MORE STRATEGIC CFOs?

Corporate performance management provides a way for finance executives to unify decision makers and move their businesses forward.

By **PAUL A. SHARMAN**

Does the following conversation between a CEO and her CFO sound familiar? If so, does it cause you any anxiety?

A CEO is asking the CFO: "Because we have dramatically increased production to meet our growth goals, we need to be confident that our pricing strategy is optimized. What can *you* do to ensure that we make the right pricing decisions as we roll out our marketing campaign internationally? Next month, the board wants to see how each potential decision will affect overall earnings, cash flow, and share price. And before I bring anything to the board, I want to know the risk exposure for each scenario."

This true-to-life example reveals three imperatives that finance executives need to prioritize to expand their role in shaping their businesses' most critical decisions. Specifically, CFOs need to:

1. **Enhance** organizational alignment by integrating planning and reporting to create "one version of the truth" that unifies all decision makers,
2. **Facilitate** informed decision making to increase organization value, and
3. **Manage** the impact of change and volatility to ensure stability and business growth.

Corporate performance management (CPM) software solutions can help address each imperative. (For more information about CPM, see "Creating Value with CPM" by Paul Sharman in the March 2016 issue of *Strategic Finance*.)

Imperative No. 1: CFOs need to enhance organizational alignment by integrating planning and reporting to create "one version of the truth" that unifies all decision makers.

Accounting has changed to keep in step with how business has evolved around the globe. For example, when the economy was driven largely by manufacturing, management accounting and executive decision making were more predictable. That's because businesses operated within the bounds of manufacturing capacity and the speed at which that capacity could be increased or decreased. Today, in contrast, 84% of the world's capital value is related to service industries, fueled by intellectual property (IP) and intellectual capital (IC), which are empowered by technology innovation. (See "Manufacturing's Declining Share of GDP is a Global Phenomenon, and It's Something to Celebrate," U.S. Chamber of Commerce Foundation, 2012, and "8 Facts: Manufacturing's Shrinking Share of U.S. GDP," *The Globalist*, January 14, 2015.) As a result, the practice of accounting is evolving in response to the increased pace of change that accompanies a knowledge-driven economy.

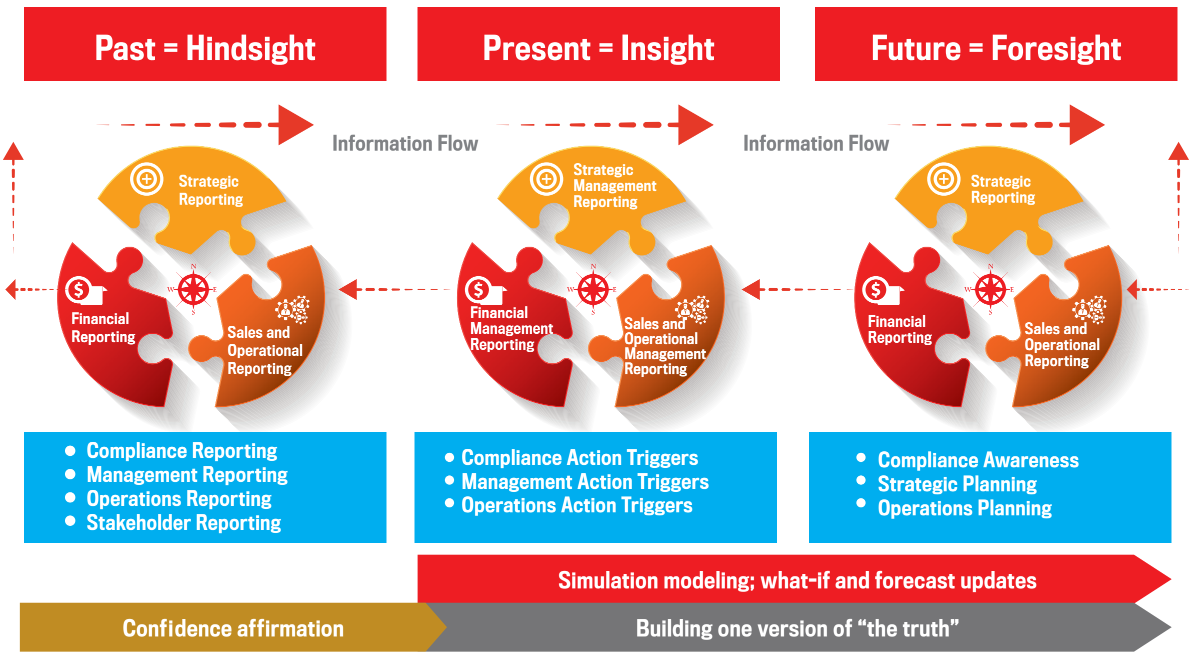
For organizations, that increased pace means that opportunities appear, mature, and disappear more quickly than ever. In this dynamic business reality, an organization's ability to survive and thrive depends on having instant access to data that's accurate, reliable, and up to date. Furthermore, to ensure strategic and operational alignment, that data needs to be uniformly understood and accepted—serving as a trusted foundation for action across an organization. In other words, decision

CFOs demonstrate their value as broad-thinking professionals who contribute to their businesses' overall health and longevity.

Figure 1:

THREE PERSPECTIVES OF PERFORMANCE PLANNING (FUTURE), MONITORING (PRESENT), AND REPORTING (PAST)

Creating one version of the truth for enhancing organizational alignment



makers at all levels will recognize the information because it comes from or is directly relatable to their own records.

CFOs play a key role in ensuring that such data—and the wisdom that it creates within an organization—is gathered, interpreted, managed, and put into action (see Figure 1). To do so, CFOs already tap into traditional financial reports that provide relevant historical context (i.e., *hindsight*). They can go one step further by compiling and interpreting key performance measures to generate true *insight* to use during planning. In practice, this would include implementing real-time communication of financial and nonfinancial indicators that would serve as an early warning system highlighting material variances so that senior management could take immediate action. According to Prophix CFO Darren Griffith, "The ultimate goal for the forward-looking CFO is to build on those insights by generating 'what-if' scenarios that span their organization's entire operations" (i.e., creating *foresight*). He adds, "Having this foresight in the form of up-to-the-minute forecasts transcends all budgets and serves to focus energies on ensuring that organizations achieve or exceed performance commitments in the short-, mid-, and long-term." CPM solutions provide CFOs with such foresight, bringing them to the strategy-setting table and giving them the ability to champion organization-wide alignment.

By increasing organizational alignment through integrated planning and reporting, CFOs demonstrate their value as broad-thinking professionals who contribute to their businesses' overall health and longevity. To ensure their ongoing success in this role, CFOs need to develop *pan-organizational* views. This becomes the next CFO imperative. For example, in the case of our opening CEO/CFO situation, the ways in which the CFO can respond to questions from the CEO and board of directors are dramatically different from the past. Historical data from both operating and financial systems is already accessible and reconciled in CPM, which makes it available to rapidly perform powerful simulation modeling and multiple what-if scenarios for different options, including assessing various possible risks.

Imperative No. 2: CFOs need to facilitate informed decision making to increase organization value.

Whether CFOs oversee the finance area at a for-profit organization where their focus is on optimizing future discounted cash flow or at a not-for-profit organization where they are concerned with managing operating income and maintaining required reserves ratios, the core of what they do is to ensure that their organization creates value.

But CFOs also find themselves under pressure to help shape decisions about how to allocate available resources that have organization-wide consequences *without* being able to adequately validate underlying assumptions. For example, the CEO and CFO in our opening scenario may have to make a series of assumptions about the future in order to provide ranges of possible outcomes to inform their decisions. In Burlington, Ontario, Canada, in the same meeting of elected officials where they debate and approve the proposed annual budget, finance staff provide a 10-line driver-based 20-year tax rate simulation model premised

HOW INTERSTATES COMPANIES USES CPM

Operating since 1953
Head office: Sioux Center, Iowa
Employees: 500+
Annual revenue: $100 million+

Using spreadsheets to conduct its financial processes manually caused numerous challenges for Interstates Companies, an electrical engineering and construction group. The biggest challenge stemmed from the need to consolidate the financials for all of its 11 companies because each one had separate divisions. This caused significant frustrations when it came to tracking down data, reconfiguring broken formulas, and accommodating changes. Then the company's accounting department chose a corporate performance management software that, over time, would do more than automate the budgeting, forecasting, and reporting.

Personnel and Capital Expenditure Planning. Interstates Companies builds its personnel plans using CPM software, factoring in a range of important detailed information, including names, annual and hourly wages, bonuses, divisions, departments, and health insurance types. This gives the company a true depiction of staff turnover and payroll costs by department as opposed to a strictly consolidated view. The organization also conducts CapEx planning, with budget owners drilling into each line item and setting out their projected capital expenditures. The accounting group then sets approvals and preapprovals related to these planned purchases. If Interstates Companies hits certain revenue targets, the department managers receive related approvals for their desired expenditures, such as electrical tools, computers, office furniture, office remodeling, and other renovations.

Utilization Planning. The accounting group uses CPM software to generate benchmarks for employee productivity and for the company's overall performance. This allows them to project the revenue these employees can generate for Interstates. Evaluating job hours using CPM also ensures that these same employees can perform the work without being overworked. That way, Interstates employees aren't forced to take shortcuts or unnecessary risk and therefore compromise quality or their own performance.

Job Costing. Interstates' accounting experts use CPM software to calculate overhead costs related to different divisions and determine the amounts that should be allocated to each job hour. This means that employee wages and benefits get allocated to jobs and integrated into the costs/rates proposed or charged to customers.

Performance Reporting. Interstates Companies produces financial reports that analyze the differences between targets and actuals to track alignment with annual budgets. It also uses its CPM tool to drill across functions to investigate anomalies in their enterprise resource planning (ERP). And Interstates has created reports that track the gap between the company's revenue to date, backlogged revenue, and the revenue that the company has targeted for the future.

Strategic Planning. The analysis and numbers in the financial summaries from Interstates Companies' CPM tool tie into the strategic corporate plan. Each company under the Interstates Companies umbrella has a five- or 10-year plan. Information developed in the CPM helps build those plans—and allows the organization's accounting group to evaluate progress.

These companies are part of Interstates:

1. **Harbor Group,** parent/holding company
2. **Interstates Construction,** electrical installation (mainly industrial, some commercial)
3. **InterFab,** prefabrication of electrical components for electrical installation
4. **Interstates Control Systems,** electrical automation and design
5. **Interstates Engineering,** electrical engineering and design
6. **Harbor Consulting Group,** small business leadership consulting
7. **Interstates Instrumentation** (recently dissolved and merged within Interstates Construction and Interstates Engineering), did electrical instrumentation design and installation

The rest of the companies that make up Interstates Companies are small subsidiaries of the above companies. They perform work similar to that of their parent companies.

on assumptions about salary, inflation, capital spending increases, and debt servicing costs, along with commodity, legislation, service level, and cost improvement changes. The simulation provides a benchmark for anticipated inflation rates and has the effect of halting any ambitions the elected officials may have to introduce new programs in the budget under review.

To address this challenge, CFOs are stretching beyond their comfort zones and acting more like orchestra conductors—pulling out the best data/insights from across departments, business units, and office locations. In doing this, they reveal the short- and long-term impact of poten-

5 TIPS FOR CHOOSING A CPM SOLUTION

Most growing organizations find that spreadsheets have limited capabilities when it comes to budgeting, planning, and analyzing data. According to Gartner's 2014 Magic Quadrant for Corporate Performance Management Suites, "CPM Suites facilitate efficient, compliant and transparent processes within the office of finance. They enable CFOs and other business leaders to effectively guide strategic direction and increase organizational agility."

There are many options, features, and capabilities to take into consideration when selecting a CPM vendor. Here are some of the essentials:

1. Scope of Functionality
As you evaluate CPM solutions, consider your current needs or an existing business challenge but also what the organization may need in the future and the ability to add functionality with ease.

Gartner identifies five critical components of a CPM suite:
- Financial consolidation and close management;
- Financial and management reporting and disclosure;
- Budgeting, planning, and forecasting;
- Strategic planning and forecasting and strategy management; and
- Profitability modeling and optimization.

2. Reports
Producing and automating accurate, visual, and detailed financial and management and operational reports is one of the greatest advantages to implementing a CPM solution. In addition, an integrated CPM system allows for dashboards and scorecards that capture critical views of your business performance at a glance and that are constantly available on decision makers' smart devices and PCs. These visual indicators provide early warning signals and highlight variances between actual and plan performance indicators for strategic and operational goals, suggesting the need for corrective actions where necessary.

3. Budgeting, Forecasting, Simulation Modeling, What-if Analysis, and Strategic Planning
CPM provides the ability to create either simple or very complex future scenarios to improve business analysis, respond to risks and opportunities, provide agility, gain efficiencies, and drive creation of business value. Rather than uploading budget data into the general ledger to automate reporting and variance analysis, actual results are downloaded from the general ledger and all other operating systems into CPM to automate all reporting and comparative analysis. Doing so can provide access to years of historical data, making it always available for performing long-term simulation modeling, budgets, on-the-fly forecast updates, and decision-critical what-if analysis.

4. User Experience
The user interface should be an important component in selection criteria. The easier it is to navigate the software, the more likely adoption will be quick and smooth. Leading vendors are focused on the end user to deliver an experience similar to consumer applications.

5. On-premise, Cloud, or Hybrid Implementation
Consider how your organization prefers to access data if it is cloud-based, on-premise, or a hybrid of both options. There can be a debate on the merits of these implementation strategies, but having the choice allows you as a customer to implement seamlessly with current infrastructure, reduce implementation time, and realize your return on investment (ROI).

tial opportunities and business risks. The result: CFOs boost their ability to increase organization value. Finance automation tools, such as CPM software, are empowering CFOs to thrive as conductors and ensure that their organizations continue to create value by allowing decision makers the opportunity to look into the future and reach conclusions about the probable outcome of any number of potential scenarios, each one assessed by the CFO presenting different properly constructed what-if scenarios.

SLG's Story

The Finance Department at Belgium's Senior Living Group (SLG) is continuously guiding, facilitating, and sharing information throughout the organization to increase the company's value.

It leverages CPM software to automate core business processes and maximize resident occupancy and staff utilization across SLG's 55 retirement homes (housing 6,300 residents), resulting in ongoing and rapid growth. For example, SLG tracks occupancy and staff availability across all of its locations on a daily basis. This includes conducting variance analysis of how many beds the company is licensed to fill and how many beds are actually occupied. If occupancy drops below 97%, the CPM system automatically "red flags" the number for members of the Finance Department. A "red flag" or early warning signal will most likely cause the finance function to perform an on-the-fly forecast update incorporating revenue, cost, and profit expectations along with analysis of marketing projections of likely new client arrival dates. That, in turn, would cause executives to issue instructions to managers across the organization to adjust staff levels and purchases of food and services at each affected location.

SLG's Finance Department reinforces its role as a conductor by gathering data from across the organization. For example, by lay-

CFOs have to look outside the finance area in order to harness data about the market, business operations, and critical business drivers.

ering CPM software on top of its enterprise resource planning (ERP) software and operating systems, Finance gains insights about its financial and operational performance. As SLG grows through acquisition, Finance builds budgets, prepares rolling forecasts, builds multiyear plans, and performs simulations that look years into the future to help SLG with its plans and focus.

SLG also gauges its overall performance on demand in order to fulfill all of its diverse reporting needs, including consolidation requirements as defined by Belgian laws, International Financial Reporting Standards (IFRS) public company reporting standards, and key performance indicator (KPI)-driven operational goals. Additionally, SLG leverages a financial consolidation view that offers detailed reporting for all of its entities, including a snapshot of how much cash they hold at any given time.

By adopting the role of conductor, the Finance Department ensures that SLG is constantly creating and increasing value.

Imperative No. 3: CFOs need to manage the impact of change and volatility to ensure stability and business growth.

Increasing strategic and operational alignment, as well as driving organization value, is essential for any ambitious organization. But underpinning both is the ability of a CFO to ensure growth despite ever-increasing levels of risk and unpredictability. This is the most important CFO imperative.

Businesses in all industries are facing a tidal wave of change, risk, and instability that threatens their ability to survive and thrive. Conditions external to a business, such as competitors' activities, rapid technological advancement, fluctuating currencies, and shifting government-imposed regulations, contribute to the challenges today's organizations face. Meanwhile, conditions within a business, such as equipment failures, slow product innovation, or pricing strategies that are out of touch with the market, lead to reduced earnings and cash flow.

When CFOs recognize these conditions as being the "new normal," they play a key role in ensuring the longevity of the business. To manage their businesses under these new conditions, CFOs have to look outside the finance area in order to harness data about the market, business operations, and critical business drivers.

According to Darren Griffith, CFOs can take very specific steps to ensure that their organizations are more resilient during times of great volatility. Among the steps that he recommends are:

- Use rolling forecasts to anticipate performance based on current and changing conditions rather than adhering to budget commitments.
- Perform sensitivity analyses and frequent on-the-fly forecast updates.
- Implement early warning systems by aligning planning and management control systems that monitor risks that impact planning assumptions.

To do this effectively, CFOs need to:

- Equip finance staff with the technology tools, time, and skills to undertake detailed business analyses, reporting, and simulation modeling.
- Develop contingency plans (and financial reserves) to increase resilience.
- Encourage a "change readiness" culture.

Forging Ahead

Today's CFOs are highly skilled and committed to seeing their organizations thrive. By enhancing organizational alignment, facilitating informed decision making, and managing the impact of change to ensure continued growth, CFOs guarantee their organization's short- and long-term success. How would that play out for the CFO and CEO in the opening scenario?

CFO to CEO: "I have the answers you and the board need. The good news is that we can be confident in our decisions. Here's why: We have been leveraging a CPM solution to conduct forward-looking what-if analyses—anticipating those factors that are most likely to have the greatest impact on production, distribution, and sales. In doing this, we've identified and ranked potential risks as well as ways to mitigate them. In part, that was made possible because the Finance Department has been conducting frequent forecasts and driver-based cost modeling. As a result, we understand revenue and inventory projections for each of our product SKUs [stock keeping units] by market segment. At the same time, we have produced consolidated financial statements for profit and loss, balance sheet, and cash flow as well as potential impact on share value. Now that you know that, let's get to the specifics."

Does this sound like your CFO? **SF**

Paul A. Sharman is president of Focused Management Information Inc. and is a consultant retained by Prophix Software Inc. as a thought leader. You can reach him at **psharman@focusedmanagement.com**.