What changes in a transformation—and why it matters to CFOs

CFOs increasingly find themselves in the thick of transformation efforts, whether they involve overhauling the finance function, reshaping the business model, or reimagining other functions. In the process, they are expected to elevate the performance of their organization and ensure there is strong leadership and a financial backbone to support and sustain the efforts, sometimes for years.

In finance transformations, CFOs are typically the sponsor and leader. But finance chiefs also are being asked to play a significant role in transformations that aren't purely finance-related—as sponsor, enabler, or co-leader—especially as their companies embrace digital and business model transformation. These areas may lie outside of many CFOs' comfort zones. But today they are expected to elevate their roles as Strategists and Catalysts within the four faces of the CFO, and deliver more impactful change and stronger performance at the corporate level.

As CFOs are asked to lead transformation, they need to consider what makes it different from everyday change, and how understanding the difference can help them lead better. Yet, in interviewing numerous CFOs and others who help deliver transformation efforts, we found the term "transformation" widely used, but subject to varied interpretations.

Based on our literature reviews, interviews, and research, we found Scott Anthony's categorization framework of operational, operational model, and strategic transformation as a useful starting classification.[1] Operational transformation means doing what you currently do better, faster, or cheaper; operational model or core transformation means doing what you are currently doing in a fundamentally different way; and strategic transformation means changing the very essence of a company.[2] Anthony makes the case for why the classification matters by asserting that each type of transformation is typically managed differently and places distinct demands on leadership.[3]

Building on Anthony's work, we seek to further clarify what transformation means in a practical way for finance leaders. In this issue of *CFO Insights*, we classify critical dimensions of a business that may be impacted by transformation. We try to focus on the collection of essential changes that are manifested or can be the outcomes of a transformation. And our goal for this article (and others to follow) is to help CFOs engage more systemically with various dimensions they must plan for and work through as they influence and lead transformation efforts.

How do transformations differ from change?

Our interviewees revealed numerous ways in which transformations and their outcomes are distinct from other change efforts. These critical shifts and characteristics are enumerated below.

1. Significant change with measurable impact: The first thing we noticed across interviews was that transformation efforts are not expected to be an incremental change to performance or procedures. As one interviewee noted, "a transformation must be 'revolutionary,' not evolutionary, and it must bring a company to a fundamentally different place—often a step function change. Otherwise, you're just putting new paint on the walls, and it's going to peel in six months."

In quantifiable terms, most of our interviewees noted that a worthwhile transformation effort must drive performance improvement by at least 30% compared with prior levels—whether in cost reduction, revenue growth rate, market share, speed of execution, or another type of operating or capability metric.

> "It's important to be able to take the strategic vision and set milestones to guide and measure progress from the beginning point to where we want to be, looking three to five years ahead. Having those target milestones helps me know whether we're on the right path versus just having a vision so that we can be agile in adjusting while keeping the end goal in sight."

Kelly Kramer
CFO, Cisco

In cases of strategic transformation, the impact would most likely be material to the performance of the company and require external reporting to investors and shareholders. Our interviewees also noted that having clear and new metrics at the outset of the transformation was vital to focusing and incentivizing executives on the critical behaviors and improvements they must deliver. Moreover, traditional metrics may not apply to such goals as a major transformation of a company's culture or emergence into a new industry.

2. Scope of change: Unlike many change efforts, transformations are broader in scope, going beyond any one function and requiring change—in talent, resources, capabilities, work and other processes, and often systems—across multiple functions to be impactful. Business model, strategic, and operating model transformations can extend across the enterprise and even beyond its boundaries. Major shifts can occur along various dimensions, such as:

- **Enterprise-wide systems**, e.g., moving from in-house to cloud-based service;
- **Products or services offered**, e.g., moving from a standalone product or service to a combined product and service or a different pricing model, such as a subscription;
- **Markets and geographies served**, e.g., shifting and/or expanding the customer base or locations of service;
- **Customer interactions and relationships**, e.g., going from bricks-and-mortar retail to purely digital transactions, such as on a mobile app;
- **Stakeholders and managing complex relationships**, e.g., addressing the interests and concerns of the board of directors, regulators, the Street, and others;
- **Vendor and alliance networks**, e.g., allowing for changes in the ecosystem of critical resource providers in the supply chain.

> "If you're doing a large-scale transformation, you better do an honest assessment and ask: Is your organization capable of transformation and large change management? Companies are made up of people, process, and systems. You almost have to drive change in that order: get people right, then process, then systems. But if you deal with the people part serially, one layer at a time, you'll die of old age. You can't get there fast enough for investors. So, you have to find a way to do it faster."

Bob Halliday
Retired CFO and EVP, Corporate Business Development, Applied Materials

3. Duration: Given the scope of change, our interviews revealed that effective transformations almost always exceed a year and often extend to three and five years given their breadth and scale. As transformations demand effort and energy, a lengthier effort can bring organizational fatigue and increase the likelihood of failure.

Tied to duration was the importance of clear and sustained leadership during the transformation. Given that the average tenure of CFOs is approximately five years,[4] and that of other senior executives is somewhat longer,[5] a lengthier transformation is likely to face further risk from leadership change or executive burnout, and a pummeling from the Street if expectations are not met.

4. People, mindsets, and culture: Business transformation is very personal—to the executives leading it and to the people who may be affected and asked to support it. At the conclusion, the organization and its culture will have likely shifted its focus and required its people to behave differently. In our interviews, we heard a common refrain: One-third of the people will buy into the transformation and be ready to pursue it; one-third of the people may never get on board; and one-third will be on the fence and need to both buy into the transformation and become part of the fabric this pattern requires. This means changing out people who cannot adapt, changing mindsets and culture, and changing behaviors to work in new ways and make the transformation successful. For example, as CFOs seek to improve efficiency and be better business partners to support data-driven and insightful decision-making, they may have to change out people who cannot adapt and help their team work in new ways with the businesses.

5. Work, workforce, workplace, and organization: Transformation efforts almost inevitably change the nature of work in the company. Some work may be automated or eliminated. Other work may require higher levels of skill in finance and other functions, with new and faster processes. The changes may require training and adaptation by the workforce. Alternatively, the workforce itself may change. Some work may no longer be undertaken by employees but instead by so-called "gig workers." Other work may shift—for example, geographically or organizationally—to shared service centers. Transformation efforts therefore often lead to significant changes to work, workers, and the organization's reporting lines.

6. Infrastructure, processes, and workflows: Traditional infrastructure and processes can be at odds with a transformation's ambition to change behavior and drive new ways of working. For example, legacy IT systems may not interconnect and provide data in a timely way for decision-making, or work processes are disconnected, leading to excess inventories or delays across processes. Therefore, in addition to changes to work, transformations are likely to entail changes to infrastructure, business processes, and workflows. These changes will require acceptance and adaptation by the organization's talent for the transformation to be effective.

7. Capabilities: Transformation almost always requires new capabilities to execute and deliver, and often, acquiring new technology capabilities is a starting point for transformation. This may entail new data and systems to support new processes or customer demands. It may entail new communications capabilities to engage both internal and external stakeholders in the transformation, convey key changes, and align stakeholders. CFOs may need to upgrade analytics and forecasting skills in their organization, as well as the business acumen and mindset of staff to shift from controlling to partnering. Understanding the critical capabilities for success can help focus transformation efforts.

"As part of our transformation, we felt we needed to build select core competencies in strategy, marketing, global operations, and procurement, and we formed a strategy group that was largely from outside the company. So, there was a mix of inside and outside perspectives to shape our direction."

Mark Buthman
Retired CFO, Kimberly-Clark

8. Governance, decision-making, and decision rights: Without strong governance and a clear set of decision rights and their owners, it can be difficult to execute a transformation and sustain its benefits. Decision-making should not necessarily be confined to the top echelons. As one interviewee suggested, finance chiefs need to take their CFO hat off, think of a transformation as a greenfield opportunity, and empower others by pushing certain decisions and responsibilities to them.

As transformation inevitably changes key roles, it may require a realignment of decision-making and decision rights of key executives, and even the governance of the business and key processes in the company.

9. Capitalization: Transformations are expensive. They can require raising new funds to invest in the execution. For example, a CFO may have to raise debt or equity to fund an M&A-driven transformation, or alternatively, control and lower costs to create headroom for investment in the transformation. This may require review and approval by the board, or communications that reset the

Street's expectations for free cash flows and earnings. Budgeting practices may also have to become more agile. Instead of annual or biannual budget cycles, some funding may have to be set aside for financing experiments and testing the feasibility of transformation initiatives.

10. The future narrative: Collectively, the shifts described in the above nine attributes also change the future narrative or the story of the company or function being transformed. In our interviews, we heard the need for leaders to create and communicate an inspiring ambition of the transformation at both the enterprise and personal levels in order to engage and mobilize people, win stakeholder commitment, and sustain the effort through various challenges, internal and external. Therefore, creating a compelling future narrative of the transformation from beginning to end and communicating it with discipline internally and externally are essential to supporting the transformation journey and those involved in it. And, without doubt, CFOs play a vital role in shaping and communicating this narrative to stakeholders.

"As Group CFO, I don't focus on technology's cost or ROI; rather, my benchmark is how much the technology will help innovate the company's businesses and disrupt the traditional way of doing business—internally as well as externally—and improve efficiency and enhance the customer experience."

V S Parthasarathy
Group CFO and CIO, Mahindra

"For our global leadership team, communicating our multi-year transformation strategy and plan to the Street was a top priority."

David Gibbs
CEO, YUM! Brands

Takeaway

Transformation is not simply change. Our research found that it must be materially impactful, have significant scope, and takes at least one year (and often three to five years) to execute.

Transformations also generally lead to changes across some or all of the following: people, capabilities, infrastructure and processes, work, governance and decision-making, capitalization, and the company's narrative.

When considering these different dimensions of transformation, decide which are the easiest areas to manage and which are the hardest. For each one, identify the people, capabilities, investments, stakeholders, and actions that would be needed to drive execution, and how much time you have before the transformation languishes or completely fails. Also consider what you would tell employees, investors, and Wall Street.

Why consider transformation across all of the above dimensions? We heard in our interviews that attention to only a few of these areas or attention to them in a random manner will likely lead to an incomplete or failed transformation.

Confronting resistance in transformation

For many CFOs, becoming an effective change partner requires employing fundamentally new skills beyond those that got them to the CFO position. For example, CFOs may have to change the culture of the finance organization they inherit or partner with CEOs on broader organizational transformation. To do either successfully, they need to diagnose sources of resistance to change[6] and develop appropriate strategies to mitigate that resistance, and they may need to exercise greater influencing skills in the process.

Resistance to varied workloads, changes in power, or shifts in work satisfaction are relatively easy to diagnose and can be addressed through careful process and work design or by getting critical sponsorship. In contrast, CFOs and CEOs are usually most challenged by the need to change culture. Here, CFOs can help CEOs and others on the leadership team correctly diagnose beliefs, behaviors, and outcomes that do not serve the organization well. They can provide the facts based on outcomes to help CEOs and other leaders create narratives to disaffirm beliefs and evaluate the costs of replacing staff and redirecting the organization. CFOs can also act as role-models for desired behaviors and help create incentive programs to sustain new behaviors.

Endnotes

1. What Do You Really Mean by Business "Transformation"?, Scott D. Anthony, Harvard Business Publishing, February 29, 2016.
2. Ibid.
3. Ibid.
4. Volatility Report 2019, Crist Kolder Associates.
5. Ibid.
6. Navigating change: How CFOs can effectively drive transformation, *CFO Insights*, CFO Program, Deloitte LLP, June 2012.

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