Delivering Business Results in the Age of Volatility

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This essay is part of a series, *Controllers' Corner: Two-Minute Essays on Financial Management and Control*, which asks industry thought leaders for their opinions on critical issues facing today's finance organizations.

The volatility of the current economic environment demands that Finance take a broader, more holistic approach to performance management, including the assessment and management of risk.

Q **How should organizations incorporate risk management capabilities into their enterprise performance management processes?**

Volatility and uncertainty have reached such levels that the ability to swiftly adjust to changes in the business climate is not only a competitive advantage, but in many industries it is now critical for survival. This capability means being both "proactive in strategy" and driving "excellence in operations." Finance plays a crucial role in this transformation. And Finance needs to elevate its functional focus to develop a holistic enterprise performance management (EPM) capability. Additionally, Finance needs to achieve excellence in operations by creating a scalable operating model that enables agile responses to changes in business conditions. For the purposes of this discussion, we will focus on what it means to be "proactive in strategy."

The recession of 2008-2009 forced many companies to evaluate their true profitability drivers and competitive advantages in a period of dramatic deterioration in the business environment. It forced them into making tough decisions that in many cases were long overdue. However, because the implosion was so sudden and so deep, many organizations ended up having to make across-the-board cuts just to survive, rather than the kinds of changes needed to structurally improve productivity.

On the other hand, companies that anticipated the disruption and had contingency plans in place made their changes more deliberately, resulting in sustainable improvements to their cost structures. Their foresight proved tremendously valuable under the highly volatile and uncertain conditions that materialized.

Many finance organizations simply extrapolate from past experience to predict the future and use the annual budget cycle to set the direction. However, those finance organizations that are more advanced capture real-time data about business conditions, use sophisticated scenario development and modeling techniques to drive periodic forecasts, and have contingency plans in place for various scenarios.

For companies to become proactive in strategy, they need to develop a holistic enterprise performance management capability. Holistic EPM has three dimensions:

1. EPM should cover financial, operational and strategic aspects of performance
2. The scope of EPM needs to include performance, opportunity and risk management
3. EPM is implemented as an integrated, closed-loop performance cycle

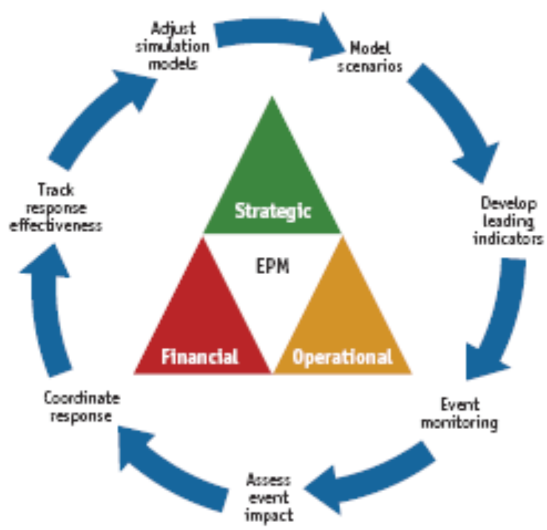

Figure 1: EPM Performance Cycle

Viewed as a continuous series of stages (see Figure 1), it covers the entire performance management life cycle:

- Model performance, opportunities and risk
- Develop scenarios for performance variance, risk events and business opportunities
- Put in place and maintain "closed loop" measurement systems
- Understand those metrics that are the company's leading indicators of future business activity
- Monitor occurrence of risk events and market opportunities and assess performance impacts across the entire enterprise value chain
- Coordinate the formation of appropriate strategic responses or tactical adjustments
- Support execution of the required actions
- Track and report actual impact of actions
- Adjust simulation models and underlying drivers based on actual performance

Performance, opportunity and risk management are all well-established business practices. However, it is crucial for finance organizations to expand their view of performance from their specific functional domain and lead the charge in elevating performance management to the enterprise level.

At the same time, finance organizations need to incorporate risk management into the EPM framework. As with EPM, enterprise risk management should be implemented as an integrated, top-down approach to managing risk and must move beyond the historical, functionally focused definitions of risk such as credit risk, loss prevention, insurance and compliance. The risk management model should reflect a comprehensive view of internal and external risk, including:

- Geopolitical
- Foreign exchange
- Interest rate
- Regulatory
- Market
- Operational
- Supplier
- Credit
- Liquidity

Companies that are most successful at adapting to the era of volatility will thrive, while those that cannot do so risk decline or even obsolescence. Finance needs to take an active leadership role in driving their organizations to be more proactive in strategy. They must be at the forefront in expanding performance management and integrating risk management at a truly enterprise level.

None of this is going to happen by accident. Companies need the support and direct involvement of senior business leadership and representation from all areas of the business along with a fundamental recognition that the past is no longer an accurate predictor of the future. The status quo is no longer sufficient to meet the challenges of the age of volatility.

About Tom Willman

Tom Willman is the Global Practice Leader of the Enterprise Performance Management Executive Advisory Program for The Hackett Group. With more than 15 years of experience in finance, accounting and consulting in a wide range of industries, Mr. Willman focuses on helping CFOs and other finance executives transform their organizations by deploying more efficient and effective processes, service delivery models and enabling technologies. Mr. Willman may be contacted at twillman@thehackettgroup.com.

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