

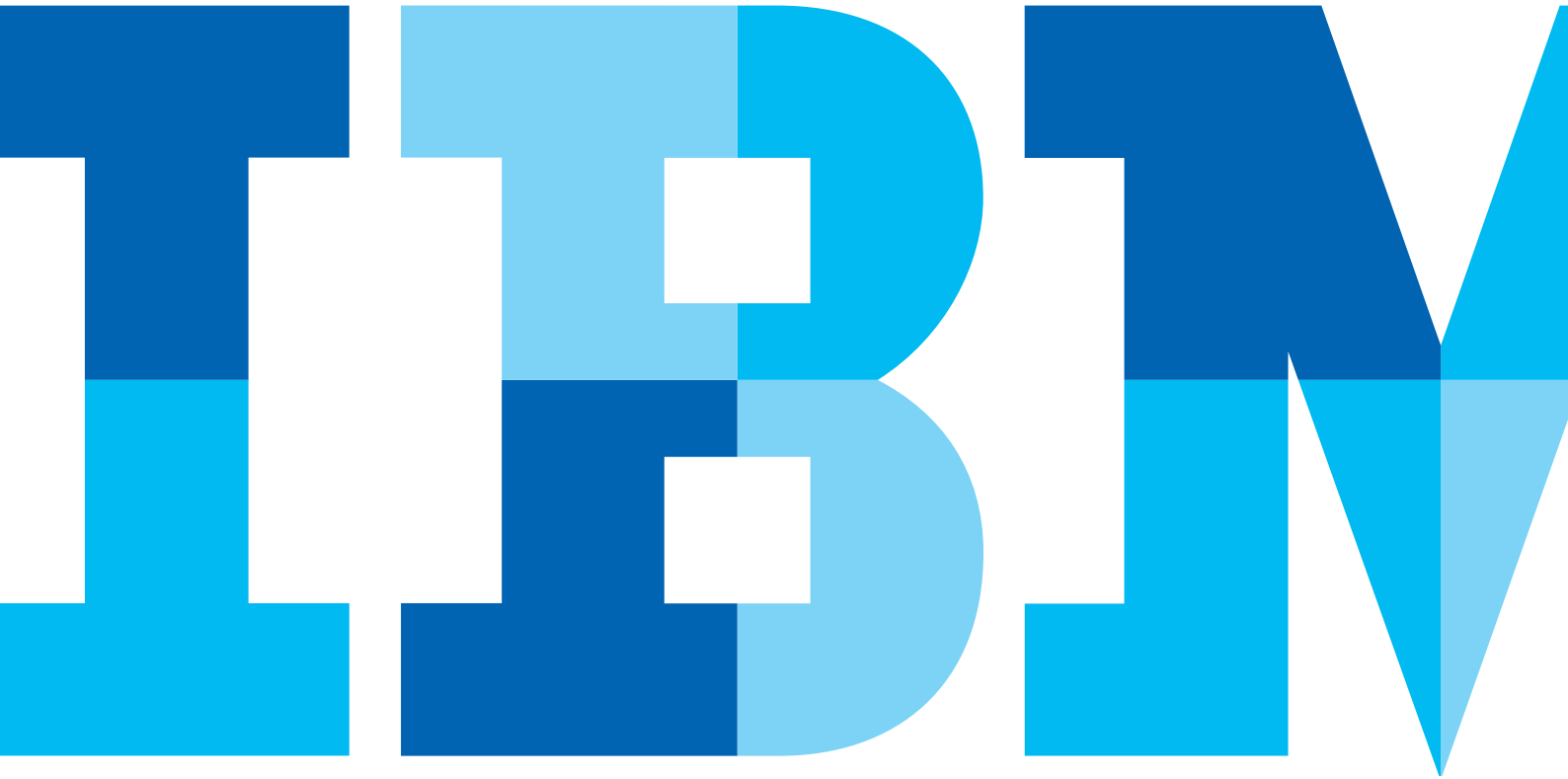
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White Paper

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Finance 2011 – Time to Build the “Last Mile”

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IBM

In recent years the telecommunications industry has popularized the term, “the last mile” to describe the technology required to connect the end customer to the central network. For many, the last mile has been a bottleneck, preventing consumers from taking full advantage of the breadth and speed of digital service in their home or office until the final connection is built. Many finance professionals feel similarly constrained.

The last 20 years have seen transformational change in the finance function. Benchmarks show that costs have more than halved, levels of automation have increased dramatically and changes in organizational structure have driven economies of scale, created centers of expertise and allowed for much closer alignment of finance and business. Advances in computer and communications technology have enabled many of these changes, including the:

- Automation of transaction and accounting processes
- Creation of shared service centers
- Selective outsourcing of non-core processes
- Integration of disparate data sources through database management systems, data warehouses and enterprise performance management systems
- Development of the globally networked finance organization

The results are clear: lower costs, higher productivity and reduced error rates. Yet for many finance teams there is still a level of frustration—so much has been accomplished but the journey to truly high value-added business partnership is not complete. Professional staff still spend far too much time on the mundane—digging for data, assuring data quality, maintaining complex spreadsheet models, manually assembling critical management reports, assembling data needed to meet

ever-changing external reporting requirements, and creating numerous ad hoc analyses of questionable value. As in telecommunications, the “last mile” of connecting business and finance managers to true value is proving to be a hard slog.

The global recession of 2008-09 simply served to highlight the gaps: planning processes were unable to cope with the speed and severity of the downturn; risk management processes were found lacking; and the ability to deliver timely, insightful analytics to speed decision-making was hampered by incomplete systems, weak tools and over-burdened professional staffs.

As the global economy slowly heals, finance leaders are looking to fulfill the promise of the last 20 years. Much of the hard work has been done; the infrastructure is largely in place. The challenge is to build upon this platform to drive dramatic improvement in the quality and value that finance delivers. Specifically, this means focusing on three key areas:

1. Integrating insightful analytics into every aspect of the management process
2. Operationalizing enterprise risk management into a holistic system of prevention, detection and risk mitigation
3. Liberating finance professionals from the collection, organization and communication of routine business information

Integrating insightful analytics

Today, timely and insightful analytics are not simply something for finance to do when things go wrong or when someone has time to spare. Analytics must be a core competency for all finance teams. The ability to derive insight from data and then translate that insight into meaningful decisions in a timely

manner is increasingly separating the best from rest. Business leaders are turning to their finance teams and demanding more insightful analysis on the impact of risk, uncertainty and volatility. And we, as finance professionals, must be able to respond.

Forward thinking finance teams are embracing a much broader range of analytic tools to address uncertainty and better understand likely future performance. Instead of simple NPV (net present value) or IRR (internal rate of return) analyses, organizations are using Monte Carlo simulations, portfolio analysis, real options, scenario planning and other tools to address the range of possible outcomes of any investment or initiative.

Monte Carlo analysis is a core element of pharmaceutical company Merck's research planning model to assess the probability of early stage drug compounds successfully reaching market. Oil giant Chevron has used real options to evaluate everything from the selection of technology providers to sizing offshore drilling platforms. The Australian Tourist Authority uses scenario planning to provide analysis to its members (e.g., hotels, resorts, airlines) on the number of tourists expected to visit Australia under different scenarios regarding global economic growth, airline pricing and exchange rates. Private equity investors are driving significant corporate restructuring through the use of portfolio analysis to identify undervalued assets buried in corporate portfolios. The December 2010 announcement that Fortune Brands (Jim Beam and Courvoisier liquor, Moen bathroom fixtures, Titleist and FootJoy golf equipment) would split into three different businesses is just one recent example of portfolio analysis at play. At Dorel Industries (see case study below), automated analytics provides immediate alerts to managers when forecasts change, allowing for rapid analysis and decision-making.

Analytics is all about deriving insight from data, but that is not the end of the process. Above all, analytics is a decision-support tool. Analytics are only as good as the decisions that result. Getting from analysis to decision is as simple as asking three questions:

1. Are the results or conclusions of the analysis material?

If yes, then:

2. What are the implications?

Once the implications are understood, the final question is:

3. What action should be taken?

Directly linking the results of analytic work to the decisions that are taken is crucial to realizing the value of an organization's investment in analytical skills and tools. Fast, confident decision-making demands focus. The volume of data that could potentially be analyzed is so vast (and growing exponentially) that analysts need to be very selective in choosing what to analyze. Designing analytics capabilities with a sound understanding of business drivers (those items that materially impact performance) and key performance measures provides a solid foundation for organizing analytic work.

Think of focused analytics as being akin to the performance reporting and analysis systems in your car. The combination of dashboards, on-board computers, real-time sensors and GPS systems provides a complete and integrated management system. Historically, automobile dashboards simply reported facts such as speed, fuel level, and the like. In recent times, a layer of real-time analytics has been added, which provides the driver with a richer set of information from which to make informed decisions, without getting bogged down by extraneous data. Sensors now monitor a myriad of facets of performance, but alert you only if there's a problem—a perfect example of

just-in-time reporting. For instance, a warning light alerts you when the engine is overheating—and hopefully provides you with enough time to make adjustments to correct the problem; fuel levels are translated into an estimated range based upon speed and driving style; tire pressures trigger warnings when minimum safe thresholds are reached; and GPS systems alert you to impending delays and also craft an alternate route. The dashboard gives you the *right* information at the right time, but doesn’t inundate you with all the information.

Making the case for investing in analytics has never been easier. Events of the last few years have shaken management confidence and highlighted the deficiencies in traditional reporting and analysis. Rich and insightful analytics are now fundamental to effective management decision-making and hence corporate performance. However, pick your targets wisely. Don’t try and deploy analytics everywhere immediately or, like many “big bang” projects, it will fail. Focus on the areas where enhanced analytics can have a meaningful impact fast, as in the case of Cellular South (see case study below). Identify a pain point within your organization and apply the right analytic tools to deliver insight. Demonstrate the value to management and then use the goodwill created as a foundation for deploying more broadly. Done right, analytics will not only improve performance but will also create more interesting and rewarding careers for people in the finance organization, ensuring that you can attract and retain the best talent.

Operationalizing enterprise risk management

Historically, risk has been defined narrowly as the measurement and management of financial risk. Market price, interest rate, credit and exchange rate risks have dominated management’s

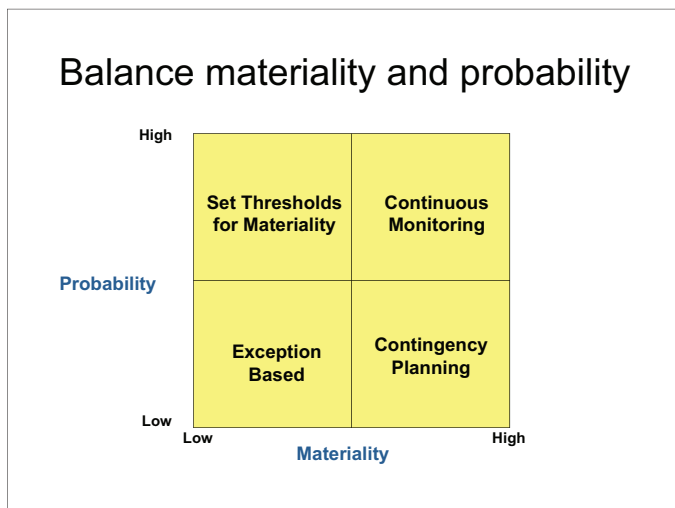
attention and are well understood, if not always managed effectively. However, such a narrow view is no longer sufficient. The impact of specific risk factors, from the stability of global supply chains to the threat of attack from special interest groups, represents just part of the increasing portfolio of potential risks that can impact performance. In most organizations, vital risk management information is buried in silos, so that data gathered in one department or function, which could prove invaluable to another, are never identified or communicated and the aggregate impact of different risks is missed until it is too late.

Today, risk management practices must be embedded in operational and management processes so that an organization can:

- Identify the risks to which they are exposed
- Quantify the materiality and probability of occurrence
- Determine the need for mitigating strategies
- Develop appropriate mitigation plans
- Drive timely decision-making
- Monitor execution and results

A systematic approach starts with the routine review of many factors that are not typically addressed by traditional financial risk management processes, such as: the quality of corporate governance and compliance, employee management, and customer management processes; the company’s use of technology and its business interruption plans; the deployment of best practices; the sensitivity of the company’s products to technological obsolescence; the adequacy of contingency plans against possible pandemics (e.g., SARS, H1N1); and the degree to which the company is subject to attack from special interest groups.

A starting point for developing an effective risk management framework is understanding the level of business risk—and hence future financial risk—to which an organization is exposed. Organizations must fully leverage many of the tools they have become accustomed to using in recent years, such as contingency planning, market and competitive intelligence, scenario planning and data mining—but with a new focus and discipline. The challenge is that much of the information is assembled in an ad hoc manner, and there is no unifying process to provide a complete organizational risk profile. Moving from an ad hoc and largely subjective process to a systematic, fact-based measurement system of Key Risk Indicators (KRI's) is crucial. Organizations need to be able to identify trends and determine materiality and probability; the combination of these two factors sets the parameters for the type of risk mitigation strategies that need to be employed.



Risk matrix balances probability and materiality (potential for harm).

All available intelligence must be collated and synthesized; new technologies that enable the aggregation and organization of data from multiple sources can speed this process greatly. Many organizations are implementing risk-based early-warning systems as part of their overall risk management process. These tools allow finance and risk management staffs to identify and quantify major trends and assess the degree of exposure.

Establishing a risk-based early-warning system demands that companies look beyond the data in their enterprise resource planning (ERP) or general ledger systems. In parallel with collating the internal data on opportunities and threats, organizations must look outside, seeking out those trends or events that signal opportunity or threat. Quantitative data are important, but companies must also obtain and synthesize qualitative data. However, effective identification and measurement of risk only goes so far. Managers must then answer two questions:

1. Is the risk significant enough to require action?
2. What is the most appropriate mitigation strategy?

In developing sound policy, determining whether a specific risk requires mitigation demands that managers not only understand the likely probability and impact of the risk but also the risk appetite of the organization and its owners. The same risk can be viewed differently by two different groups, which can affect the choice and appetite for different mitigation strategies. For example, many companies choose to self-insure themselves against worker compensation claims while others buy insurance from an outside vendor.

For risks that an organization chooses to mitigate, the next decision is to agree on appropriate policies and approaches. Generally speaking, these fall into five different categories:

1. **Avoid.** Redesign the process or eliminate certain activities to avoid particular risks, with the aim of reducing overall risk. Many of the innovations in supply chain management over the last two decades have sought to reduce the risks of tying up too much capital in inventory and ensuring that risks of stock-outs or surpluses are avoided.
2. **Diversify.** Spread the risk among numerous assets or processes to reduce the overall risk of loss or impairment. Examples include building redundancy into communication networks and control systems, or backing up business-critical data.
3. **Control.** Design activities to prevent, detect or contain adverse events or to promote positive outcomes. An example would be to demand positive verification that a person’s bank account has adequate funds in it before processing a payment as opposed to performing this check after the payment has been cashed.
4. **Share.** Distribute a portion of the risk through a contract with another party, such as an insurance company. Numerous examples of this approach can be found; the recent trend of investor groups combining their resources to make acquisitions is a good example.
5. **Transfer.** Distribute all of the risk through a contract with another party, such as outsourcing or factoring.

Deciding on and implementing a risk mitigation strategy is not the end of the process. The effectiveness of the chosen strategy needs to be measured and, if necessary, the strategy must be modified. Also, risks do not remain static. Risk management processes must adapt constantly to the changing risk profile of the organization as well as to changes in the organization’s risk appetite.

Effective risk management is no longer optional; it must be an integral part of any performance management process. Improvements in the ability to predict future performance—either positive or negative—offer managers the most valuable commodity of all: time to think and act.

Liberating finance professionals

Despite two decades of investment in enterprise systems, data warehouses, best practice processes and business process re-engineering, finance staffs still spend far too much time on the routine and mundane, and too little time developing insightful analysis to support effective decision-making. Benchmarks consistently estimate that 60%-75% of professional staff time is poorly utilized. Again, much of the blame lies in the failure to complete the “last mile.” Professional staff time is still consumed by:

- Digging for data sourced from myriad disparate systems—some of them still manual
- Organizing data into spreadsheets to validate accuracy, drive reporting and facilitate analysis
- Creating numerous offline ad hoc reports using Microsoft® Word, Excel® and PowerPoint®
- Performing routine error checking, auditing and compliance tasks

For all the automation of basic transaction processing and accounting, the tools that many finance professionals use to analyze such data have barely changed in 25 years. Excel has replaced some of the earlier spreadsheet products, but that's about it! It doesn't have to be that way. The last few years have seen tremendous advances in technology support for end-user reporting and analytics. Today, no finance professional should be spending time digging for data, organizing it into spreadsheets, checking every number for accuracy and then extracting the results and dropping them into a pretty PowerPoint presentation. Professional staff time should be spent on developing insightful analytics and engaging in meaningful discussions with decision makers.

The good news is that the cost to implement such tools and the time to value have both dropped dramatically. Even relatively small organizations can justify the investment and as the Time Warner and Cellular South case studies illustrate, realizing real value in 90 days or less is now the norm.

So what does the "last mile" look like for finance? Simply put, it means providing finance professionals with the time, tools and technologies that enable them to devote more than 75% of their time to business analysis, decision support and risk management. In practical terms, it means:

- Eliminating all manual handoffs in the collection, validation, reporting and dissemination of information
- Tightly integrating analytic toolsets with core business information systems to allow for fast, easy and accurate access to data
- Developing effective monitoring and early-warnings systems that quickly direct professionals to areas of opportunity or threat
- Embedding control and compliance policies, practices and metrics into all operational processes so that confidence levels are high and exceptions are immediately identified
- Investing in the attraction, development, retention and rewarding of talented finance professionals

The benefits of liberation are compelling: productivity can be tripled; the best talent is retained; risks are more effectively managed; reporting is both timely and focused; and, most important of all, analysis delivers insight and direction that drive smarter, more confident decision-making.



Preferred allocation of professional finance staff time.

Conclusion

Talented finance professionals are scarce. Squandering such talent is not just inefficient, it is negligent. In the flat and globally connected world, the most successful organizations will be those that effectively utilize all their resources to make smart, fast decisions, which are then executed with precision and confidence. Integrity of reporting, assured compliance and insightful analytics are vital tools, not just for leadership but for survival. Building the “last mile” to finance value is no longer optional, it is imperative.

Time Warner: Using Automation to Improve Confidence, Quality and Productivity

Time Warner Inc., the parent company of Time Inc., HBO, Turner and Warner Bros., is a \$26 billion media company. Until early 2009, the corporate financial reporting team spent a significant amount of time working with large spreadsheet models and Microsoft Word templates to compile the firm’s quarterly and annual reports (10Q and 10K). Professionals in the corporate reporting group spent many hours every reporting period ensuring that the right data was collected and located in the correct place in the reports, then making sure that the extensive narrative that accompanies the financial statements was complete. It was a slow and tedious activity.

The inefficiencies were clear, so the company started to look at possible systems solutions. At the same time, the Securities and Exchange Commission (SEC) introduced rules mandating that public companies submit quarterly and annual reports using the XBRL (eXtensible Business Reporting Language) common reporting format. As Mark Lelyo, Executive Director of Corporate Financial Systems at Time Warner commented, “We now had added incentive to find a solution.”

Remarkably, less than three months after making the decision to implement Clarity’s FSR™ system, the company successfully submitted its first 10Q to the SEC in April 2009. Since then, adoption has moved ahead at a rapid pace. The company now uses FSR for its annual 10K report including the Management Discussion & Analysis (MD&A), developing quarterly earnings press releases, and for producing a number of internal management reports. The company’s UK operations will also be using the tool for local statutory reporting. In the near future, the company plans to expand usage to financial planning and analysis and offer the tools to each business unit to assist in their own data collection and reporting activities.

The benefits have been threefold. First, the company has dramatically increased its confidence in the accuracy and quality of its reporting by being able to ensure the consistency and integrity of both numbers and associated text on a repeatable basis. Second, the time taken to compile the reports has been reduced by two days, allowing the corporate function to give more time to the business units to complete their own reporting and review processes. Finally, and perhaps most significantly, staff in the corporate reporting group have been liberated from much of the less value-added tasks of manual collection, collation, organization and validation that previously consumed such a large amount of their time. As Mark Lelyo commented, “We can now increase our focus on content and interpretation, rather than making sure the numbers tick and tie.”

Time Warner’s automation of its corporate reporting is a wonderful example of a finance team completing “the last mile” to deliver real value through the application of technology.

Cellular South: Focused Analytics Driving Growth

Cellular South is the largest privately owned wireless company in the United States, primarily serving customers in Mississippi, Alabama, and Tennessee, yet the company must compete with industry titans AT&T, Verizon and Sprint. Up until late 2007, the company relied upon an aging general ledger as its primary information source. This severely constrained the company's ability to complete timely and rich reporting and analysis in a rapidly changing industry. With the rise of the smart phone, dramatic growth in data usage and the increasing popularity of pre-paid cell phone plans, the industry was rapidly becoming more complex. All this was happening at the same time as the country was experiencing its worst economic downturn in decades. Undeterred, the team at Cellular South embarked upon an ambitious and rapid program to upgrade its systems and enhance its analytical capabilities.

“Less than three months after the project kicked off we were building our budgets in the new system”.

*—Justin Croft, Manager of Financial Planning and Analysis,
Cellular South*

The first task was to replace the general ledger to provide a more robust and flexible accounting solution. Next up was providing a sound platform for financial reporting and budgeting. In 2008, the company selected the IBM Cognos® TM1 enterprise planning software. As Justin Croft, Cellular South's Manager of Financial Planning and Analysis explained, implementation was rapid. “Less than three months after the project kicked off we were building our budgets in the new system,” he said.

Not only did the new systems eliminate much of the tedious manual manipulation and reporting of data but they also provided the company with the rich, multi-dimensional view of the business that was essential for successfully managing growth in a fast-changing industry. For example, the company is now able to analyze the changing balance of voice and data usage that the rapid adoption of smart phones is driving at the individual customer level. Modeling alternative scenarios for such usage has allowed Cellular South to ensure that its data plans are both attractive to customers and profitable.

Developing a more detailed understanding of customer profitability has had a direct impact on the company's ability to meet its primary goals of customer growth and retention. As Croft explained, “We can now model customer profitability based upon the type of device they use, the plan they have and their pattern of usage. That gives us great information to support our negotiations with handset providers and also allows us to increasingly tailor plans to the needs of the individual customer.”

Moving beyond financial reporting, budgeting and analyzing customer profitability, the company has expanded its use of analytics to develop a revenue forecasting model and is now working on a cost of goods sold model that will allow the company to better understand the economics of different handsets. In less than three years, Cellular South has become a nimble and sophisticated user of analytics while also successfully liberating many of its staff from tedious data collection and reporting tasks—a great example of a telecommunications company that is successfully covering the “last mile.”

Dorel Industries—Global Integration through Technology

Until 2007, Dorel Industries, a \$2 billion consumer products company, relied a great deal on the use of increasingly complex spreadsheets to move information between its many divisions and the corporate headquarters in Montreal. It took a long time, was not necessarily consistent across all divisions and provided reduced visibility. As Ian Farthing, Dorel’s VP of Corporate Services commented, “a seemingly simple question such as “How much business do all our divisions do with Wal-Mart globally?” could only be answered with manual effort and the aggregation of spreadsheet data.” With Dorel growing through acquisition and expanding its global footprint to more than 60 countries, a better solution was needed.

The push for change came not only from Finance but also from Operations; the lack of consistent, high quality information was handicapping decision-making. Dorel got to work implementing IBM Cognos Business Intelligence and financial consolidation (IBM Cognos Controller) solutions and things soon looked a lot better. Management now had greater confidence in the consistency of management and financial information; visibility into sales and expenses was greatly enhanced; and weekly sales forecasts from each division were now automatically compared to expectations, and alerts were generated when material variances were identified. This compared to often waiting for monthly results to be completed to see how all divisions were doing across the company.

The biggest challenge during implementation was not the technology. As Farthing explained, “There was a large learning curve for our U.S.-centric IT team in getting to grips with the different ways Dorel did business in its global markets.” Looking forward, Farthing wants to refresh the company’s dashboards. “Our current measures are too backward looking,” he said. “We need to try and develop forward-looking measures that can help direct more predictive analytics.”

Dorel illustrates the importance and value of successfully integrating the information flows across a complex global organization in order to make more timely decisions in an increasingly volatile world.

About David A.J. Axson

David A.J. Axson is a consultant and author of *The Management Mythbuster* (Wiley 2010) and *Best Practices in Planning and Performance Management* (Wiley 2010). He is a former Head of Corporate Planning for Bank of America and was a co-founder of The Hackett Group. Axson has been an advisor to IBM since 2006.

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