Innovation in Action Series
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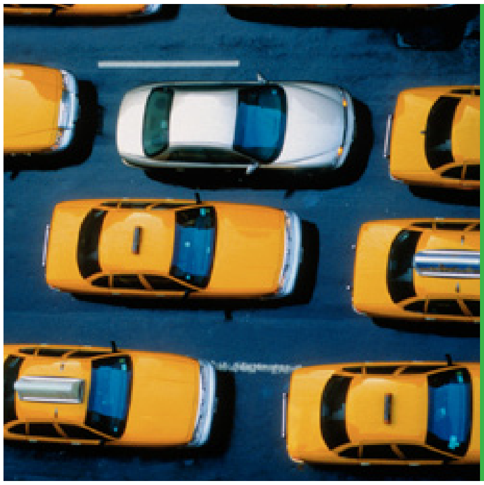

Innovation roundtable San Francisco

Decide where you want to go. Give people the means to get there.

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Creating a shared vision for performance management

Collaboration, shared objectives, and visibility are essential to improving the planning process — and performance. The ability to rapidly change plans, adapt forecasts, and question assumptions when business conditions change is essential to success. And reducing the level of detail enhances performance whatever the business climate may be.

These were some of the topics discussed at the IBM Cognos Innovation Roundtable (the third in a series of four) held in San Francisco.

Twenty finance executives from the retail, logistics, pharmaceuticals, communications, high tech, and manufacturing industries came together to hear new ideas about performance management and the emerging opportunity for Finance to take the lead in making innovation work in their organizations.

The key message: While Finance was once considered expensive overhead, it can now drive breakthrough financial performance and enable process change.

The San Francisco Innovation Roundtable was hosted by the IBM Cognos Innovation Center for Performance Management. A featured presenter was the senior manager of corporate financial planning systems for a large biotech company anticipating dramatic growth over the next three years, who outlined how his company is transforming its forecasting system to enable and manage that growth. Featured also was David Axson, co-founder of the Hackett Group and longtime leader in designing financial benchmarks and best practices, who spoke on the effect bad forecasting can have on critical business decisions.

Through this proceedings document, you can benefit from the new ideas, approaches, and ways you can drive innovation in your organization.

At the inaugural Innovation Roundtable in Orlando, participants discussed the shortcomings of traditional budgeting, the value and process of moving to rolling forecasts rather than rigid budgets, and how identifying the real drivers of your business – rather than bogging down in the myriad line items in the general ledger – can streamline the planning process and improve decision-making. You can find a proceedings document summarizing the event online.[1]

Planning to plan in biotechnology

The IBM Cognos Innovation Center for Performance Management
The Innovation Center for Performance Management puts new ideas about planning and performance in action. It draws on the expertise of an advisory council with members from systems integrators, Global 1000 companies, and industry leaders, as well as its many participants. It offers the opportunity to:

- Find out about new planning processes and practices, as well as understanding the technologies that can enable them.
- Network with industry leaders like themselves.
- Broaden knowledge and vision for performance management.

Aiming high

Innovative companies turn challenges into opportunities. Growth, restructuring, and acquisitions can put a strain on existing systems and processes. They can also be an impetus for change. The senior manager of corporate financial planning systems for a large biotech company is finding ways to meet the challenges of change. At his company, plans for aggressive growth meant planning for increased headcount and capital spending and accommodating greater complexity across the organization.

Rather than simply keeping record of the related transactions, Finance grasped an opportunity to drive the growth process through:

- Increasing visibility into the planning process
- Increasing collaboration and participation from people across the company
- Focusing on how to solve business problems

The goal wasn't simply to process transactions more quickly or more efficiently. The goal was much higher – to improve overall business performance.

At the time, the company had no enterprise-wide financial system. Rather, they relied on a collection of disconnected spreadsheets maintained separately by each business unit and department. On the process side, each department created individual forecasts that were linked to an annual budget, rather than to business drivers.

Problems were rife. Senior executives had no visibility into key metrics or calculations and couldn't get the reports they needed to create accurate forecasts or gain insight into performance. In addition, the company was managing a concurrent migration to SAP that would make the existing financial system obsolete. Things had to change.

But rather than simply implement a new system, the company began by asking key stakeholders questions about their business goals: What challenges did they want the system to overcome? What approach did they plan to use?

"It wasn't as simple as asking people, 'How do you accrue your revenue?'" the speaker said. "We wanted to figure out how people wanted to solve business problems."

This collaboration took the form of a "visioning" process to help executives find the best way to answer these questions. Discussions touched on several topics and approaches: driver-based planning, level of detail, and planning timelines and horizons. "They were all open questions," said the speaker. To ensure that other interests were represented, group controllers from each business unit were also invited to participate in the discussion.

For its second meeting in San Francisco, participants at the Innovation Roundtable included executives from the following organizations:

- Advanced Fibre Communications Inc.
- Carl Zeiss Meditec
- Chiron
- CSAA
- DIRECTV
- Dreyer's Grand Ice Cream
- FedEx
- Hewlett-Packard
- Kaiser Permanente
- Nike Corporation
- NUMMI
- Pfizer
- PMI Mortgage Insurance Company
- Vitria Technology Inc.
- Wells Fargo

Addressing the need for change

Based on their collaborative discussions, the key stakeholders decided the new system would need to meet three objectives:

1. First, help Finance "get out of the detail business" and create a long-range plan for the next three years and beyond. The goal was to spend less time combining spreadsheets and more time analyzing the numbers.[2]

2. Improve decision-making around resource allocation. "Developing a molecule is a $60-to- $100 million dollar bet," said the speaker. "You don't know if there will be any revenue coming from that."[3]

3. Improve transparency. Previously, key calculations had been done offline by finance officers for their respective function—research and development, manufacturing, and so on. The new system would need to make the process transparent so other offices could see the calculations and understand the business.

Finance took a phased approach to its implementation. The first phase was a pilot program geared to improve one process and one function. Success in this phase would lead to the next. "That really was the litmus test for us—we knew we wanted to change the way we did planning, but was this the actual application we wanted to use?"

The second phase involved a rollout of IBM Cognos Planning enterprise software across all corporate finance and planning processes. In completing these phases, the speaker's team succeeded in joining corporate finance to transaction processing on a single platform.

In the third phase, Finance rolled out IBM Cognos Planning to all finance functions and planning areas across all business unit planning processes in: R&D, commercial, manufacturing, and so on. The projected fourth stage will complete the deployment and provide the company with integrated financial planning and reporting, as well as integrated financial and operational planning.

> *"It's a continuous process for us. We got to the top of the mountain, but the view from the top was different from what we thought."*

Implementing new abilities

Finance is now driving plans around growth. Helped by its visioning process, the company now has the capabilities to manage growth, both in the short term and in coming years. Finance now drives increased accuracy, better decisions, and greater visibility throughout the company.

Greater accuracy to chart a course for growth

The company now has a long-range plan (LRP) that looks out three years and drives business expectations. These expectations, not the budget, now drive the forecast. IBM Cognos software also helped the company create the LRP in half the time. This has given Finance what it had desired from the outset—more time to analyze the numbers. "There's a lot of time in there for people to talk and strategize," said the speaker.

Better decisions to improve resource allocation

The company's executives can now make more effective decisions around resource allocation. Solving a human resources challenge has become a successful application of the new system. The company expected to hire 2,000 people—the equivalent of one-third of their current workforce. Using IBM Cognos Planning, Finance created an application to ensure that HR had the appropriate resources at various locations across the country to smoothly manage growth. The application took into account the number of hires, their levels within the company, their locations, and other factors. Delivered in a month, this application was a "quick win" for the team.

Greater visibility to clarify and test new ideas

Finance can now deliver a complete and role-appropriate financial picture to employees at every level of the organization. Using the IBM Cognos planning platform, finance officers across each business unit now work with the same data and calculations, all of which is visible. “People can see how key metrics are calculated. It’s not resting in a spreadsheet somewhere,” said the speaker. “That’s been very powerful for us.”

Finance can manage forecasts, communicate adjustments, and annotate information across multiple locations online. This increased visibility has led to new insights and helped people refine their hypotheses. “It’s a continuous process for us. We’ve had a vision of where we want to go and we got to the top of the mountain. The view from the top of the mountain was different from what we thought.”

Value in coming together

Participants in the San Francisco Roundtable had an experience similar to those at the inaugural event in Orlando. When asked about the likelihood of their recommending a Roundtable event to a friend or colleague, 100 percent responded “likely” or “very likely.”

Participants also said the Roundtable stimulated new thinking and helped clarify their ideas around performance management:

“It validates our approach to re-engineering planning: start small, gain some quick wins, allow positive feedback to permeate throughout the business, then tackle bottom-up planning as users request change in processes and tools.”

“David Axson gave several ideas to think about related to the purpose and focus of planning.”

“It stimulated thinking about what information most effectively supports the decision-making process.”

Selling the idea to the organization

The success of a new system or process depends on the willingness of people to use it. Overcoming resistance to change can be difficult. However, the more people can participate in shaping the new system, the more easily this resistance can be overcome. And success – on a larger scale in a shorter time – is always the most convincing argument for change.

Users at the company initially balked at using the new software and struggled to adopt the new models. "People are very married to the past and what they used to have," said the speaker.

However, the increased transparency users enjoy has helped overcome much of this resistance. Group controllers in the manufacturing and commercial groups are now using the driver-based system and are connected to a central platform. Forecasts from these groups are then communicated to Finance, which – working from the same platform – consolidates them and presents them to the board.

Accuracy and compensation

A related discussion centered on forecast accuracy. Steve Player, of the Beyond Budgeting Round Table and an advisor to the Innovation Center, said that to increase accuracy, many companies tie forecasts to compensation – the classic "carrot and stick" scenario.

This is a mistake, Player said, because "you're paying people to tank." Instead of trying to exceed expectations, people usually perform to results that are lower than expected, but that they know they can achieve without too much work. From there, it's simply a question of people hedging managers' expectations to prepare them for sub-par results.

"If I can get to 12, I collapse on 4," Player said. "Because I can get to 4 very regularly, but I'm sub-optimizing performance. The only way I'm going to get there is either to get really lucky or by manipulating the inputs." Nowhere in this scenario is there an incentive to go beyond what was forecast.

David Axson: Bad forecasting means bad decisions

> Suggestions for future reading: The following titles are available free of charge from the IBM Cognos Innovation Center for Performance Management:
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> *Best Practices in Planning and Management Reporting*, by David Axson. Published by John Wiley and Sons.
>
> *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap*, by Jeremy Hope and Robin Fraser. Published by Harvard Business School Press.
>
> For other titles, please visit www.cognos.com/innovationcenter

In addition to showcasing successful customer deployments, the IBM Cognos Innovation Center spreads the word of leading thinkers in performance management. On this evening, the second guest speaker was David Axson, well-known co-founder of the Hackett Group and longtime leader in designing financial benchmarks and best practices. To illustrate his points, Axson drew from recent experience as head of corporate planning at Bank of America.

When Axson arrived at Bank of America, it had $700 billion in assets and $42 billion in revenue. It also had a serious problem: A lack of visibility into the forecasting process was leading to bad business decisions. Forecasts were so inaccurate and the process so sandbagged that the CEO was considering serious top-line action to prevent a shortfall, and layoffs, acquisitions, and cancelled investments were clearly on the table.

> *"It's amazing how forecast accuracy improves when bosses see who the sandbaggers are."*
>
> *David Axson*

How bad was the situation? In one year, the bank posted a $9 billion profit. Yet its forecast variances totaled $4.5 billion—nearly half the total. EPS for the year ended at $6.20, but during the course of the year estimates had ranged between $4.80 and $7.20. "Trying to make a business decision was a bit of a problem," said Axson.

Axson had one year to fix the problem. He set to work discovering the sources of the variances, which business units were the biggest culprits, and which variances were preventable.

By doing two simple things, he succeeded in reducing variances by 80 percent.

First, he identified the sandbaggers. Every two weeks, Axson presented his CEO with a simple list of the business units that had missed their bottom-line forecasts by the largest amount. And he informed the respective managers that he was doing it—an unprecedented move. This eliminated $1.6 billion in variances in four weeks. "It's amazing how forecast accuracy improves when bosses see who the sandbaggers are," he said.

Second, he linked business drivers to the operational plan. This revelation cut out half a billion dollars of forecast inaccuracy. Managing by leading indicators lets companies quickly adjust to changing markets. Managing by anecdote lets executives fudge the truth to cover up sandbagging. Bank of America used anecdotal information, and it was starting to cost them.

Sell the need for change

Newton's law of inertia says that objects at rest will stay at rest unless acted upon by an exterior unbalanced force. This was the principle Axson encountered in trying to change Bank of America's forecasting process.

The bank's retail division, which accounted for 75 percent of its revenue, had no understanding of scenario planning around its major business drivers. It relied on a highly detailed plan that after nine months proved obsolete. Said Axson, "They had a precise number – precisely inaccurate."

The bank's investment division, which accounted for the remaining 25 percent, wasn't interested in doing forecasts at all and wouldn't give Finance the time of day. The usual response? "If I knew what my business was going to look like tomorrow I wouldn't be working here."

To overcome the inertia, Axson recruited a marketing expert to package the new process like a new product. The approach included brochures, focus groups, and specially chosen evangelists in every part of the business. These evangelists would meet with their peers and make the case for change: "People couldn't escape."

Axson then presented each business unit with a challenge. He created three scenarios for each business unit and tasked them to create a game plan to respond to each. The business units were asked to create leading indicators that would tell them whether their market was growing or shrinking; they also had to create a contingency plan based on each outcome. This approach successfully eliminated knee-jerk reactions and helped each team improve its responsiveness in dealing with external events.

Respond to external events

During Axson's tenure, Bank of America found itself on the front page of the Wall Street Journal three times. Each time it was for the wrong reasons:

- The mutual fund scandal, in which the bank was implicated
- The collapse of dairy giant Parmalat, in which the bank was a major investor
- The bank CEO's decision to acquire Fleet Boston for $46 billion, considered by many to be an ill-advised move

Using the unwanted press coverage as a springboard, Axson mandated a reduction in planning time from 22 weeks to six. And he ordered re-forecasting as often as necessary. The number of forecasts went from five to 37. Each took a day to complete.

This dramatic re-organization forced the business units to rethink which numbers were truly important. Some chose to continue planning expenses at the departmental level. But as it was now their own decision, said Axson, they could no longer "blame corporate" should they continue to miss their forecasts or experience delays in creating them.

Match planning and forecasting to business drivers

No one would argue that different companies face different challenges and rely on different drivers. Yet few companies apply that truth to their forecasting. "There is a right way to do accounts payable. There's not a right way to do a forecast," Axson said. "Based on the nature of your company, you have to do things differently."

Only a small proportion of companies—15 percent—are in what Axson called the "innovation and leadership stage." A further 25 percent are stagnating, while the remaining 60 percent are in decline. [4] Each stage has different drivers, said Axson. Leaders should focus on distribution and customer acquisition. Stagnating companies should focus on cross-selling to existing customers. Companies on the decline—the vast majority of the market—should focus on customer retention.

The task for Finance, said Axson, is to help business units understand these realities, help them align forecast detail and frequency to their respective stages and business drivers, and give them the flexibility to structure plans and forecasts locally while giving corporate executives visibility at the highest level.

Avoid the trap of excessive detail

Axson described a finance executive at brewing giant Labatt, who had what he thought was a great idea to save money: He would forecast packaging requirements by brand, beer type, and container (bottles vs. cans, big vs. small) for the coming 18 months. He used a spreadsheet. "It was a Microsoft® Excel® jockey's dream," Axson said.

A Labatt purchasing agent, seeing this new forecast, secured a long-term contract with their packaging supplier at a substantially reduced rate. This turned into a disaster.

A few weeks later, Labatt competitor Anheuser-Busch began a retro-themed campaign that drove a spike in consumer demand for beer in long-necked bottles—a move Labbatt hadn't planned for. Lacking a contingency plan, the company was caught flat-footed with a warehouse full of cans. Labatt eventually did respond to the Anheuser-Busch campaign—more than six weeks late because of the lead-time needed to design and produce new packaging, and only after shipping extra bottles to their plants at considerable expense.

> *"Many projects list criteria for success. but how many define criteria for abandonment or failure?"*
>
> *David Axson*

The moral? "The problem isn't in the colossal waste of time it takes to forecast in detail," said Axson. "It's the bad decision-making that results." Labatt's reliance on multiple layers of detail hampered its ability to respond quickly to competitors and focused people's attention on the wrong things.

Ask the right questions

Which is more effective in driving change: "Thinking like a customer" or contemplating how a project can fail?

When you need to change behavior, said Axson, having the right people ask the right questions is more effective than any finely worded strategy. Another of Axson's unprecedented moves at Bank of America was to have their CEO ask each business unit president three simple questions about their forecasts:

- What if you're wrong?
- How will you know?
- What will you do to fix it?

This, said Axson, did more to change the way people thought about the planning process than any strategy. "Finance is in the perfect position to ask questions and play devil's advocate," he said. "I think we should take advantage of that role far more often than we do today."

Four things to consider

Axson concluded his presentation with a list of four aspects of performance management for finance to consider:

1. **Understand business risk.** Demographics. Competition. Offshoring. Special interests. Employee loyalty. And many more. Think about which of these forces is going to threaten your survival, then ask yourself how much time you account for them in your planning process, and whether or not you have any content or measures around them. Build contingency plans in advance of adverse events.

2. **Match forecasting time to risk, not to comfort level.** Encourage people to spend time on innovation initiatives or the risks associated with new projects, not on costs that don't change from year to year. Executives are most likely more worried about the risks associated with launching a new product or entering a new market than with stationery spend and flooring costs.

3. **Improve the quality of your reporting and analysis.** Focus on helping executives understand what's going to happen next, not what happened last month. The most valuable information is external and leading: data that can tell you what your competitors and customers will do tomorrow. Then focus on internal leading information to find out where you're likely to fail next. The least valuable information – data about what you did six weeks ago – is internal and lagging.

4. **Build a flexible decision-making culture.** The business school axiom of "all analysis, all the time" is killing intuition. Strive instead for "informed intuition" by listening to your gut and checking the numbers to see if they support your ideas. Reward change and speed. Liberate people from the details. Contemplate the ways a project can fail.

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.

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IBM Canada
3755 Riverside Drive
Ottawa, ON, Canada K1G 4K9

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Endnotes

[1] A proceedings document from this and other Roundtable sessions is available free of charge from the IBM Cognos Innovation Center: www.cognos.com/innovationcenter. Other Roundtable events were held in Dallas, New York, and Chicago.

[2] This desire echoes recent research conducted by CFO Research Services, a sibling of CFO.com. The survey found that of 287 companies surveyed, 60 percent of respondents said spreadsheet-based planning takes too long. Nearly 43 percent cited a lack of time to analyze the data. "When Do Companies Outgrow Their Spreadsheets?" CFO Research Services.

[3] Pharmaceutical companies allocate resources to molecules in development based on their probability of technical success, or PTS. The "PTS-view" of a molecule helps determine the revenue a drug will generate if it's approved. The "non-PTS" view determines how much money the company can expect to lose if the molecule fails. The more accurate these views, the earlier a company can stop research on an unsuccessful molecule and reallocate funds to those with a higher PTS.

[4] Hackett Group research.

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