CFO-Discussion

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Innovation management and the role of finance: status, challenges, and vision

A discussion with the senior executives and CFOs of six leading European companies

by Juergen H. Daum – with Dieter Brandes, Dr. Werner Brandt, David C. Davies, Johan Kestens, and Dominic Moorhead

As businesses are engaged more and more in innovation, change will become the standard. This will affect also finance – a support function, which has to react to the new business requirements and has to adapt structures, processes and its service offering accordingly.

On one had, finance has to become a better business partner that is supporting the business in innovation and growth. On the other hand finance has to become more efficient and also has to deal more and more with external regulations – creating a need for optimizing financial processes and financial control. As a result, some kind of 'innovation in finance' is required as well.

How do CFOs see innovation and their role in it? What are the major building blocks and challenges in transforming finance? And what is their vision about the role of finance in 10 years? These are some of the questions discussed in the following panel discussion

In this panel discussion, wich took place at the fourth SAP European CFO Roundtable Meeting on December 2, 2005, in Vienna, Austria, Juergen H. Daum explores with the CFOs and senior executives of these six companies what they regard as best practice in innovation management and the practical consequences for finance and for the future role of the CFO.

This article has been published in: Controller Magazin, 6/2007, pp. 595-603.

Innovation: Why, and what are the challenges?

Juergen H. Daum: Mr. Brandt, what does successful innovation mean for you and what are the major challenges?

Werner Brandt: First of all you have to differentiate between invention and innovation. Invention is different from innovation because innovation includes introducing products successfully into the market. And innovation for SAP is key in order to drive profitable growth and that's important to keep up and increase shareholder value.

There was one thing in your presentation this morning I liked a lot: the objective of innovation is not limited to create technological novelty. We really have to be careful not to innovate just for technology's sake. We have to ensure – and that's the challenge from my perspective – that we really meet customer requirements in everything we do and that we have the right technology for our customers, that we have the right solutions for our customers in all of the different industries we are engaged in. And for me this means that we have to enable our customers by providing them with our innovations to successfully master their challenges.

There are two further aspects I would like to mention with regard to our customers. On the one hand, customers expect us to help them grow their business. On the other hand, they have to keep costs low and on the IT side this means to reduce their total cost of ownership. With our products and solutions we want to help them to do this. And this is where our innovation process starts: with what our customers want to achieve, with their pain points. It's an outside-in approach we follow here. And the fine line we have to follow, where we have to keep the balance, is really to figure out what is the essential for customers rather than what we think is a fancy new technology that may be worthwhile to follow just for its own sake.

Juergen H. Daum: Mr. Reichenberger, at the begin of the new year you will be in a new role. Your main business then will be innovation by managing the Nestlé Growth Fund. But you will pursue this task outside Nestlé. Can you tell us more?

Wolfgang Reichenberger: Yes. We have to look at the innovation process to explain it. It starts with "invention", then moves through concept development and testing, over to new product development or implementation, which really is "innovation", then to business development or expansion and finally to what I would call 'harvesting'. Now, what a company has to think about is: What parts of the process are we good at? And I believe, and this is very simplified, that most large consumer goods companies are excellent at the beginning of the process and again at the end. That means I think we are best in "invention" and in larger scale marketing and sales. You know we have larger and well funded and equipped research facilities, we have great contacts in the scientific world, and consequently produce innumerous new ideas and innovative concepts. But we often do not succeed as easily in implementation, and only very few of the bright ideas actually become big products. But once a new product has been successfully brought to the market, or purchased through an acquisition, then the qualities show again in full: in better distribution, international expansion, realization of synergies, and finally we harvest the benefits.

Juergen H. Daum: And in between you risk to get stuck with new products that do not make it in time to market? Was that the reason why Nestlé was not so successful with LC-1, compared with Danone's Actimel?

Wolfgang Reichenberger: LC-1 is exactly one of those examples. It was a great new concept. LC-1 is a bacteria, a very healthy bacteria protecting the intestine, which we discovered and which we had registered and even patented. It showed better results than anything else on the market, including Actimel, the product Danone came up with later. LC-1 was launched as a Yogurt in a number of countries, some of them with initial success, but our decentralized business model at the time, with each market having its own strategies and priorities, it did not help to sustain the product in all markets.

Juergen H. Daum: That was because of Danone came up with Actimel?

Wolfgang Reichenberger: Danone picked up the idea, and made it a success, mainly because they had one organization focused on chilled dairy, while we in our markets were managing 10 or 12 different product businesses in parallel, which was probably not leaving enough attention for LC-1. And because LC-1 had to compete externally and internally with the other existing products, it didn't get the attention it needed to become the success it deserved, to become an Actimel or Red Bull or something like that.

But I think that this ‘implementation gap’ is not the same for all industries. When I listened this morning to the presentation of Dominic Morehead, I got the impression that pharma is doing better here than consumer goods, because they can do more successful implementation in-house, within the organization. My perception is, that this is not the case in our industry. That’s why we have to think about other ways, other solutions, about complementing the in-house innovation process with outside innovation, so that the two together then arrive at a total, which is achieving relatively better results than traditional in-house innovation.

And this is what Inventages, the fund managing group I will join to manage the Growth Fund will focus on: on the expertise in late-phase testing and implementing and early expansion - the tasks Nestlé has decided to outsource.

Juergen H. Daum: So do I understand it right: the Nestlé Growth Fund that you will manage, will invest in smaller companies outside Nestlé with innovative new products and will help them to implement and develop these new products until the business is mature enough to be integrated into the big international Nestlé marketing and sales ecosystem? So you would create a space for testing, implementation and first expansion outside the Nestlé organization and use these smaller companies to do the job, where Nestlé is not so good?

Wolfgang Reichenberger: Yes, we clearly see a space for a different, more entrepreneurial, small-business model for fast and more efficient product development and launches.

Juergen H. Daum: That reminds me about the example of Genentech that Dominic Moorhead was talking about this morning. Roche didn’t integrate Genentech, a biotechnology company Roche acquired in the US, into the Roche organization, but left them outside, enabled them to continue to act like an entrepreneur. The motto is 'leave them alone': let them do their job of innovation and implementation, there are things that can be done better in the ‘biotech’ environment than in the ‘big pharma’ environment. Then later, you might market the products through the big pharma channels. It seems to me that Nestlé is applying now a similar approach in consumer products that Roche is already using successfully in pharma: outsource those parts of the innovation process, that can be better performed outside the organization.

Dominic Moorhead: But that’s it! I mean, all innovation can’t possibly be within a single company - thus what you really want is the ability to access innovation wherever it is. It could be your own in-house innovation preferably, or you could have broad access to another company via a strategic alliance (such as Genentech), or have licensing relationships with a range of external partners such as biotechs and universities. However rather than seeing this as outsourcing of innovation, we see this as building an ‘innovation network’ or cosmos. And of course you need to be an attractive partner; this requires a conceptual framework for working with partners, clear contractual agreements for sharing of the risks and rewards, as well as the commitment to act as a good partner. These relationships are expensive and risky for Big Pharma, but it is the access to innovation that is the key - if you’ve got access, then you can make the choices.

Juergen H. Daum: It seems that this model is working already very well in pharma, particularly at Roche. Mr. Moorhead, what would you say are the remaining challenges in pharma innovation?

Dominic Moorhead: Yes this model is well established in Pharma, but it is by no means a guarantee of success. Moreover there is always the danger that the model is replicated for its own sake, and there are many examples where such relationships have failed or resulted in disagreement. Foresight, commitment and patience are key ingredients for success here. Although today Roche has a successful strategic alliance with Genentech, it has to be remembered that this relationship started in 1990 and required significant commitment until the first products came to market.

We have to keep in mind that innovation is really about bringing value to customers, or patients in the case of a Pharma company. And it is not a matter of scale in just pursuing everything, but really focusing on where you think you can bring real differentiation and leverage, versus your competitors. You have to always focus on what your customers want and will really appreciate. In our sophisticated world there are surprisingly few disease cures, and still many unmet medical needs. On the other hand, there are many significant developments in technology, that have yet to be exploited. Thus the drive to innovate is as strong as ever.

So far we have discussed gaining access to external innovation. However it can also be that you have an in-house innovation that you choose not to exploit, because it is too risky, does not fit our strategy or requires heavy investment. Yet a third party sees value in that opportunity. You may decide to license-out this to the third party and let them exploit it in exchange for a financial participation, or a right to opt-in at a later date. This too is part of your “innovation network”. I think that we have to be similarly open to this approach to innovation.

And as Wolfgang Reichenberger was saying about Nestlé: you can still innovate within your current mindset to an extent, but sometimes you experience blockages. Then you have to be able to let somebody new come into the equation, who looks at it in a different way and sees some new value in there. You can often just get too fixed a mindset after a while, such that you’re locked into a perspective and can’t see the full value of your innovations. So there are still plenty of challenges for us.

Juergen H. Daum: Mr. Davies, what does innovation mean in the oil & gas industry and how do you approach it at OMV? What is your view – also based on your wide experience from the companies from other industries you worked with in the past?

David Davies: I think it's interesting listening to Wolfgang Reichenberger and Dominic Morehead. Innovation in their companies seems to be very much focused on the process of product development and on controlling it in the right way, that is: defining the winners, controlling the mechanics of the process, facilitating and encouraging the whole mechanics of the process to yield success. Whereas in the oil industry innovation is traditionally happening more on the technical level, that is on the supply and production side in terms of new techniques to drill oil or to produce it cost- effectively.

For a company of our scale though - which doesn’t mean that we are a small company – the challenge is to compete here with the supermajors in the oil industry who continue to dwarf us. Exxon has a market cap of 300 billion dollars or something like that, and the BPs and Shells along with them clearly have access to substantially more financial resources than we have. As a consequence they engage in innovation on a technical level, which is beyond our dreams, to be perfectly honest, such as deep offshore drilling and such like. The capital that they put at risk there is beyond our scale, quite frankly.

And although we clearly believe we are – on the technical level -, still quite innovative relative to our scale, I think where innovation is more relevant to us as a group is innovation on the market presence and business model level. Really looking where we were in terms of market presences, say 3 or 4 years ago, and where we wanted to get to and also considering that there were various elements of the business model that we were going to have to change, I think that was really where innovation within our group took route. And I think I am part of it, but only one very small part of it, because most of the change had to happen within the business: the way it's been structured, the way new people have been brought in, the way existing people have been assessed and coped with - which has really been a process of major cultural change.

If you wind the clock back 20 years to OMV as a 100% state-owned company, which is what we were and which by and large focused only on one or two markets, and compare it with where we are now, a presence around the world in the upstream business and very strong focus on the emerging central European markets in the downstream business, then it becomes very clear that you have to become something different to actually achieve transformation on such a scale. Therefore I think our innovation has perhaps been much more on the soft side, on the people side. Realizing - looking on where you are and where you want to get to, on the new structure - that a mindset, a culture, that is consistent with that new end point needs to be created. When you start to actively shape the cultural change so that people become more creative and innovative, it drives the business transformation process. That is the area where innovation for us has been particularly relevant.

Juergen H. Daum: Mr. Kestens, what means innovation for Swift, what are the innovation challenges at Swift, and how do you tackle them? I think you are the right person to ask this question, because as a product manager innovation is, so to speak, your day-to-day business.

Johan Kestens: At Swift we are this global utility which provides messaging services for the financial industry worldwide. Yesterday I spoke about the 204 countries which we have to support and the systemic importance for us of always functioning. We are a little bit like a blood circular system. If it stops, the body – in this case the financial industry – does not function any more. And it is for us a huge aspiration to conserve this, to ensure the stability of our services. In innovating that aspiration is a huge obstacle we have to try to get around. But what is innovation?

A lot has been said about the innovation process and about the difficulties of going from idea to blockbuster or fully rich and developed product families. For me all starts with the customer. Our customers have an expectation, what I call 'business as usual'. They expect us to deliver the same quality of service, of product functioning, at roughly 10% less cost per year. Roughly 10% less per year for the same - and that is the challenge we always have to meet. It is the right to stay in business. And that means that we continuously have to find better ways of utilizing bandwidth, cheaper computers, more efficient ways to deal with customer service calls, whatever, you name it. We can call this micro process innovations that are continuously being done and they give us the right to stay 'alive'. But I wouldn't call it innovation. For me innovation is that a customer says "this is new". This is something that I didn't had before and that enables me either to make more money by either having new revenues or by having lower costs. That to me is something that I would call innovative. But if the customer doesn't see it, when your are just doing your homework a little bit better to earn you the right to stay in business – that isn't innovation.

One of the biggest challenge in innovation that I have to deal with in my role is that customers cannot articulate their true requirements. For example you may have read in the newspapers that the whole payment industry in Europe is transformed, there is this thing called Single European Payment Area – SEPA – with the aim that international money transfers within Europe will have the same price as domestic transfers. Nobody really knows what is required to implement it. My biggest challenge in such a situation is to involve the customer in such a way so that they are able to discover what their true requirements are. It's a bit different than in the pharmaceutical industry, because an indication is an indication, although you have to understand that indication. Financial institutions work within a regulatory framework, that is true, but there is a large degree of freedom to meet these requirements. So you have to define what it is that you really want.

I'll give you one example of an innovation failure. It was called GSDPA - an initiative in the security industry to settle security transactions within one day after the trade has happened. The objective was to reduce the time between trade and the final settlement of the custodian to only one day: 'T+1'. Today, stock markets in the world are somewhere between 'T+2', meaning there are two days between the trade and the settlement, and in certain countries it's only 'T+5'. So people said "T+1 would be great, less risk!". Because between the trade and the settlement the counterparty can go bankrupt. 70 million were poured into the project. All the big banks around the table *said* that they wanted it. Great software code was written. It was a beautiful system and everybody was ready to roll. But then it appeared to be twice as difficult to deliver. Additional money was needed and nobody wanted to fund it. It was really a stalemate situation. You could see them sitting around the table, all the big banks, and everybody was looking at one another and nobody dared to move – and the project was stopped and failed.

For me, the only solution is to help customers articulate their requirements and to get them enthusiastic about those requirements and committed. I use techniques such as some simple form of conjoint analysis to force them to make choices. Otherwise you get this ‘Well, I want it cheaper, I want it faster, I want it better, I want everything’. But what do you really want? If you only can have one thing, what would it be? And those are extremely difficult and painful discussions to have, but they are vital in order to bring something new to the market. And then, when it works, it usually sells itself. These are the things that work. There are others that do not work, because we cannot get the customers to really articulate and want, sufficiently want what they were asking for. So for me innovation is to understand what the customers want, get them to really want it, and then deliver.

Juergen H. Daum: Mr. Brandes, what means innovation for you and from an ALDI perspective? What are the real innovation challenges and how would you tackle them?

Dieter Brandes: First, I would differentiate between product innovation and innovation in process and operations. I remember Dominic Morehead telling us this morning that product innovation at Roche is the core. And this is very clear for me from a Roche perspective. If you take in contrast ALDI, at ALDI innovation in products is not the core. The core at ALDI is innovation in process and in operations. For Roche it’s important to find the right products and bring them to market. For ALDI it’s important to improve constantly how they operate. And innovation in process and operations, these are the many, many small things, which can be found and which can be improved every day. And sometimes there are also big ones.

The barcode – as ALDI uses it three to five times on a single package in order to better and quicker read it with the scanner - is it an innovation or not? Yes, sure, it is an innovation in processing and in operation which never before was used anywhere in the world. Another example is how pallets are carried on a forklift and on the electrical cars in the warehouse. When I started at ALDI we carried only one pallet at a time. Only one! And when I left ALDI we carried three. This was implemented by our warehouse managers together with the manufacturer. They created this new machine. Today, in all the warehouses at ALDI forklifts carry three pallets at a time. This is saving time and money and improves productivity. This is innovation at ALDI.

But no matter were innovation should take place, you need to have an innovation culture. And I only want to mention one important element which you need to stimulate it. It is related to how you organize. If you create an atmosphere of autonomy, decentralization, delegation and areas of tests, areas of trial and error, meaning a business that is built on autonomy and freedom and decentralization and things like this, this will make it easier to innovate, to find new products, to implement and to market the new products and to come up with these many small or bigger improvements every day, which you need to be successful. I'm very much convinced that you need such a kind of organization to be innovative.

Juergen H. Daum: That’s an interesting statement you just made about the many small improvements every day at ALDI. It remembers me the case of Toyota where they also have such a culture of autonomy and innovation and where every employee has to come up every week with at least one idea for improvement, for an innovation. He or she should find every week something that could be done better at the place where they work and then implement it. And I believe you are right, if you have such an organization, which functions that way, process innovation happens automatically. I call this bottom-up innovation.

Dieter Brandes: Let me add one thing. Often people think that innovation has to come from outside the company, because employees and managers are so focused on their existing business, on their day-to-day tasks, that they cannot invent something really new. But if you have a really decentralized company like ALDI, where the 65 regions in Germany have a quite high autonomy to, for example, test a new idea how to better carry pallets on a forklift, this is almost the same as if you would have third parties and outside companies who would do that for you. Because if you provide the autonomy to test new ideas in the different regional organizations, the company as a whole can later pick the best ones that work and can make it available to all regions. So, how you organize counts – especially in innovation. Tom Peters once said, if you look on all your problems you have as a company, then probably 50% of the solutions are in the organizational structure, meaning 'who is responsible for what?', 35% of the solutions are in the processes, and only 15% in personnel. So organizational structure, how you organize, is key for success – also in innovation.

Innovation and the role of finance

Juergen H. Daum: I want to shift the perspective now a little bit and want to come back to finance. If we consider what has just been said about innovation in general, from the perspective of the business, and if we now think about innovation in finance, change in finance, what can we learn from this? Why does finance has to change at all? Why do we need innovation in finance and how do we organize for it? What are the building blocks of transforming finance, of the finance strategy? And what are the challenges? Mr. Brandt, what is your opinion from an SAP perspective.

Werner Brandt: First of all, I would like to emphasize that the finance strategy – and this also includes innovation in finance – must be aligned with and must support the overall strategy of the company. It is not per se a strategy for finance. Bearing this in mind, we then have to think about the role of finance in the organization. It has already been mentioned in the presentations during this roundtable that finance has a dual role: the business partner role, where finance as a business partner supports the business in achieving its business objectives, and the stewardship role, in which the finance function has to safeguard shareholder interests and ensure good corporate governance which includes the paradigm "compliance without compromise". It's clear that we need a good balance between both roles. We all know that it can be very difficult to fulfill both roles at the same time. I think Dominic Morehead's presentation gave us a good example with Roche for how it can work, if you have the right people in the organization and if accountability and responsibility exist for the things the finance organization has to deliver.

At SAP, our task as a business partner role as finance people is to support the transformation of the company, the transformation from a product company to a business solutions platform company with a growing focus on the volume business in the mid-market, which will offer for our customers not just single products, but a business process platform that can integrate various services in a flexible way. This allows our customers, for example, to better support innovation from the IT side and it can reduce the total cost of ownership at the same time. And that's a tremendous shift for our organization, for how we go to market in the future, for what we sell to the market, and for all the related areas. And as a consequence, being part of this strategy and in order to be able to support this change in the business, we also have to change within the finance organization. We have to adapt how we operate and we have, for example, to focus much more in the future of really being able to support the business as a true business partner.

When I look at our finance organization, for example in a particular country, then this means for the local CFO to support the operationalization of our strategy in this country, and thus that the CFO needs to change as well. It especially implies a shift away from transactional processes to be able to focus more on the business partner role. We have to support this by implementing shared service structures around the world in order to free up resources to then better support the business. I do not talk about the stewardship role now. That's something that we have to do anyway and in parallel. There can be no compromise on compliance.

Juergen H. Daum: Mr. Reichenberger, what is your opinion?

Wolfgang Reichenberger: I agree with what Werner Brandt just said. We have to really live this dual role, these two very different roles. And this means not only having two different mindsets, but to act in two very different ways. The co-pilot role requires that you should continuously challenge and drive for innovation. And that means, for example, also to nurture sometimes a spirit of creative destruction. We are trying to live this within the finance&control function at Nestlé. For example, we said, let's consider to stop reporting. While this may be radical thought we stimulated a very positive and creative discussion about how we could turn reporting, which should provide people with relevant information to help them to make better decisions, from a process, which is 'pushing' a lot of un-relevant information on them, to a process where people 'pull' the information they really need – meaning a change from a 'push' to a 'pull' mode. But to get to that discussion and to this new concept, I first of all had to destroy the idea that we always will have reporting as we had it.

On the other side, in your stewardship role, you have to be concerned at the same time about what Dominic Morehead called in his presentation 'guarding the financial peace'. It means that you have to innovate but, at the same time, you have to still ensure good financial governance. You have to make sure that your innovation doesn't put your finance&control framework and the financial and operational stability at risk.

So you have to live both roles at the same time, even within finance&control. But with a very different approach, in a very different way. You need both. You do not only want financial peace. You all fall asleep, if the company would just manage for financial peace, and there would be no growth and no competitive strength any more. On the other side, if you would allow too much creativity and innovation, this can also destroy the company. So you have to balance both approaches and both roles. And that, I think, is more of an art than a science.

Juergen H. Daum: That's an interesting thought you brought into the discussion, Mr. Reichenberger: that you first have to stop doing things, the old things – at least in thinking -, before you are really ready to start something new. This is what Peter Drucker, who also originated, like Joseph Schumpeter and yourself, from Austria, wrote in one of his last books. He wrote that every organization has to become today a change leader. And he defined some principles for this. The first principle he defined is that every organization has to practice organized abandonment. That means, organizing to be able to stop things in a systematic way. Because if you have a running business, you have a lot of resources tied up in your existing processes and in the things you do, for example traditional reporting. The whole thinking is in that space. And to be able to do something new, you first have to stop the old process and create space for something new – at least in thinking.

Mr. Moorhead, what's your view on innovation in finance and what are the related challenges at Roche?

Dominic Moorhead: As I was saying earlier, unfortunately Finance probably isn't a primary source of competitive advantage as such in most companies. Its role is more to support the 'differentiating factors' within the business. However in doing this I believe Finance is clearly an important 'enabler' of innovation.

So when it comes to 'innovation in finance', I think we have to differentiate. There are areas where you might ask if we should be really that innovative. In the area of the core finance processes, I think it's more about continuous improvement and requires lots of smaller incremental steps. Whereas in the area of business support, for example in support of Marketing and R&D, 'disruptive change' is more important. Here you have to try to get out of your comfort zone, in order to challenge the business and to look for the value potential – this requires innovation in the way you work.

And because finance is clearly a support function, you require empathy with your internal customers. And if your customers, your partners, the whole company, is in a mindset of innovation, then Finance can't be of a different mindset. You have to move towards your customer, otherwise you loose the foundation for communication and decision-making. So I think innovation is a mindset in the end, and thus becoming more innovative is a behavioral change. The challenge is to think differently and to look at the opportunities that really add value.

And there are things that we can do within Finance to be either more innovative ourselves, or by fostering the mindset to actually help our partners within the business to see things differently. So I think innovation also applies to Finance, but you have to be careful about how it is framed.

Juergen H. Daum: Mr. Davies, what's your view on innovation in finance from an OMV perspective and what are the major challenges or building blocks in transforming finance?

David Davies: I think, and it has been said before, the first thing is that the fundamental finance strategy needs to be aligned with that of the strategy of the group. In doing that, I think that finance can contribute strongly to achieving the group´s overall strategy.

Four years ago we were very decentralized, especially on the sales and marketing side of our business. When we started to rethink how we wanted to manage that business - in particular seeking to grow the non-oil business and to get it more into convenient retailing - we found that we had to reconsider our supply chain structure. How we decided what articles to stock, who we are buying from and how we can leverage relationships with suppliers for example. It then became very clear that we needed to have a far more standardized approach, a centralized approach by and large. And this has set also the agenda for finance. Finance had to support this standardization and centralization strategy of the group. And for our own finance/back-office strategy it also became clear that we needed to standardize our processes in order to simplify things and reduce costs further. So pressure was coming also from within finance. In this context we were looking at how we could optimize back-office costs by avoiding them being duplicated in every market. So we have met in the middle really – our overall group strategy of standardization and centralization with the finance strategy of standardization. As a result, we were moving in the same direction. Because when you are standardizing things, it's not simply a case of having the same version of system applications, it actually goes to the heart of how business gets done. And to manage such a change successfully requires a strong alignment between finance and the business. Finance can actually be an enabler as well, in accelerating the process of standardization and centralization. And that is certainly a role I have seen finance play in OMV.

To Wolfgang Reichenberger's point, being provocative sometimes in saying, let's stop something we are used to doing, such as reporting or whatever it is, I think that in every discipline that kind of off-the-wall challenging thinking is healthy. It forces you to think outside the box and challenge yourself. If we take the example of reporting, that is still a challenge. Over the last 10 years many of the technical innovations that support effective financial management – we talked a little bit about it last night with these dashboards and cockpits for example -, have been in general very helpful. But there still is in some areas of business a kind of inertia to change the fundamental approach to enable technical innovations to really make a difference. Too often banks of data are pushed at people. Data is not the same as information however. And you can certainly see some parts of our organization miss opportunities for not really being able to see exactly what is the core of the problem. Things are seldom as complicated as people sometimes articulate them. You can distill down even the most complex problems to two or three factors. I think that this is something on which we have to focus more in our finance strategies, in our finance transformation strategies. And if you do this right, then the technical innovations can really help. I have always been a great believer in using such tools to enable management to reach effective decisions quickly.

I remember some time ago when I was with a company in the UK, a controller at a meeting where we were piloting a data management software for spotting trends within large banks of data. One of the general managers got up and was making his usual presentation about what was happening in his business. Simultaneously the controller was calling up charts seeking to support the GM in his presentation. The amusing thing was that every point the GM made the charts said exactly the opposite. Major shifts in margins and selling prices had been missed for years and this fresh way of simply pulling the real value out of the data enabled us far more quickly to identify the real issues in our business.

It's amazing really when you can break through into something like that and that sort of step improvement with really valid information you can act upon. But I still think there is a long way to go in many finance organisations to make that change happen.

Vision for the future of the finance function and of its role

Juergen H. Daum: Mr Kestens what is your view from a SWIFT perspective on innovation in finance? And what is your vision where innovation in finance and in financial markets will lead us to in the next 10 years?

Johan Kestens: I think one issue, which we haven't discussed yet, is to achieve a step improvement in working capital management. Our members at SWIFT, the banks, tell me that across all industries there is a trillion dollar of working capital sitting idle in companies. And this is an issue for the CFOs, for you, because a part of that trillion dollars is yours. How much exactly may differ from company to company, but if you are able to reduce it, you could lower your cost of capital and you could improve your financing structure.

Another issue is: how many of your global businesses have a structural exposure to one of the three major currencies, the Yen, the Dollar or the Euro, because your cost-currency-structure is not exactly reflecting your revenue-currency-structure? And what are you doing about it? The interesting thing from a macro-perspective is, that the gross risk exposure in that area, of all of you together, is a multiple of what that net risk really is. So I believe an opportunity exist to optimize currency risk management if we can find new solutions here. But we are not going to solve that question today.

So these are two issues. But where are we going in terms of the financial markets in general? I think over the next 10 years, if you look at what is going on, there are a couple of big development streams. One is an increased focus of regulators on the ethics of the finance business. It will be in the focus for the next 5 to 10 years. And we have seen that with Sarbanes-Oxley that the pressure on executive roles has increased because of that. The same will happen in the finance business. And the banks are at the heart of it, because they are the middlemen. And they will ventilate some of that pressure on the corporations.

Another one is: how can we avoid a global financial crisis? Because the dependencies are so big today, a global financial crisis could be very bad for the world economy. So I think a lot of innovation will happen in the area of risk models based on extremely innovative mathematical concepts. And to figure out what is needed here is going to be a big challenge.

Then, I think, we will see more concentration in the financial services sector for realizing economies of scale based on a strong capital basis. We will see financial institutions with an extremely strong capital basis being able to take risks and develop finance projects or innovations to a scale not seen before. And that is one important reason why banks are merging. We will see more concentration also in financial market infrastructures in terms of payment infrastructures or stock exchanges and that will lead to a new concept of liquidity, because that is what the middlemen in the broker industry are looking for: liquidity, liquidity, liquidity. That is what they need in order to be able to trade.

And I also believe that something will happen and has to happen in the derivatives world. I believe that has gotten out of control. Today it's a casino. And that is where hedge funds come in. In the OTC market nobody has a clue how much relative exposure has been written upon the limited notion of outstanding. And that I think is a time bomb.

Coming back to the trend to concentration and economies of scale in financial services, I believe we will see an incredible surge in the importance of the reinsurance function. The reinsurance function is becoming more and more important, because it is – beyond what the central banks do, who are suppliers of liquidity in the last resort – the only one which provides solutions to manage structural risks, for risks of more of an international nature. And that function needs to grow. And you can see it already, if you look at Swiss Re or any other, their dealing room is about as complex as the dealing room of a major bank, because they ventilate the risk off into the financial markets.

And then, what I see, is the further integration and automation of the financial supply chain, where I can see a lot more of innovation. Every movement in the logistical chain is followed by a mirrored movement in the financial supply chain, which is ultimately what will take away a lot of risk out of the system. And that is going to be the real systemic driver to significantly reduce your working capital.

And finally, as outsourcing will grow, the financial links to specialized suppliers, contractors etc. will multiply as well and the number of financial transactions will grow further. My theory, based on observation, is that every percent of your cost base that you outsource increases your financial transaction volume by 3%. And so the dependency on the financial systems and on their accuracy, on their reliability grows exponentially – as well as the need for solutions to assure those.

Juergen H. Daum: Mr. Brandes, what is your vision for the future of finance?

Dieter Brandes: My subject is not, like the one of Johan Kestens, to simplify how you handle money, but simplification of reporting. I would expect, really expect and also hope for it, that in the future less will be more, less reporting will be more. And less is more means: less innovation in finance I would say, less of the nice to have things. That of course depends on how many MBAs will be attracted by finance, because they like the nice to have things. But less nice to have is also a good idea.

I argue for less data and for more orientation and knowledge. But knowledge, understanding and orientation means responsibility. And my view is that the line managers, who are in charge of sales, of purchasing, of logistics, have to take over full responsibility – also for their reporting. The controllers and the finance people have to help them a little bit to understand the financials and economics, but the line managers have to remain responsible. They have to know and they should tell their CFOs and controllers what they need. And if they are not be able to tell you, the finance people, what they need, then they are really not able to run their business and are not the right persons for this job. But when line managers take over that responsibility, then, I think, we will have financial peace.

Juergen H. Daum: Mr. Brandt, would you like to add to this?

Werner Brandt: I would like to refer to what Johan Kestens said earlier with regards to the capital markets and risk management. Two comments if I may: Firstly, I think from a capital market perspective I agree that this is a challenge in itself, and there we need innovative ideas. I share your view on the healthiness of the financial market as a whole. If you think about what happens on the corporate side, for instance in the automotive industry with GM and Ford, and if you then ask people in the financial sector: does it have any implications on the financial sector if something seriously goes wrong in the automotive industry? – then the answer usually is 'no, it's already priced in'. Personally, I do not think it is. That is my first comment.

My second comment refers to credit link derivatives. This is an issues to be taken seriously. Credit link derivates and similarly innovative financial instruments are an issue for companies because at the end of the day you do not know who your creditor is. Who is your counterpart?

Finally, I am convinced that risk management is becoming ever more important. And not only on single risks. We have to identify the entire risk portfolio we have. At SAP we have implemented a global risk management function reporting to the CEO and CFO. It is embedded in the business processes. And I think that's important: You have to manage risk where it originates. They have to be managed there, but then you need a central understanding of your risk portfolio in the company. These are my points – beside innovation. And these are very serious topics for a CFO.

Wolfgang Reichenberger: I also want to react Johan Kestens comments. I agree with your view on the growing risk in the financial markets. But let's not, as industry leaders, call for more regulation or even be interpreted as calling for it, because that will and has not solved the problem. Look on Sarbanes-Oxley, on the new accounting standards - and I've been closely involved in that: all this has a tendency to shooting far beyond what the original intention and objective was and will increase the resources that we have to put behind it without, in many cases, giving us better information or assistance.

There is obviously a lot of leverage in financial markets. Nestlé's deals in cacao equals are share of about 13 or 15% of the world cacao market, but our share in the cocoa derivatives is less than 1%, and that despite the fact that we are very active in those markets. Somebody has to explain to me where the other volume is. It's clearly not people who use cacao and probably don't even know the difference between a cocoa and a coffee bean. But it adds to the liquidity. But I will never call for regulations or additional restrictions.

But I fully agree that we have to have better information, that we are better integrated, that we have to reduce working capital. At Nestlé, with our GLOBE project, we implement a new information system infrastructure that should allow us particularly better planning. Working capital is to a large degree required for stock needed as a buffer to be able to serve your customers in time. But by better planning, you can reduce the need for stocks and can also better manage your risk. I think not only we, but the whole industry can do a much better job – by better planning and by using better information.

Juergen H. Daum: Mr. Moorhead, what is your vision for finance transformation and for the finance function in about 10 years from a Roche Pharma perspective and what are the major challenges on the way?

Dominic Moorhead: If we consider the key drivers that will influence the role of Finance in the future, then on one side there are increasing regulations such as Sarbanes-Oxley that will require even more attention from Finance. I see this more broadly as what we within Roche call 'financial peace' – ensuring that our systems, processes and people protect the integrity and reliability of our business information. Then there is the shared service center movement - pushing out more and more of the lower value-added transactional activities. On the other hand we need a strong focus on 'business navigation', which requires a closer integration with the business in order to be a better partner in terms of supporting the innovation effort in the next 10 years, as they become more demanding and more specialized. And from this I see a major challenge for the Finance organization in the future. Taken to the extreme if we finally outsource all of our transactional processes, and then the other half of the finance organization is closely integrated into business - the challenge will be to keep the two parts together! It reminds me of the past when we had separate groups for finance and for controlling - and we had good reasons to move away from that. Now we will see again a lot of pressures to pull these two roles apart

Juergen H. Daum: Mr. Davies, your final statement please. What is your view of the finance function in about 10 years time?

David Davies: This notion of 'financial peace' is pretty close to my heart. I always say in terms of supporting innovation in the business and helping to drive the business forward, that this is really where value is added by a finance function to an organization. If the reliability of your numbers goes off, or if business performance really starts to suffer however, that is when you really show your worth as a financial manager. I don't think you should ever lose sight of that. The first box that you have to tick is: is everything under control?

And as businesses become more complex and I'm talking particularly about innovation in terms of product development, this is becoming even more important. In the oil industry there is very much at stake here, because of the significant cost of exploration and the cost of development.

In terms of a vision for finance, I couldn't help but actually have that as the first priority. One of the primary role investors see in the CFO of the business they invest in, is that they want to have confidence that someone is securing the financial peace of the organization and keeping things under control.

Juergen H. Daum: So you mean: back to the basics.

David Davies: Yes. And you should never lose sight of that priority.

Juergen H. Daum. Thank you all for this very interesting discussion.

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