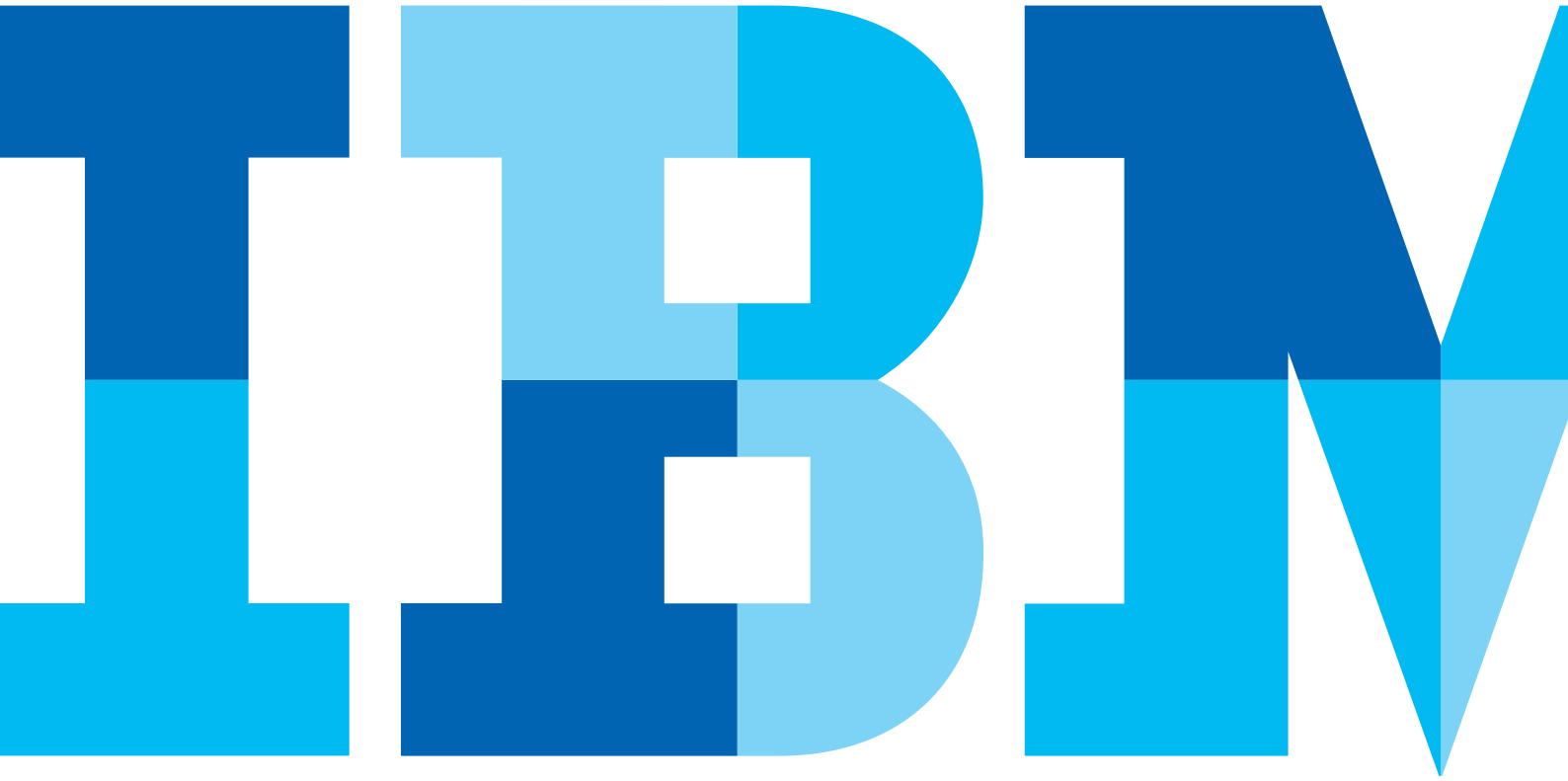


Bridging Operational & Financial Forecasting



Introduction

The global economic downturn has accelerated a trend that has been gathering momentum for years. CFOs, and corporate offices of Finance generally, are getting more involved in operational decisions than ever before.

IBM even spotlighted this trend by giving its 2010 Global CFO Study the title *The New Value Integrator*, emphasizing the importance that successful CFOs now put on applying their insights “across the enterprise from strategic planning to operational optimization.” Over the last two years, “volatility and uncertainty drew [CFOs] into more frequent boardroom conversations about forecasts, profitability, risk management and strategic decisions related to supply chains, pricing and production.”¹

But while the need for CFO input into operational decision making has been growing, reliable information that CFOs can trust to support that decision making has been lacking. On a high level, Finance can spot the obvious trends in revenues and expenses. But the view is often short on granular detail and timeliness, and hampered by static and very often rigid budgeting processes.

This white paper examines the need for an analytic and planning environment based on definitions and metrics that are common to operations and finance. An environment like this can 1) provide Finance with richer insight into operational performance, 2) enable better responsiveness, and 3) allow organizations to more transparently align strategy, processes and operations with common KPI definitions. We will underscore the relationship of operational insight to financial performance, and consider some of the specific operational issues that IBM Cognos solutions can address.

From Static to Dynamic

As they seek more insight into operations, Finance organizations are often confronted with silos of domain-specific information. Different areas of the business collect data from multiple sources in multiple formats. And they often do a poor job of consolidating it for users outside of their own discipline. As a result, when different business units or parts of the business operating in different geographies report on their performance, inconsistent metrics can make it nearly impossible for Finance to make objective, apples-to-apples comparisons and draw useful insights when assessing performance.

Many Finance organizations also lack the ability to respond to business change dynamically because they adhere to outmoded methods of planning and budgeting. All too often, an annual planning process produces static budgets that are out of date before the budget year even begins. In addition, their analysis and reporting involves intensive customization and manual spreadsheet-based tasks, which are prone to error.

The economic turmoil of the last few years shows how quickly and dramatically budget assumptions and forecasts can be rendered obsolete. We saw oil prices soar to nearly \$150 per barrel in the course of only a few months, and then fall to half that level just as quickly. Equity markets fluctuated wildly. And credit became difficult to obtain for even the most creditworthy businesses, as financial markets attempted to reconcile the tumult caused by complex derivatives and collateralized debt obligations.

In their book *Future Ready*, authors Steve Morlidge and Steve Player noted that, in this environment, “the ability to forecast results” was the number one internal concern of CFOs in Europe, Asia and the U.S., ahead of such issues as balance

¹ IBM Institute for Business Value, *The New Value Integrator: Insights from the Global Chief Financial Officer Study*, March 2010

sheet weakness or supply chain risk. They also observed that “Budgeting is based on the assumption of predictability rather than the reality of change. As a result, we do not have a process legacy that helps us forecast well or a mindset that helps us deal with changes and turbulence.”²

To deal with the volatility, Finance needs better access to operational information, and a planning and forecasting approach capable of driving better decision making. In terms of systems and processes, this means access to reliable content from heterogeneous data sources, and an analytic and scenario forecasting model that uses common definitions and KPIs across widely dispersed departments, regions and business units.

“Budgeting is based on the assumption of predictability rather than the reality of change.”

—Steve Morlidge and Steve Player, *Future Ready: How to Master Business Forecasting*

Giving Finance an Operational Line of Sight

The CFO Study emphasized the need for Finance to participate in operational decision making, observing that, “With the appropriate analytical capabilities spanning process, technology and talent, Finance can turn this wealth of financial and operational information into business insights.”

To get there, however, organizations need to consider a two-step process: First, creating a common decision making continuum from which to analyze operational performance consistently across the enterprise. Second, aligning management and staff assessments and responses to anticipated risks and opportunities.

IBM Cognos Analytic Applications, together with the budgeting and planning capabilities of IBM Cognos TM1, provide all of these and give Finance the actionable insight to synchronize financial and operational planning, linking bottom-up operational and top-down financial planning.

Step one, then, begins with Cognos Analytic Applications and its four packaged solutions. These provide a unified view of performance across the specific operating domains and functions that exist in virtually every organization. The applications provide ready-made reporting and analytics. They can source and model critical data, transforming it into a strategic asset that can be used to measure and assess operational performance.

Their common analytic model is based on the Cognos Adaptive Analytic Framework. It provides shared measures and dimensions, which enable Finance to monitor and measure performance within a specific business function or cross-functionally. In addition, the highly adaptive nature of this model enables organizations to modify their reporting environments to meet new business requirements, ensuring continuously relevant analytic content. The four Analytic Applications are:

- **Financial Performance Analytics:** This package provides standard, packaged reporting and analysis that Finance organizations need to manage general ledger, accounts receivable and accounts payable data in their transaction systems, while improving visibility into working capital and automating internal management reporting.
- **Workforce Performance and Talent Analytics:** For most organizations, the workforce represents the single largest cost the organization incurs. But unlike other resources, the workforce cannot simply be increased or decreased at will without serious long-term consequences in terms of the ability to expand the business or maintain a competitive advantage in product or service quality. The more insight that Finance has into workforce metrics, the better able they will be to balance short-term cost-saving imperatives with long-term growth potential.

² Steve Morlidge, Steve Player, *Future Ready: How to Master Business Forecasting*, John Wiley & Sons, Ltd., 2010

- **Supply Chain Performance Procurement Analytics:** Perhaps no area of cost has as many variables as does procurement. While an increasing number of products are becoming “commoditized,” the same cannot be said of supplier relationships, in which factors such as service, reliability, and payment flexibility will often override the most basic of financial considerations—price. This application enables organizations to analyze and manage spend and supplier performance with easy-to-use, standard reporting that enables finance to accurately calibrate operating costs and mitigate supplier performance risk.
- **Customer Performance Sales Analytics:** Sales and marketing teams must be constantly active, and there is no more reliable indicator of an organization’s prospects for the future than its pipeline and sales trends. The sales analytics application helps companies anticipate and adapt to changing market opportunities and track the entire sales cycle, from sales rep quota attainment to pipeline to conversion rates to order fulfillment. For Finance, insight into future revenue opportunities helps provide stability in the budgeting and planning process, and ensure greater accuracy and predictability.

Knowing Today, Planning for Tomorrow – Operations Meets Finance

Step two in our process consists of applying a common forecasting model to Cognos Analytic Applications with Cognos TM1. Cognos TM1 is a comprehensive solution for planning, budgeting and forecasting that is capable of reducing planning cycles by as much as 75% and shrinking from days to minutes the time needed to create reports. Cognos TM1 enables Finance to build “what if” scenarios quickly and use the operational insights drawn from the analytic applications to support dynamic decision making.

Cognos Analytic Applications and Cognos TM1 help companies align strategy, processes and operations to deliver:

- **Trusted insight:** All business activities exist within a pipeline or sequence, with actual revenue following orders, which follow price quotes, which follow “opportunities” (at various stages), which follow sales leads, etc. On the other side of the ledger, actual expenses follow invoices, which follow procurement, which follow requisitions, and so on. Using packaged analytics, organizations can gain insight quickly using a common business model, either within these specific functions, or cross-functionally.
- **Responsiveness:** Prudent resource allocations can be supported by dynamic “what-if” analysis, more efficient planning and faster insight into new opportunities and markets. The challenge for most organizations, however, is not the strategic planning process itself, but changes to assumptions as the plans are executed. Here, adapting and responding to changes, so that their implications are cascaded throughout an organization’s planning cycle is critical.
- **Transparency:** When common definitions are used across the business and plans can be adapted quickly to perpetually changing markets, performance can be measured consistently and decisions and actions can be tied to business imperatives anew. Root cause analysis can scan different operational domains, in workforce, procurement, and sales, as well as cross-functionally. Operational and financial planning become synchronized. And decision making becomes more fact-based, justified by linking situational fact to measured courses of action.

Improving Sales Forecasting – A Scenario at Work

How do these solutions work together in the real world? Let's consider the following example of an organization using packaged analytics and the historical insights provided by the sales application to conduct a “what if” analysis of a rebate program to bolster revenue in Q2.

In this scenario, the sales team is suggesting an across the board rebate on the company's product portfolio to help them meet their revenue goals for Q2. But what are the wider implications of this Q2 rebate? That's where Finance comes in, for rebates are fundamentally a Sales and Finance conversation that requires rigorous analysis.

Our scenario starts with the Sales VP reviewing an executive-level dashboard representation of Sales Analytics packaged reports. Here, she gets a snapshot view of:

- Worldwide sales relative to plan
- Margin amount for the current year vs. prior year
- Sales for the quarter vs. same quarter last year
- Open orders
- New/lost customers, and
- Opportunities by stage, for a dollar value of opportunities currently in the pipeline

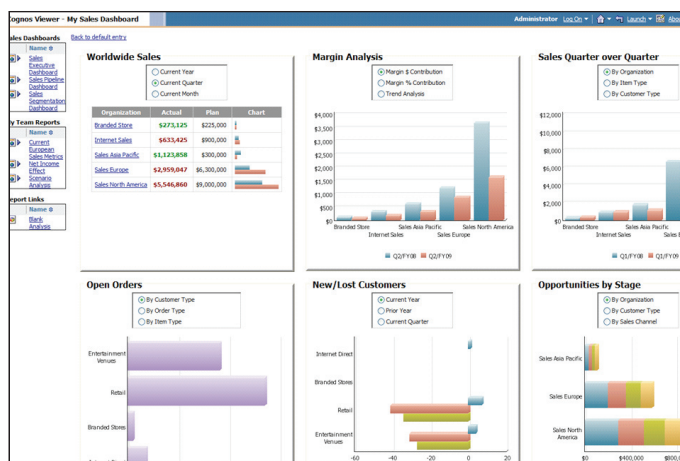


Figure 1: Sales Analytics Dashboard—a consolidated view of different analytic reports.

She drills down and discovers that Sales Europe has a \$6M variance in actuals to revenue plan. The Sales VP then flips to her pipeline dashboard. Here she can gain a quick and consolidated view of:

- Open opportunities
- Open opportunities expected to close
- Open opportunities by regional trends
- Pipeline stage to win rate
- Average win rate duration
- Stage to stage duration, or conversion rate

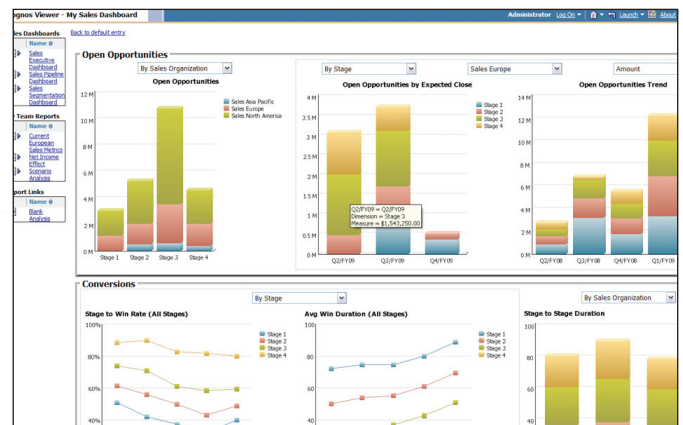


Figure 2: Sales Analytics Dashboard gives a consolidated view of pipeline health and an overview of open opportunities in the pipeline.

She examines opportunities that are expected to close by sales cycle stage in the current quarter and for Q2 and Q3, which suggests a prolonged conversion rate. The Sales VP then examines the current forecast and expected revenue for Q2, based on expected win rates.

What she discovers is that there is nearly a \$1.5M shortfall for the quarter in Europe. Her goal is simple - meet her revenue target for Q2. Broadly considering all her sales tactics, she wants to gauge the possible impact of rebates on Q2 opportunities.

Working with her colleagues in Finance, she modifies her forecasts and accompanying expected revenue by sales pipeline using Cognos TM1. To get to that modified forecast – where there is no \$1.5M shortfall – she needs to propose a level of rebates that could secure that additional revenue.

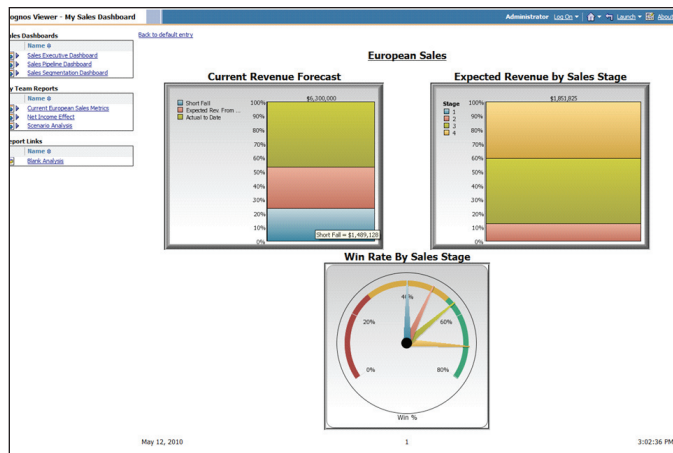


Figure 3: IBM Cognos TM1 Dashboard provides a snapshot of expected revenue shortfall in Q2.

She starts with a 10% rebate, and projects a 25% uplift in stage four of her company’s sales cycle. This approach eliminates the shortfall. She can now confidently explore a rebate program with her Marketing VP using the facts driven by her sales analytic application and the “what if” scenario modeling of Cognos TM1.

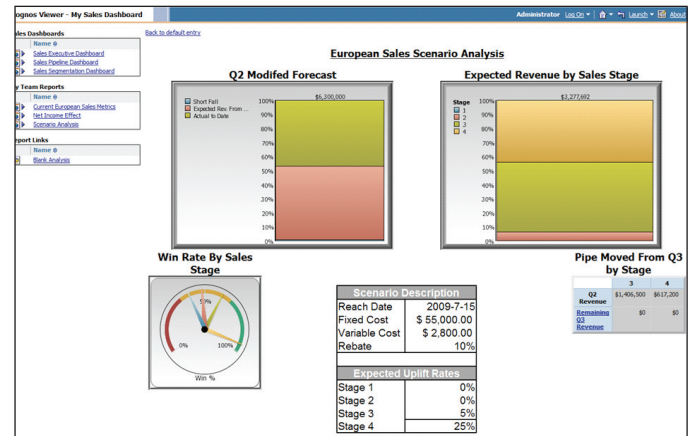


Figure 4: “What if” scenario model examines the impact of rebates on conversion rates in the pipeline.

Lessons Learned

So what have we learned from this scenario? We have seen how packaged sales analytics, and Cognos TM1 can be brought to bear on a discreet business problem of the sort that happens every day. With the right level of insight, our Sales VP can understand the implications of “what ifs” and make better, more informed decisions at the point of business impact.

Finance, meanwhile, can exercise greater control over the company’s sales forecasting assumptions and have greater confidence in the analytics that underpin sales performance. Cognos Analytic Applications can provide the common reporting environment that enables Finance and line of business professionals to understand variance from plan, cross-functional analysis and historic trends. With common definitions, KPIs and planning models, Finance can align decision making through continuously relevant analysis of risks and opportunities. The Finance team can then reconcile strategy formulation and its execution quickly, consistently, and cost-effectively.

With Cognos Analytic Applications and Cognos TM1, organizations can assess, forecast and act upon the perpetually changing risks and opportunities that every business faces – either globally or locally – to improve financial and operational performance.

Conclusion

In today’s ultra-competitive and volatile economy, it’s critical for the CFO to be actively engaged in the management of operational performance, and act as an effective guardian and steward of enterprise strategy.

Those organizations that can integrate different sources of enterprise insight simply perform better. Cognos solutions help the office of Finance and its line of business counterparts synchronize financial and operational planning at the point of business impact to optimize performance, no matter how volatile business environments become, or how quickly annual plans change.

About IBM Business Analytics

IBM Business Analytics software delivers complete, consistent and accurate information that decision-makers trust to improve business performance. A comprehensive portfolio of business intelligence, advanced analytics, financial performance and strategy management and analytic applications gives you clear, immediate and actionable insights into current performance and the ability to predict future outcomes.

Combined with rich industry solutions, proven practices and professional services, organizations of every size can drive the highest IT productivity and deliver better results.

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June 2010
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