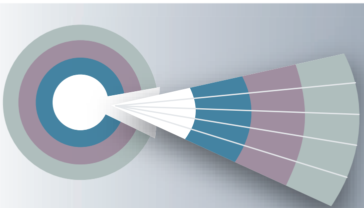
FINANCE: Trusted advisor or compliance enforcer?



The Performance Manager Series

INTRODUCTION

The new business book, ***The Performance Manager***, can help you turn the growing information-intensity of your job from a challenge to a competitive advantage. Its thesis is simple—rather than sifting through all the data your organization may produce, if you pay attention to certain sweet spots, you will make better decisions, create better goals, and set better plans about issues that truly drive your company. We're pleased to offer you this chapter for **Finance** drawn from the book.

The Performance Manager, *Proven Strategies for Turning Information into Higher Business Performance* looks at the partnership between decision-makers and the people who provide the information that drives better decisions. It offers suggestions for 42 decisions areas, or information sweet spots, taking into account your need to not only understand data, but also plan and monitor your performance. These decision areas are organized by the eight major functions of a company: Finance, Customer Service, Marketing, Sales, Product Development, Operations, Human Resources, Information Technology, plus an over-arching section for Executive Management. You will find seven of these decision areas in this paper.

Each chapter introduces key challenges and opportunities companies face in the specific function. ***The Performance Manager*** then dives into each decision area, illustrating the core content of the corresponding information sweet spot. These are organized into two types of measures: goals and metrics, and a hierarchical set of dimensions that allow you to look at the information from a variety of vantage points.

Each decision area then offers advice on who beyond the specific function would benefit from seeing the information (e.g., Marketing should see Sales pipeline targets) to make better performance a truly cross-organizational exercise. We hope you see the value in this white paper and investigate other functional areas and their decision areas, or take our offer for the whole book, ***The Performance Manager***.

We acknowledge and thank the great thinkers at Business Intelligence International, PMSI, and the IBM Cognos® staff and customers who offered their insights to make this publication possible.

Trusted Advisor or Compliance Enforcer?

Can anybody remember when the times were not hard and money not scarce?
Ralph Waldo Emerson

Of all the various roles Finance can play in a company, the two most necessary to balance are complying with legal, tax, and accounting regulatory requirements and dispensing sound advice on the efficient allocation of resources. In the first, Finance must focus on checks and controls. In the second, it leverages its extensive expertise in understanding what resources are required to generate which revenues. It is uniquely positioned to play this second role because, while most business departments push as far as they can in a single direction, Finance must evaluate the company's contrasting realities.

How Finance strikes this balance (and many others) to a large measure determines the success or failure of the company. *Is your budget a tool to control costs, or to sponsor investment?* Depending on your industry, and where your company is in the market life cycle, one choice is better than the other.

Finance is the mind of the business, using a structured approach to evaluate the soundness of the many business propositions and opportunities you face every day. Information feeds this process, and Finance has more information than most departments. As it fills its role of balancing—aligning processes and controls while advising the business on future directions—Finance faces a number of barriers when it comes to information and how to use it.

Barrier 1: ***Lack of information needed to regulate what has happened and shape what will happen***

Finance requires new levels of information about past and present processes and events to meet its regulatory compliance responsibilities. *Did the right employee or department sign off a particular expense item? Did customer credit checks take place before accepting and shipping an order?* For some companies, the information demands of compliance and control have forged better relationships between Finance and IT. They have led to changes in information gathering and collaboration methods (such as linking disconnected spreadsheets, for example), lowering the control risks these represent.

But while Finance works to manage these issues, it must also ensure the information investment helps drive its other key responsibility: helping guide decisions that make a difference to the future bottom line.

The executive team and sales reps both look to Finance to help the business plan its future with confidence, not simply manage money in and money out. Finance must pay attention to the drivers that make profit, using value-added analysis to extrapolate the impact of these drivers on tomorrow's results—and anticipate them when necessary.

Valuing, monitoring, and making decisions about intangible assets exemplifies the interconnection and sophistication of the information Finance requires. Regarding human capital, for example, Human Resources and Finance must work together to identify the value-creating roles of individuals, reflect their worth, and manage their growth, rewards, and expenses.

Without information sweet spots that show both the status of control and compliance and the impact of drivers on future business opportunities, Finance can't strike the necessary balance.

Barrier 2: ***The relevance, visibility, and credibility of what you measure and analyze is designed for accounting rather than business management***

Finance collects, monitors, and reports information with distinct legal, tax, and organizational requirements to fulfill its fiduciary role. But Finance also needs an integrated view of these and other information silos to fill its role of advisor. This role requires not simply reporting the numbers but adding value to those numbers.

For example, international companies that operate across several countries usually separate sales and production entities. Without see-through profit, a local sales office may cut products that appear to be loss-making but in fact still make a marginal contribution to the production company's profit.

Another example: Marketing must understand spending on various activities. Finance must categorize relevant expense accounts across a wide range of detailed and hierarchically complex general ledger accounts. Without this comprehensive view, the same expense may be classified in different accounts by different individuals.

Barrier 3: ***Finance must balance short term and long term, detailed focus and the big picture***

Finance balances different and contradictory requirements. It must deliver on shareholder expectations every 90 days; it must also determine a winning vision and a strategy to achieve that vision over quarters and years. Companies can cut costs and investments to meet short-term profit objectives, but at what point does this affect long-term financial health? A well-informed executive team is able to understand the drivers, opportunities, and threats when balancing short- and long-term financial performance.

Executives and financial analysts define performance in terms of shareholder value creation. This makes metrics such as earnings per share (EPS) growth or economic value added (EVA) important. However, these distilled financial measures tell only one piece of the story. You need to augment them with more detailed measures that capture sales, market share gains, and revenue growth targets to understand the real health of the company, and strike a good balance between long- and short-term growth.

Barrier 4: ***Finance must find the path between top-down vision and bottom-up circumstances***

To what extent should goals be set top-down versus bottom-up? *If the executive team mandates double-digit profit growth, does this translate into sensible targets at the lower levels of the organization? Does it require a double-digit target at the lowest profit center?* Top-down financial goals must be adjusted to bottom-up realities. Finance must accommodate top-management vision while crafting targets that specific business units can achieve.

This barrier in particular illustrates the importance of engaging frontline managers in financial reporting, planning, and budgeting. The need for fast and relevant information requires an interactive model. Frontline managers must assume some budgetary responsibility and feed back changes from various profit or cost centers as market conditions change. This decentralized model engages the business as a whole rather than relying on a centralized function to generate information.

Besides freeing up Finance for value-added decision support, bottom-up participation generates an expense and revenue plan that overcomes hurdles of relevance, visibility, and credibility. Individuals who engage in the process take responsibility for delivering on expectations. This helps expose drivers of success and failure that are otherwise lost in a larger cost calculation or financial "bucket"—for both the frontline manager and Finance.

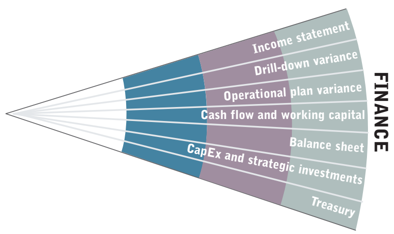
Balancing Short Term and Long Term, Past and Future, Compliance and Advisor

The information Finance uses to report what has happened and shape what will happen is critical to the rest of the organization. Dynamic tools that allow Finance to balance compliance and performance, accounting and business structures, short term and long term, top-down vision and bottom-up reality are more important than ever. Information sweet spots can support Finance's responsibilities and decision areas.

A Balanced Financial Experience

Finance decision areas:

- **Income statement** ➔ How did the business team score; where was performance strong or weak?
- **Drill-down variance** ➔ What causes changes in financial performance?
- **Operational plan variance** ➔ How do we best support, coordinate, and manage the delivery of meaningful plans?
- **Cash flow and working capital** ➔ How do we manage working capital, collect accounts receivables, and monitor cash use effectively?
- **Balance sheet** ➔ How do we balance and structure the financial funding options, resources, and risks of the business?
- **CapEx and strategic investments** ➔ What are the investment priorities and why?
- **Treasury** ➔ How can we efficiently manage cash and liquidity requirements?



Income Statement

This decision area represents the bottom line. It is the cumulative score achieved by everyone in the business for a set period. Everyone needs to understand his or her individual contribution and performance measured against expectations.

You must understand where variances above budget occur so you can correct the course. If costs are increasing too quickly, you risk damaging future profits unless you control them, adjust selling prices, or develop new markets. Unexpected revenue spikes can mean additional resources are required to continue future growth. Adjustments such as these take time: the sooner you take action, the sooner you improve margins and realize the full potential of a growth opportunity. The ability of Finance to quickly identify, analyze, and communicate important variances has competitive implications for your company. How quickly the business capitalizes on a new situation is determined by how quickly it discovers budget variances.

GOALS	METRICS	DIMENSIONS
Actual vs. Plan Variance ($/%)	Fixed Costs ($/%)	Fiscal Month
Net Sales ($)	Gross Profit ($/%)	Year
Operating Profit/EBIT ($/%)	Interest ($/%)	Quarter
	Marketing Costs ($/%)	Month
	Material Costs ($)	Organization
	Material Margin ($/%)	Division
	Net Profit ($/%)	Department
	SG&A ($/%)	Org. Code
	Tax ($/%)	Plan/Actual Scenario
	Variable Costs ($/%)	Scenario
		Product Line
		Product Line

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit	Executives			•
	Managers	•		
	Professionals	•		
Customer Service	Executives		•	
Distribution	Executives		•	
Human Resources	Executives		•	
IT / Systems	Executives		•	
Marketing	Executives		•	
Operations / Production	Executives		•	
Purchasing	Executives		•	
Product Development	Executives		•	
Sales	Executives		•	

Each month, about 1.2 million records of financial information—income statements, invoice lines, and balance sheet analyses—from 80 sites are loaded into the system. Users feel encouraged to perform analyses without bothering about the nature of the original data source.

Nicolas Mathei, International IS Project Manager, Vesuvius Group

Drill-Down Variance

Once you identify a difference between actual and plan, you need to drill down into the details to understand what caused it. *If sales increase by five percent between two time periods, was the cause greater volume, higher price, or a change in the product mix? Did your competitors have the same increase in sales? If profits increased, was it due to increases in the cost of goods, a change in product mix to lower margin products, or a reduction in discretionary spending? Did your competitors experience the same increase?*

Finance needs to understand the *why* behind changes. Knowing what drove changes in revenue and profit provides a more complete picture to help guide the company.

GOALS	METRICS	DIMENSIONS
Profit Change ($/%) Sales Change ($/%) Volume/Price/Mix Variance ($/%)	Avg. Unit Cost ($) – Actual Avg. Unit Cost ($) – St'd Discount (%) GL Expense Detail ($/%) Net Change ($/%) Net Price ($) Net Sales ($) Units Sold (#)	Billing Customer Industry Group Industry Category Customer Name Fiscal Month Year Quarter Month GL Lines Organization Division Department Org. Code Product SKU Product Line Brand SKU

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit				
	Executives			•
	Managers	•		
	Professionals	•		
Customer Service				
	Executives			•
	Analysts		•	
Distribution				
	Executives			•
	Analysts		•	
Marketing				
	Executives			•
	Analysts		•	
Operations / Production				
	Executives			•
	Analysts		•	
Purchasing				
	Executives			•
	Analysts		•	
Product Development				
	Executives			•

Operational Plan Variance

Once Finance understands what caused performance variances, it can lead discussions about future operating plans. The ability to advise and push back on management plans is important. Knowing the *why* behind variances from plan helps companies re-evaluate and improve the next plan.

Without this information, plans lose their purpose and become academic exercises to please senior management. Ideally, Finance offers input and feedback that other business areas can use for guidance. At the same time, these other areas provide frontline information to Finance that helps improve the plan. Such cross-functional and coordinated effort lets you test the roadworthiness of existing business plans.

GOALS	METRICS	DIMENSIONS
Operating Cost Variance ($/%) Overhead Cost Variance ($/%) Prod. Cost/Sales Ratio (%)	Actual vs. Plan (%) Avg. Unit Cost ($) – Actual Avg. Unit Cost ($) – St'd Distribution Cost ($/%) Employees (#) Forecast ($) Labor Costs ($/%) Marketing Costs ($/%) Overhead Costs ($) Plan ($) Production Costs ($) Production Hours (#) Sales per Employee ($) SG&A ($/%)	Fiscal Month Year Quarter Month GL Lines Organization Division Department Org. Code Plan/Actual Scenario Scenario Product Line Product Line

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit				
	Executives			•
	Managers	•		
	Professionals	•		
Customer Service				
	Executives			•
	Analysts		•	
Distribution				
	Executives			•
	Analysts		•	
Marketing				
	Executives			•
	Analysts		•	
Operations / Production				
	Executives			•
	Analysts		•	
Purchasing				
	Executives			•
	Analysts		•	
Product Development				
	Executives			•
	Analysts		•	
Sales				
	Executives			•
	Analysts		•	

Because all the processes are connected to each other at different levels, we are able to check the various plans for reliability on a regular basis, while at the same time adhering to the strategy and taking action quickly when necessary. We have a much better view of where and when deviations from the trends will occur. This is a key indicator of what action we have to take.

Eelco van den Akker, Business Planning Manager, Philips

Cash Flow and Working Capital

Effective collection of accounts receivable fuels better performance. The cost of delay is high; managing the profiles of aging accounts receivable or the days of sales outstanding (DSO) is a key priority for any company. The flip side of the coin is that delaying your own accounts payable is good for cash flow. In both cases, Finance must have insight into customer and supplier preferences to ensure the bottom line does not damage valuable relationships.

Investment analysts scrutinize working capital requirements as one factor in determining financial performance. *Is the business managing its valuable cash resources? How does the ratio of debtors (accounts receivable) to sales or the DSO compare to the industry average? Are stock days increasing, meaning more cash is being diverted to holding stock? Are the accounts payable days increasing?*

Working capital requirements have a direct impact on the market valuation of a business. They are a critical area for Finance to monitor.

GOALS	METRICS	DIMENSIONS
A/R Days (#)	A/P ($)	C/F Lines
Net Cash Flow ($/%)	A/P to Sales (%)	Class
Working Capital Ratio (%)	A/R ($)	Sub-class
	A/R to Sales (%)	Account
	Current Assets ($)	Fiscal Month
	Current Liabilities ($)	Year
	Inventory ($)	Quarter
	Inventory Days (#)	Month
	Inventory to COGS (%)	Organization
	Net Change ($/%)	Division
	Quick Ratio (%)	Department
		Org. Code

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit				
	Executives			•
	Managers	•		
	Professionals	•		
Human Resources				
	Executives			•
IT / Systems				
	Executives			•
Marketing				
	Executives			•
Operations / Production				
	Executives			•
Product Development				
	Executives			•
Sales				
	Executives			•
	Analysts		•	

> *Thanks to the colour codes and other alerts provided, our users can easily keep track of outstanding debts. We are also better at credit control, with indicators clearly highlighting our clients' outstanding balances. In addition, the local office managers now have access to tools for monitoring their sales figures. More generally, the whole way that the business is managed has clearly been improved.*
>
> Mikael Perhirin, Head of Decision Support and Infocentre Unit, Générale de Protection

Balance Sheet

This decision area balances the financial structure and resources of the business. How much debt, long and short term, can the business safely take on? For shareholders, a higher debt-to-equity ratio means higher rewards and greater risk. A highly leveraged business will generate attractive financial rewards, but if operating profits fall this may jeopardize the company's ability to deliver on interest and debt repayments. The company's financial structure is a balancing act that must be based on business fundamentals. *Are future market conditions likely to be favorable? Are sales increasing or decreasing? Is more cash investment needed in the company's future assets?* Depending on the strategy and future direction, Finance has to accommodate such demands while maximizing returns.

Capital employed—working capital plus fixed assets—and return on capital employed (ROCE) are critical factors that influence how lenders and shareholders value a business. Investors perceive an intensive and high-capital-employed industry as more risky. A high fixed-assets-to-sales ratio is more difficult to manage in an economic downturn, as for example in steel production. ROCE reflects how well the business can convert investment into profit.

Selling the financial attractiveness of the business to new investors is an important Finance function. ROCE is a benchmark that reflects positively or negatively on senior management and Finance. It highlights the importance of managing future investments and having a clear understanding and sense of priority about which investment projects generate better returns. This understanding leads to the next decision area.

GOALS	METRICS	DIMENSIONS
Capital Employed ($) Debt-to-Equity Ratio (%) ROCE (%)	Actual ($) Assets ($) Debt ($) Equity ($) Fixed Assets ($) Fixed Assets/Assets (%) Liabilities ($) Liabilities-to-Equity (%) Market Value ($) Sales/Capital Employed (%) Sales/Operating Assets (%)	Bal. Sheet Lines Class Sub-class Fiscal Month Year Quarter Month Organization Division Department Org. Code

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit				
	Executives			•
	Managers	•		
	Professionals	•		
Marketing				
	Executives			•
Operations / Production				
	Executives			•
Product Development				
	Executives			•
Sales				
	Executives			•

CapEx and Strategic Investments

Since capital expenditure (CapEx) has an impact on ROCE performance, businesses must evaluate and monitor investment decisions carefully. Asset investments can range from minor to strategically significant: from a new computer to a new production plant in a new country. Finance must ensure that CapEx and investment requests don't simply become wish lists.

Finance must establish the basis for prioritizing and justifying capital expenditure. This means coordinating with different function areas. For example, Finance must understand the impact of both yes and no before agreeing to new investments in plant and equipment. *Will the business lose sales if you don't build the plant? Will this action fix product quality problems? Will production costs increase or decrease?*

Mergers and acquisitions represent the strategic dimension of investments. *What are the potential cost savings from combining these two businesses? If the companies serve the same market, will customers be concerned about high supplier dependency and reduce orders? If the businesses are complementary, what is the volume of incremental sales?*

Understanding upside and downside impacts from potential investments is part of the evaluation process. Finance arbitrates such decisions, and requires detailed financial scenarios that forecast investment ROI and payback.

GOALS	METRICS	DIMENSIONS

Investment ($)
NPV ($)
ROI (%)
	Acquisition Profit Growth (%)
	Acquisition Sales Growth (%)
	Assets ($)
	Breakeven Months (#)
	Capital Employed Change ($/%)
	Fixed Assets ($)
	IRR (%)
	Payback Months (#)
		Bal. Sheet Lines
		  Class
		  Sub-class
		Fiscal Month
		  Year
		  Quarter
		  Month
		Organization
		  Division
		  Department
		  Org. Code
		Plan/Actual Scenario
		  Scenario
		Potential Projects
		  R&D Project Type
		  Project
		Project
		  Project/Program Type
		  Project

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit	Executives			•
	Managers	•		
	Professionals	•		
Marketing	Executives			•
	Analysts		•	
Operations / Production	Executives			•
	Analysts		•	
Product Development	Executives			•
	Analysts		•	
Sales	Executives			•
	Analysts		•	

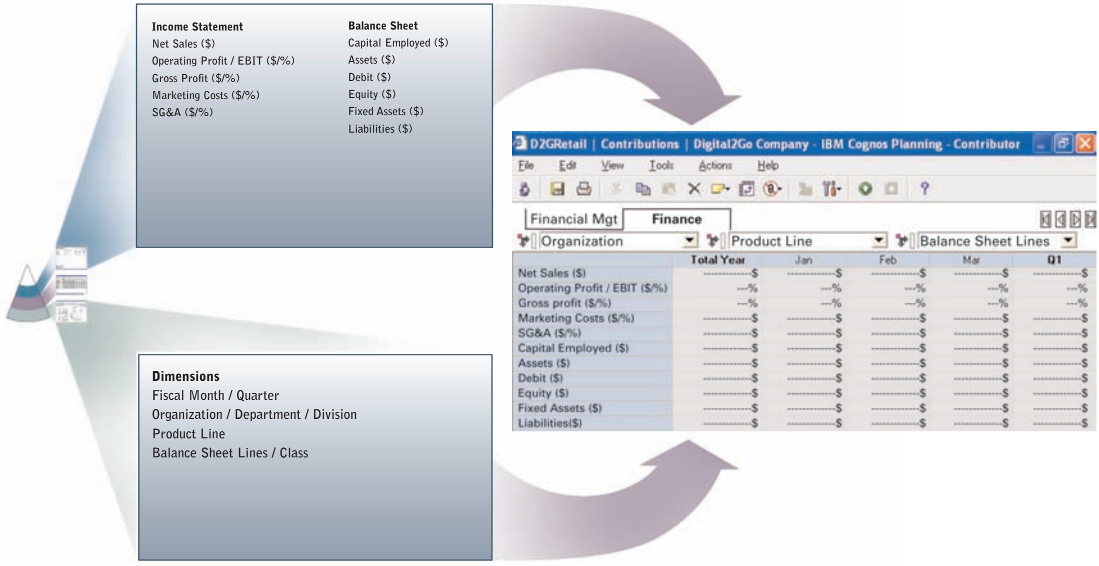
Treasury

Moving beyond the strategic finance structure of the balance sheet, there are regular day-to-day liquidity management concerns that require constant attention. Treasury is concerned with the effective management of cash and liquidity, financing, bank relationships, and financial risks. *What are the options for short-term borrowing and cash requirements? Should any surplus cash be placed in the money markets or into a bank account—and if so, at what rate of return and for how long?*

Effectively managing these liquidity options and dealing with bank relationships requires constantly updated information. Having access to current market information and aligning it with future business requirements is the key to effectiveness.

GOALS	METRICS	DIMENSIONS
Borrowing Cost (%)	Shares Issued (#)	Bal. Sheet Lines
Investment Yield (%)	Shares Outstanding (#)	Class
Net Liquidity ($)	Accrued Interest ($)	Sub-class
	Dividend Payments ($/%)	Fiscal Month
	Interest ($/%)	Year
	Investment Risk (#)	Quarter
	Investments ($)	Month
	Loan Balance ($)	Organization
	Net Cash Flow ($)	Division
	Options Outstanding (#)	Department
	Options Paid-Up ($)	Org. Code
	Price Earnings Ratio (#)	
	Repaid ($) – Interest	
	Repaid ($) – Principal	
	U/W Loan Amount ($)	

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit				
	Executives			•
	Managers	•		
	Professionals	•		



The Income Statement and Balance Sheet decision areas illustrate how the Finance function can monitor its performance, allocate resources, and set plans for future financial targets.

ABOUT THE PERFORMANCE MANAGER

The book, ***The Performance Manager***, is authored by:

Roland P. Mosimann *Chief Executive Officer, BI International*
As CEO and co-founder of BI International, Roland has led major client relationships and thought leadership initiatives for the company. Most recently he drove the launch of the Aline™ platform for on-demand Governance, Risk and Compliance. Roland is also a co-author of the Multidimensional Manager and the Multidimensional Organization. He holds an MBA from the Wharton School of the University of Pennsylvania and a B.Sc. (Econ) from the London School of Economics.

Patrick Mosimann *Founding & Joint Managing Director, PMSI Consulting*
As co-founder of PMSI (Practical Management Solutions & Insights), Patrick has led major client engagements and has significant experience across a number of industry sectors. Patrick Mosimann also holds an MBA from the Wharton School of the University of Pennsylvania and a B.Sc. (Econ) from the London School of Economics, University of London.

Meg Dussault *IBM Software Group, Information Management Corporate Positioning*
Meg started her marketing career in 1990, beginning with campaign management for the national telecommunications carrier of Canada. She then moved to market development for Internet retail and chip-embedded smart cards before moving to product marketing with Cognos (now part of IBM). Since joining the company, Meg has worked extensively with executives and decision makers within the Global 3500 to define and prioritize performance management solutions. This work was leveraged to help shape the vision of the company's performance management solutions and to communicate the message to key influencers.

About IBM Cognos BI and Performance Management

IBM Cognos business intelligence (BI) and performance management solutions deliver world-leading enterprise planning, consolidation and BI software, support and services to help companies plan, understand and manage financial and operational performance. IBM Cognos solutions bring together technology, analytical applications, best practices, and a broad network of partners to give customers an open, adaptive and complete performance solution. Over 23,000 customers in more than 135 countries around the world choose IBM Cognos solutions.

For further information or to reach a representative: **www.ibm.com/cognos**

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