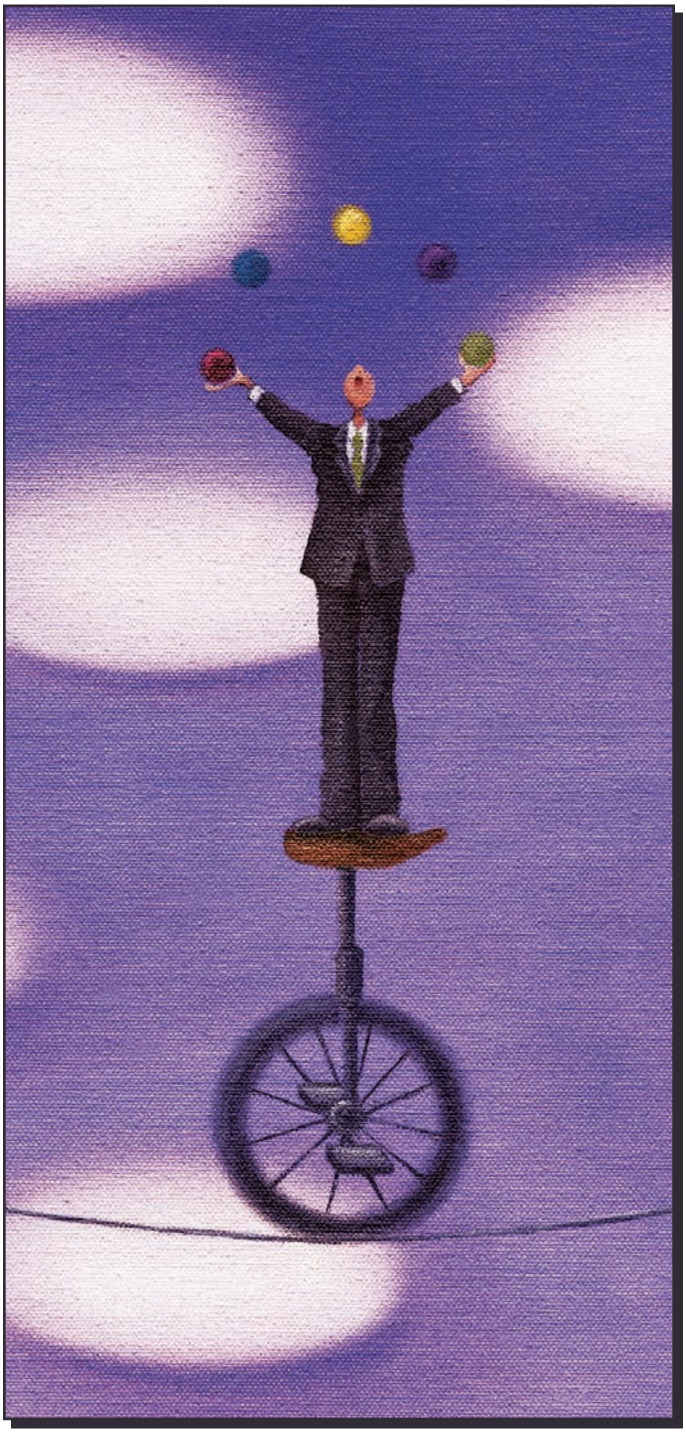
Solving the Performance Challenge

A company can successfully balance performance management needs and juggle regulatory burdens—provided it has the right system in place.



It's a classic collision: Irresistible force meets immovable object, with the added spectacle of the overextended, overstressed CFO stuck in the middle.

Even as he or she struggles to improve financial performance in the face of fickle customers, shrinking product cycles, ever-changing technology and volatile economies, the Chief Financial Officer is besieged by the escalating distractions—and costs—of regulatory compliance. Every day, it seems, there are more controls to correct, more questions to answer, more reports to prepare, more rules to follow.

It's not a pretty picture. In fact, it's grisly. CFO turnover rates are soaring to 17 percent a year, on average, which makes the post less secure than even that of CEO. According to Washington, D.C.-based trade association CFO Executive Board, CFOs have taken on so many extra responsibilities—with compliance topping the list—that increasing numbers of them are failing at their main task of managing financial performance and, in turn, driving shareholder return.

In response, CFOs say that automation of financial controls is crucial to solving their long-term compliance challenges as well as giving them the tools to improve financial performance. A May 2005 survey by CFO Research Services found most respondents foresee that automation will be "extremely important" to their compliance efforts (see chart, Automation Drives Compliance, on page S2).

Costs Are Up

In the short term, though, the costs of financial management are rising for most companies because of investments in people to contend with the compliance challenge. Although aggressive automation in the processing of transactions had kept the cost trend on a downward slope for more than a decade, now they're suddenly up, says Richard Roth, Chief Research Officer at The Hackett Group, an Atlanta-based research and advisory firm. The main drivers: Sarbanes-Oxley and strenuous efforts to close widening gaps and improve visibility in performance management processes. "The issue is access to information," Roth says. "The average company is spending more time and expense on simply finding and reconciling data."

Within The Hackett Group's survey database of nearly 3,000 global organizations, the 15 percent that have achieved world-class financial performance have done so only after years of re-engineering their finance functions. They've devised processes and implemented performance management systems, for instance, that give CFOs and their staffs essentially fingertip access to rich data about customers, product profitability and global cash flows.

The difference between the "peer group" and the "world-class" players is striking; this year, the world-class finance departments operate at roughly half the cost level. Furthermore, the peer group's costs have leaped 18 percent from 2003 to 2005, while the world-class performer's costs have declined. The same survey also found that Sarbox has increased costs for everyone but that the world-class companies were able to cut other costs to overcome the Sarbox effect (see chart, World-Class, Indeed, on page S3).

These world-class companies, Roth says, benefit greatly from highly efficient finance operations. Many are able to close their books in a day or two, even at $30 billion in revenues and with operations scattered around the globe. "This speed and agility means having access to meaningful data in real time," Roth notes. "These companies may have two weeks more than their competitors to play with the numbers, analyze the potential impact of pricing changes, enter new markets and change priorities.

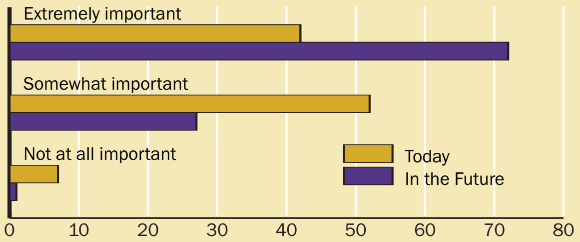
"Instead of spending time on racking and stacking data," Roth adds, the CFO can focus on analyzing data and planning the next move for the organization. What's more, the CFO is "helping to drive business strategies instead of just trying to determine what happened in the past," he says.

This speed and agility stem from improved visibility. With improved visibility into results, the CFO and his or her department can focus on adding real value while at the same time keeping the regulators and litigators at bay. "If today the finance team spends 70 percent of its time digging for information and 30 percent analyzing it, simply inverting that ratio would mean 80 percent more analysis with 20 percent fewer people," explains David Axson, President of Akron, Ohio, consulting and advisory firm Sonax Group and author of *Best Practices in Planning and Management Reporting*. At an estimated fully loaded cost of $100,000 per employee, that's a proposition most CFOs can't ignore.

"There's no question about it," says Greg Bozigian, Director of Financial Planning at Princess Cruise Lines. "The time that we can spend on analysis has definitely increased because we don't have to spend all of our time compiling hundreds of spreadsheets and making sure that everything calculates correctly. It's all there at your fingertips. It's not buried in somebody's spreadsheets."

Automation Drives Compliance

A large majority of the 225 senior finance executives responding to a survey in May 2005 said that automation was extremely important to their future compliance efforts.



Source: CFO Research Services, August 2005

Uniting Data

Alas, there's no shortcut to juggling performance management and compliance. What's absolutely necessary, experts agree, is improved information technology—specifically, a new generation of software designed to manage performance and compliance with visibility and control. These systems excel in uniting data from both financial and operational systems, organizing it for fast, accurate and insightful analysis, and presenting the results rapidly and persuasively to everyone who needs it. This software empowers the CFO—and the enterprise—in ways that just weren't possible before.

This empowerment depends, of course, on adopting best practices as fast as possible. And so the call for better software dovetails with the growing chorus of business gurus who urge their clients to radically revamp their planning and budgeting processes. Visibility into performance and control over the levers that affect it would help to improve both performance and investors' confidence in Corporate America.

"Financial and operational systems usually operate as silos within organizations. They need to be brought together and integrated," says Doug Barton, Vice President of Product Marketing at performance management software firm Cognos. "It's only by making these connections that CFOs can assess the financial impact of new initiatives, recognize opportunities, make adjustments and avoid last-minute surprises."

First and foremost among the changes advocated by experts is rethinking the use of budgeting as the most vital command and control tool. Jeremy Hope, Research Director at Beyond Budgeting Round Table (BBRT), an independent research collaborative based in Hampshire, England, and others say it's well past time that corporations rid themselves of the traditional budgeting process, which they view as outmoded and thoroughly discredited. "The budget is the root of all evil," Hope maintains. "It's a fixed performance contract negotiated between the company, its managers and the marketplace. And as such, it leads to all sorts of gaming, dysfunction and unethical behavior."

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David Axson, Jeremy Hope, Dr. David Norton and Richard Roth are advisors to the Cognos Innovation Center for Performance Management™. Members of the Innovation Center have exclusive access to original research, articles, Cognos Performance Blueprints, Web seminars and much more.
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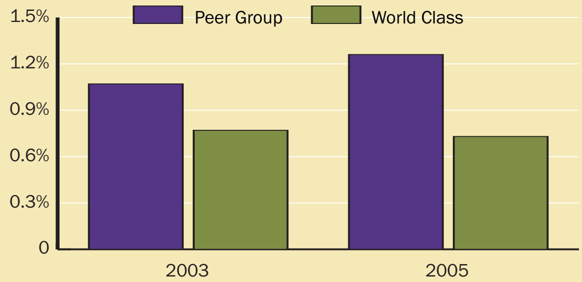
World-Class, Indeed

Of 3,000 global organizations studied by The Hackett Group, the 15 percent with world-class financial operations cost their organizations only .73 percent of revenue in 2005, while the peer group's cost of finance, as a percentage of revenue, was 1.26 percent. (finance costs as a percent of revenue)



Source: The Hackett Group

The budgeting process is based on a model of "plan, make and sell," which is increasingly anachronistic in a customer-driven world flattened by technology. "Today, customers can change their mind with the click of a mouse," Hope says. "Organizations have to be faster on their feet. So it's insane for them to lock into a model that dictates in minute detail everything that is supposed to get done over the next 12 months."

A more effective approach in an era of strategy as hypothesis, Hope asserts in *Reinventing the CFO* (a book due out in March), is quarterly planning cycles enabled by flexible, rapid-fire planning and reporting systems. "Look 12 or 18 months ahead, but back that up with a rolling quarterly forecast," he says. "Planning with a light touch, spending only a day or two every quarter to fine-tune the plan—that's where we're headed."

Princess Cruise Lines is already there. "It's been invaluable," says Bozigian. "The data is out there for all to see, and it makes analyzing and slicing and dicing on the fly very convenient. We've been able to make changes on the fly, with executives in the room."

Defining Assumptions

Dr. David Norton, co-creator of the balanced scorecard and President of Palladium Group Inc., a professional services firm headquartered in Lincoln, Mass., couldn't agree more. "The essence of strategy today," he says, "is that you don't know if it will work. Strategy is a theory that you need to test and adapt continually. A good performance measurement system should define the assumptions on which the strategy is based (for example, that better customer service will lead to great customer retention and ultimately to more revenue). It should then measure these variables continually, testing whether the assumptions were valid and adapting them as required."

Traditional performance management systems, Norton adds, have focused primarily on financial performance, using measures like return on assets. But these days, with most of the corporation's assets being intangible—brands, patents and personnel, for instance—it's difficult to determine how much value any of them is generating. As a result, "When the quarter is tight, the CFO can't make intelligent decisions about where to cut expenses," he explains. "What's needed is a system focused on executing strategy and able to capture the relationships between today's actions and their long-term impact."

Visibility and Control

A key ingredient in successful performance management is efficient and accurate data management. Currently, most organizations depend on "flaky and insecure" spreadsheets as a homegrown way to merge data from disparate IT systems, BBRT's Hope notes. He says the average large enterprise uses multiple general-ledger (GL) systems, often the legacy of mergers and acquisitions. Only a small fraction of companies have integrated their major financial systems, while around two-thirds have done a partial integration. Hope says that around 30 percent express zero interest in integrating their systems because of the daunting costs involved. Permitting core financial systems to operate in isolation from each other creates fertile soil for fraud, he notes. "The normal checks and balances aren't there."

With disparate transaction systems a reality for most companies, the ideal solution is an integrated planning, financial consolidation and reporting system that can act as an umbrella over the disparate GLs and pull information together. "This is essential for any company thinking of moving in the direction of advanced performance management," Hope contends.

Fortunately, such planning, financial consolidation and reporting systems can help meet compliance mandates as well as manage performance. "The best practices for performance management and compliance are synonymous," says Sonax's Axson, formerly head of corporate planning at Bank of America. "Companies need to develop a culture of trust, integrity and openness. They need to build quality into the process and build compliance into the process so that they can demonstrate to auditors and regulators that their processes deliver information of sufficient quality."

Trust. Integrity. Quality. Each is no doubt easier said than done. But the payback? Immense, even if it only brings a better night's sleep and, quite possibly, an extended tenure for the beleaguered CFO. ■

Written by John Verity

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