherence to financial policies and guidelines

Financially unsound decisions wipe out margins

Looking at the ripple effect (see figure on page 9) of just one type of financially unsound operational decision — pricing adjustments — highlights why the cumulative effect of poor operational decisions across the enterprise is so staggering.

Consider a company with $5 billion in annual revenue with a 21% margin on earnings before interest, taxes, depreciation and amortization (EBITDA). One such company, according to its own business managers, would likely make every year:

- 430 to 860 decisions about capacity utilization (e.g., which equipment to shut down, which to run into overtime). Each puts anywhere from $15,000 to $50,000 in profits at stake — with unsound decisions possibly wiping out roughly $8.3 million in EBITDA.
- 430 to 720 decisions by sales teams to adjust contract pricing, putting $20,000 to $50,000 at stake per deal, potentially erasing more than $7.4 million in EBITDA.

In total, that same $5 billion company could wipe out as much as 3% of EBITDA with poor judgment across all seven categories of operational decisions.

So yes, operational decision support is a big issue, and failing to optimize decisions will continue to reduce profits and/or create costs.

Ripple Effect of Financially Unsound Operational Decisions

Illustrative example of price discounts at a $6 billion telecommunications company

Source: Gartner

The imperative is to optimize decision making

The good news is there are ways to get closer to optimal decision making, and finance controls 90% of the problem (according to our regression and relative-weight analysis of decision-making factors). If finance teams want to maximize their ability to drive financially sound operational decisions, they need to improve the financial aptitude of operational decision makers and instill more finance information and analysis into those outcomes.

To do this, we suggest that finance teams reinvent their FBPs, who today often sit in discrete operating units to partner with the business as operational decisions arise. Our survey shows that 77% of FBPs are currently aligned by stakeholder in this way, but this model is becoming increasingly untenable.

FBPs have become business generalists and can't handle the growing volume of decisions. They also lack the expertise to effectively support individual decision types, because they are expected to support such a wide range of decisions.

77% of FBPs are currently aligned by stakeholder.

Some finance leaders are loathe to move from this model because they want business acumen to be a core competence for finance, and they like the hands-on support that FBPs offer decision makers. But this traditional approach requires a large team and leaves finance reacting in an ad hoc way to requests. The expertise, therefore, doesn't feed into the different types of decisions.

Progressive CFOs are shifting to a "decision expert" model.

Progressive CFOs are redefining the focus for FBPs, positioning them instead to specialize in a specific category of operational decisions. These "decision experts" support many different business managers across a defined set of operational decisions and develop expertise in a decision type (pricing, inventory, renewals analysis, etc.), rather than focusing on general knowledge of a particular business.

We found that the decision expert model is 2.5 times more effective than the business generalist model at driving financially sound operational decisions. It also thrives no matter how strong or weak the underlying relationship is between finance and the business.

CHAPTER 2

Focus FBPs by Decision Types

How to implement the decision expert model

The first step in shifting to a decision expert model is to redefine the role of FBPs — though the whole finance team doesn't need to be rescoped at once. A phased-in approach can start with as little as 20% of the team being freed from traditional FP&A activities to specialize in decision support.

As the use of decision experts becomes more widespread, finance is able to institutionalize learning from past decisions to build expertise and improve future decisions. By contrast, traditionally aligned FBPs are prone to make the same mistakes across the enterprise.

As the decision expert model matures, experts can leverage business networks, decision triggers and advanced usage analytics to sense and anticipate the business's needs for specific operational decision types without waiting to be asked for ad hoc support.

The decision expert model's many benefits make it a superior alternative to the more typical business generalist FBP approach (see figure on page 14).

What is a decision expert?

Decision experts are midlevel business finance staff that specialize in supporting a particular operational decision type. Decision experts:

- Focus on one operational decision category; they don't support multiple decision types
- Remain independent of any one stakeholder
- Institutionalize learning from past decisions to proactively develop new tools for operational decision making
- Provide proactive analysis before the business realizes a decision needs to be made
- Are accountable for improving decision outcomes; they don't have traditional financial planning and reporting responsibilities

Notably, this shift in focus is more a redefinition of the FBP role than a radical reorganization of the finance function.

A phased-in approach can start with as little as 20% of the team.

Advantages of the Decision Expert Model

Why the approach is superior to typical finance business partnering

Advantages

- ✓ Builds differentiated expertise in finance through repetition in a specific operational decision type.
- ✓ Improves ability to anticipate decisions by knowing when operational decisions happen across the business and conditions that drive these decisions.
- ✓ Improves operational decision makers' financial acumen by engaging them when they are most open to new information.
- ✓ Promotes greater scale in finance's decision support resulting from tightly scoped decision focus areas.
- ✓ Improves ability to monitor decision histories and assign accountability for improving decision quality.

Source: Gartner analysis

Think role redefinition, not reorganization

Notably, this role transformation doesn't require the finance function to radically reorganize itself. Nor does it mean the finance team has to have a dedicated resource for a particular decision type — or be at the table for every decision in their area of expertise.

Since operational decision makers are primarily midlevel management, finance doesn't have to worry about having a single point of contact either. That is a privilege reserved for very senior decision makers, who tend to make the more strategic decisions.

Finance leaders with experience in the new approach report:

- There are no overall changes in the number of embedded finance FTEs.
- They use different approaches to installing decision expert assignments; some redefine the role of embedded FBPs, others house them in regional centers of excellence.
- Decision experts spend significant time proactively teaching decision-making insights to the business and embed insights into reports and tools — more time than they spend sitting at decision tables.
- Decision experts play a more significant role in the operational decision making in their new capacity than they did as embedded FBPs.

FBPs who reinvent themselves as decision experts develop new skills and expand their knowledge of the business, so it can be a fulfilling role for finance staff who want an opportunity to impact decisions proactively beyond a limited set of stakeholders.

CHAPTER 3

Real-World Decision Experts

Lessons learned from progressive organizations

Only 23% of companies surveyed align their FBPs by decisions, but the decision expert approach is likely to gain traction as the operational environment becomes ever more complex.

The first step in such a shift is to identify for your own company what the decision expert role will look like, and how it will differ from the traditional FBP role.

Technology giant Philips initially spelled out role descriptions, responsibilities and expectations for its "Commercial Decision Experts," stipulating measurable goals and behaviors.

For example, Philips tasked its decision experts with providing options to solve pricing problems and improve price variance control outcomes by a given percentage, in addition to achieving quantifiable cost transformation hurdles. This made the experts accountable for measurable operational outcomes in a way traditional FBPs are not. Philips also emphasized the need to anticipate decisions the business hadn't yet recognized — another new approach.

Exert influence

For decision experts to have an impact, they must be able to influence business decision makers — which can be a tough ask. Business managers tend to be highly confident in their own operational logic, may be disinterested in new information and rarely seek the input of finance proactively. Decision experts should therefore create teachable moments outside the crunch time when decisions must be made. They can instead share their insights, and seek to influence the business, through informal business interactions, periodic internal reporting and ad hoc analysis.

Decision experts at medical device company ResMed provide ongoing coaching to operations teams on how operational decisions affect shareholder value. As a result, ops staff feel qualified to challenge the assumptions of decision makers in a constructive, credible and compelling manner. The quality of inquiries finance receives about the impact of proposed decisions improved threefold after these coaching sessions took root.

Clarify trade-offs and alternatives

Another way for finance to make decisions more financially sound is to help the business consider the alternatives and trade-offs of their choices. Finance decision experts can educate decision makers to recognize the urgency and nuances behind current business problems, and use their networks to create portfolio-level visibility into alternative decisions and options.

Finance can create prime opportunities for teaching moments by identifying and conveying to business managers which complications make a business situation untenable — as opposed to just supplying solutions and answers to identified issues.

Transportation giant Maersk did this via storytelling that centers on the current complications — i.e., the factors that make the current situation unsustainable. This helped the business see the most pressing operational issues and challenge their initial conclusions.

Decision experts bring a much-needed portfolio view of risks and opportunities.

Using this approach, you can consider pressing scenarios for your own business. For example, what if you have too little capacity to meet current demand, resulting in lost market share? Without the input of finance, decision makers might just opt to build capacity, asking only when they could expect a positive return. If finance articulates the complications — such as higher foreign exchange rates and long-term capacity outlooks — decision makers may ask a better question than "When can we expect positive returns?" Instead, they might ask, "What solutions do we have, given that capacity won't be online fast enough if we build?"

The conventional decision would be to build capacity. The decision influenced by the finance decision expert might be to lease or redeploy capacity, or to use alternate modes of transport.

The decision-focused FBP also brings a portfolio view of the alternatives: greater insights into external risks and opportunities, best-practice solution sharing across regions, and insights from ongoing analytics on current business problems.

Next Steps

Operational decisions are plentiful and wide-ranging, and most involve a short decision window (three days or less). These decisions compound across the different types of decisions, and over time, the cumulative financial impact is as much, if not more than, the impact of big strategic decisions. Yet the decision support resources of finance are disproportionately directed to strategic decisions — with the hope that rules will self-govern operational decisions.

The reality is that despite rules, poor operational decisions remain rampant; and operational decision support needs to be fundamentally different than strategic decision support.

To be responsive and effective at operational decision support, finance needs a scalable, widely applicable approach that can deliver a financially sound decision without delay. Finance needs decision experts, not business generalists.

Reinventing the traditional FBP model into a decision expert approach enables finance to support more of the right decisions and provide differentiated support — ahead of the decision.

To pilot the decision expert model, CFOs will need to:

- Reinvent the goals and expectations for FBPs, realign them to individual decision types and demonstrate value by improving decision outcomes
- Change FBP job descriptions accordingly
- Gauge the scope at which the model needs to be implemented — e.g., company level versus regional level
- Look for commonalities in the types of analysis or deliverables to standardize the decision support process
- Create lateral rotations for decision experts to develop well-rounded expertise that prepares them for future leadership roles

How We Help You

As more and more operational decisions arise, unsound decision making becomes a greater threat, with a potential 3% loss in profits. We help senior finance leaders:

- Understand the characteristics of financially sound operational decisions
- Create a new playbook for partnering with the business
- Take steps to move to the finance decision expert model

Knowledge becomes truly powerful when it drives action. From diagnostics and benchmarking, to peer insights and conferences, toolkits and guides — our suite of proven resources and practical solutions will help you transform your mission-critical priorities into measurable business results.

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