

A Personal Case Study: A CFO's Perspective on Business Performance Management

Academics, consultants, and vendors often define and describe business performance management in theoretical terms, while practitioners experience and develop the discipline in the real world. A former CFO of Fortune 500 multinational corporations describes anecdotally where BPM has come from, and where it's going.

by Blythe McGarvie



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THE DANISH PHILOSOPHER Søren Kierkegaard wrote, "Life can only be understood backwards; but it must be lived forwards."

If the most ardent advocates of any new ideas are either those who've conceived them or those who've used them — to their success — then I classify myself in both camps when it comes to business performance management (BPM). As a finance executive who has dedicated her career to improving BPM processes — both as an auditor in a public accounting firm, an executive in private industry, and now as a member of several boards of directors — I consider myself an accidental pioneer in some respects: Accidental, in that my expertise, like that of the BPM discipline, evolved as a matter of necessity, and pioneer because I've worked to introduce in a real-world way new methods of effectively managing complex businesses.

Aided by advances in technology, which have helped us achieve more accurate results in less time, executives like me have built a body of work that has come to be collectively known as BPM.

During the early days of this discipline, my peers and I developed tools and techniques to better operate and manage our businesses, especially in the area of corporate financial



reporting. Today, BPM represents a significant opportunity for managers to achieve strategic business and financial goals. As businesses today must respond to a more challenging and complex business, economic, and regulatory environment, it is clear we are on the cusp of a new era in which financial efficiency and integrity require even more attention to process.

Understanding how finance and accounting processes have changed in the last 30 years provides an appreciation of the benefits of BPM, as exemplified in exhibit 1. During the 1970s and 1980s, mainframe-based multi-dimensional technologies drove decision support systems (DSS), which created rough models for future planning. Functional managers in finance, accounting, operations, and marketing were limited in their analysis to considerations of distribution channel, customer, and product line. The evolution of DSS into executive information systems allowed companies to analyze and evaluate their organizational strengths and weaknesses. By the 1990s, business intelligence (BI) accelerated developments and improved planning, reporting, and analytical processes. Greater data accessibility through client/server and now Internet-enabled technology has increased efficiency, yet challenged management in the areas of data integrity, uniformity, and control. As we move to an even more dynamic and open environment, balancing performance management benefits with controls becomes even more challenging.

BPM's Evolution Personified

My career in accounting, finance, and now consulting and as a member of boards of directors, has tracked the evolution of BPM. I've grown along with this important discipline, and applied the lessons I've learned from it to every new challenge I've taken on. As Kierkegaard suggests, being an accidental pioneer in all of this, I wasn't able to tie it all together — nor to understand its significance — until well after the fact.

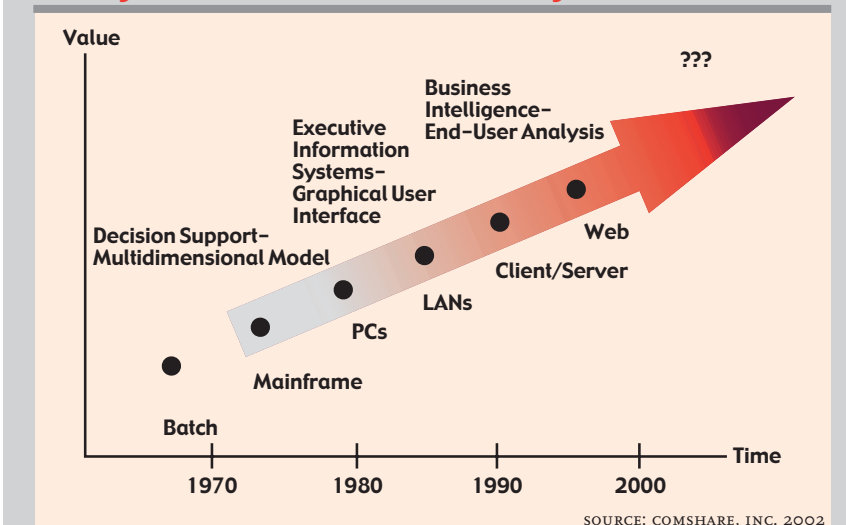
Analytics' early days. In the early 1980s, while working as an auditor for a Big Eight accounting firm, one of my earliest BPM initiatives was a project I managed for Marshall Field & Co., the famous Chicago department store.

Department store sales depend upon maintaining the inventory the customer wants to buy. Although this maxim was well understood, the store's inventory management system was hopelessly antiquated and not even close to being accurate. All of the inventory valuation data was manually noted on long strips of paper that were taped to the backs of the same bags customers used. The inventory was valued using LIFO (last in/first out), which requires strict accounting of the different layers of cost from each quarter and for each category of inventory. The company maintained 21 different categories, such as towels, shoes, and fine art. Some of the inventory moved slowly and would be in the store for many months. Instead of having this information on a report from a computer mainframe or on a worksheet that merchandisers could easily analyze, the inventory values were treated merely as data, not as actionable, strategic information. Of course, human intervention and observation from walking the store would provide some input on what to offer the consumer, but if ever there was a need for improved processes, this was the case. The millions of sales transactions created the need for in-house accounting to develop and use DSS to analyze and control the business by distribution channel, customer, and product line.

As an auditor, I observed the company develop and implement their systems to allow them to better track and manage their business. The installation of a computer system gave Marshall Field's management better and quicker information about their sales and their customers. The difficult part was that the employees were not accustomed to the new system. Changing from a well-known procedure to a

Exhibit 1

Changes in Finance and Accounting Processes



The problem of being an early adopter of new systems was that the more draconian the result of the analysis, the greater the doubt among decision-makers about the data and our analytical methodology.

new one is never easy. To ensure that the new system accurately compiled information, we tested the computer reports for accuracy. A professional, called a comptometer, had a special 12-digit machine that allowed her to add volumes of information and data and compare the result to the computer total. This position no longer exists, but at the time it served to validate and provide assurance that the information could be used and considered accurate for analysis. The accounting department and auditors exerted considerable manual effort to create an environment of acceptance of the new systems.

Technology is not needed to control and record assets; rather, the value of technology increases the more it facilitates effective analysis and decision-making. It would be unthinkable to do business today using information only accessible by manual cards. The same can be said for companies that keep their information segregated into different systems. Bringing both together, using historical data and forecasts, is a natural step in the evolution of using BPM for competitive advantage.

Integrating reporting and planning. In the late 1980s, personal computers allowed easier access to historical information and the flexibility to run “what-if” scenarios. At the time, I was a manager of accounting at Kraft Foods. The team worked closely with the marketing managers to provide information that they could use easily and in a way that could be actionable. The objective was to use the most recent information, organized by product category and by customer, to determine which products and customers were driving — or dragging — profitability for the division. With disparate systems in production, sales, and finance, and data in each varying in terms of its level of detail, data interfaces were developed and a degree of data commonality was established. From a profit perspective, direct costs were identified while indirect costs were segregated and allocated.

Most of this analysis was done by writing SQL queries, which accessed the data stored in the mainframe. In fact, my boss was pleasantly surprised to see that I could download the information to a PC and manipulate it so that the marketing department could view the analysis with descriptions familiar to it rather than with arcane names only known to the operations or financial analysts.

At the time, it was pioneering and exciting for finance to work so closely with marketing and operations to develop product line profitability reports using SQL models and queries. The historical information easily linked with the forecasts, which supported decision-making to improve the profitability of products and customers.

The problem of being an early adopter of new systems was that the more draconian the result of the analysis, the greater the doubt among decision-makers about the data and our analytical methodology. It was one thing to develop reports and recommendations, and quite another to convince key executives that we needed significantly less inventory, or that we needed to eliminate poorly performing products. We therefore eliminated only the most obvious loss makers at the direct-cost level. Once we refined the process to include sales data and trends, it became more obvious when a manager should plan to eliminate or change a product. Conversely, when sales and profits were expanding, managers could more aggressively support the product on the upside.

Planning meets budgeting. It wasn't long before the power of our planning capabilities was put to use in Kraft Food's annual budget process. For the first time in my career, budgeting became a more integrated, holistic, and foundational business-management exercise. Strategy was determined through the budgeting processes, and compensation incentives were married with business objectives.

Finance, marketing, sales, and operations worked to analyze and determine the key drivers in a given market, including economic and competitive analyses. The teams created a model that identified the sales and profit from the core business, new products, cost reductions, and new markets or distribution channels.

The difference between the model's calculated sum of the company's current attributes and the target management had established for the business represented Kraft Foods' first gap analysis. It showed what the business growth would be derived from de novo efforts, and what would be required from unplanned initiatives, such as acquisitions, to achieve our goals. This was an early form of strategic BPM, and it forced the question of how the

company would accomplish its performance objectives within the one-year annual budget timeframe.

It was fascinating to see what were once planning and budgeting tactical considerations play out in the larger world of organizational strategy. In 1988, Kraft Foods faced a classic early BPM situation — one that ultimately worked against it — with its Duracell division. Like its battery company competitors at the time, Duracell wrestled with excess inventory, deep discounting to current markets, and disruptive pricing, also known as dumping, to nontraditional gray markets. After considering the division's prospects in the context of the companies overall objectives, the decision to divest of Duracell prompted its sale in a leveraged buyout to management, yielding \$550 million in cash.

Deciding how to reinvest the profit from the sale in order to increase the return on investment for the company became one of the key budget issues of the year, but its urgency wasn't understood until it was too late. At the end of 1988, Philip Morris acquired Kraft Foods, which included the tidy sum of cash on its balance sheet.

The moral of the story is that time does not wait for management to make the right decisions. It's one thing to analyze and evaluate, and quite another to take action. Those organizations that are strong in analysis, but weak in turning information into action, may find that other organizations with their own BPM strategies will make decisions for them.

The CFO Role and BPM

As roles and responsibilities within large organizations change and grow over time, the stakes get higher. Thanks in large part to the breadth and depth of experience I had attained working in budgeting, reporting, and planning and analysis, I was prepared to take on higher-level challenges, this time as the CFO for Hannaford Bros. Co., a Fortune 500 supermarket retailer.

When I joined the company, it was expanding aggressively into new markets and investing in new store locations. As we developed new stores, certain sales levels were assumed, especially in the early years; these assumptions were critical to our analysis as to whether the capital investment would achieve the expected return. These sales levels were used to justify the capital investment decision, so I argued the same sales levels should be used for the annual budget. Once it was understood that the capital investment analysis and budgets — on which bonuses were based — were tied together, sites became harder to justify but the business performance measures began to consistently meet our expectations.

Even today, many CFOs admit that the link between capital analysis and budgeting is often weak or nonexistent. Only by being consistent is it possible to remove the obstacle of making the balance sheet and investment decisions as real to operating managers as the P&L.

Empowering line of business management through timely reporting became an important new initiative, as the competitive environment required faster, more informed decision-making. We also realized that we needed to improve financial reporting so that managers would have easier and faster access to the monthly results. The goal was to react to the competitive-market situation faster.

We tackled head-on the need to replace a 10-year-old general ledger with many customized adaptations no longer supportable by the original vendor, with a more flexible, real-time, intranet-based system. To some, this type of an initiative was viewed narrowly, as merely a general ledger upgrade. But it soon became apparent to everyone that the end result of improved financial reporting was to help others better understand the business so that it could grow more profitably. The goal was to make information available quickly and easily to those who needed it.

The cost savings appeared rapidly. One month after installation, the accounting department stopped mailing monthly reports to more than 200 locations. After the first few months, the new system was accepted and its importance grew. It inspired accountability and became the foundation for more efficient processes. Each department head became empowered to make more effective decisions with positive benefits to improving operations for our customers.

Extending BPM beyond finance. As a new CFO in the supermarket business, I quickly realized that a common industry practice to improve profits was to ship items from the warehouse

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to the store location since that was the point of revenue recognition. Most retailers, even with scanning at check-out, did not have the ability to record the exact profit at the point of sale since profit depended on the inventory value remaining in the store.

With more than 30,000 SKUs (stock keeping units) in a store, it was common to use a proxy of the inventory movement based on what came into the back of the house.

To develop a more exact system based on what was sold to the consumer at the front of the house, we created a seven-person task force from different functions to spearhead what became a significant and pioneering BPM initiative, something we dubbed the strategic information project (SIP).

At first, it seemed like an impossible task. In some meetings in which we discussed the type of cultural shift and the 9 gigabytes of storage space the SIP would require, the idea seemed to be all smoke and no fire. The project was complicated by the fact that if it worked, we would have to take a charge to the P&L for any phantom profit that did not exist in the store inventory, but which had always been assumed. On the other hand, by shifting our reporting to the more accurate profit from actual products sold, we would have a better idea of which products needed to be merchandised and at what price.

We held biweekly meetings. We planned how we could create and roll out the model in a few test stores to make sure the integrity of data existed. We identified the software vendors that could help build a model with such a granular level of detail. We decided what costs were allocated and what costs were direct. We began to assemble a picture of profitability by product and by category.

Once the system rolled out, the impact was significant. The extension of the disciplines — and lessons — learned in our earlier BPM initiatives to the SIP brought immediate and tangible benefits.

For example, many store managers never wanted to offer the more exotic and profitable vegetables because they argued they never sold. After the SIP was operable, it became evident that customers bought the higher-profit vegetables, but store managers needed to reduce the inventory of the slower moving, less-profitable items to improve their financial results. No one could argue with the information because it was clear what sold and at what profit. No longer would it be assumed that if high-profit items were sitting on the shelf, eventually they would be sold

and the profit would be recognized. The SIP analysis changed the way the store managers ordered inventory and how they did business.

Moreover, the initial fear of having to take a significant hit to the P&L as a result of having to adjust for phantom profits never materialized since the rollout schedule of a group of stores over an 18-month period moderated any big-bang effect. The transformation was completed in an orderly fashion.

Wrestling with BPM Failure

Although I've had some degree of success with BPM projects throughout my career, I've been involved in my share of failures as well. A BPM initiative — regardless of its size and scope — is challenging because it requires change. Because large enterprises are not characteristically known for their flexibility, BPM failures are still more likely to outnumber successes. That's why it's important to share our experiences and learn from our mistakes.

In this instance, our organization sought to transform its budgeting process and move toward the "beyond budgeting" concept, which is discussed by Jeremy Hope, Robin Fraser, and Steve Player in their article on page 18.

This was an exciting project since so much of the company's time was consumed with building an annual budget that in the last three years had not been achieved. A cross-functional team from our organization spent a day at

Pharmacia to learn how that company eradicated the budget and instead used quarterly forecasting for managing business and rewarding management. The company shared its experiences, even providing us with the reflections of what it would do differently if it was to do it all over again. The company was emphatic that we should hire a change management consultant because, as Pharmacia described it, this was a cultural change as much as a process change.

Unfortunately, the lessons learned at Pharmacia were not applied to our initiative. We thought we could cut corners and decided against investing in a change management consultant. We failed to break free from the old system and our annual budgeting process, which created more obfuscation than the intended simplification. Instead of eliminating the onerous annual budgeting process, we added to it an even more frustrating quarterly budgeting process. The most critical component to our failure was not having the president of the company relinquish control from the top. Instead of rolling up forecasts from line managers closest to the customers and the marketplace, we revised forecasts, which continued to emanate from the center of the company. The benefits of incorporating dynamic changes to assumptions and responses to competitive situations never materialized.

There are times when organizations simply do not have the luxury of managing a smooth transition from one system to another. Inertia, fear, culture, cost — whatever the impediment — even organizations that are convinced of the benefits of BPM may find circumstances can work against their initiative's success.


Business and Legal Implications

As my experiences testify, there is much more to BPM than reporting and budgeting. Although its genesis might be the general ledger, BPM's reach should extend far beyond finance. The benefits derived are obvious, but better business management is no longer a choice. In today's economy, it's a requirement.

The fact that BPM is de rigueur in business today was driven home when I read a brief job description for a CFO position at a Fortune 100 company (see *Requirements of a 21st-Century CFO* above).

It's obvious to me that it's assumed that integrated reporting and budgeting is already in place. It's assumed that the finance department works closely with all of the organization's stakeholders. It's assumed the CFO will work with all functions — worldwide — in developing and implementing strategies and tactics to balance growth and profitability to maximize value. A qualified CFO is expected to have experience administering, managing, and extending the discipline of BPM enterprisewide.

The increased legal risks and financial costs to operate as a public company represent additional rationale to extend BPM disciplines. As CEOs and their boards require more transformational skills from their CFOs, there is now an expanded legal liability for the board of directors if processes are not working. With increased director liability in place, a broader and strategic approach is critical at all levels of the company.

The next generation of accidental pioneers in BPM are already developing, implementing, and managing systems and processes that will make a growing universe of information actionable, not merely for the sake of compliance, but to better manage the business and operational risks inherent in their businesses in a complex, fast-changing world. 

Requirements of a 21st-Century CFO

The following excerpt from a major executive search firm's recent job specification indicates that there is much more to the CFO job than keeping the status quo.

The CFO will provide financial expertise and judgment to the CEO on a full range of long-term and short-term strategies, tactics, and issues to maintain the correct balance between growth and profitability to optimize shareholder value. Also, the CFO must work effectively with the board of directors. The CFO, with the CEO, must strengthen confidence and trust, and build relationships within the investment community. He or she will play a supervisory and coaching role in all merger and acquisition activity from identification through due diligence, negotiations, and integration aligned with strategic goals and objectives. The CFO must upgrade and integrate the company's various financial components into a cohesive, responsive function.

Among the highest priorities are:

- To become a valued adviser to the CEO and board of directors.
- Establish with the CEO a reliable and knowledgeable presence in the investment community.
- Get the right expertise in each function (tax, treasury, audit, etc.), develop people, and build an integrated, seamless financial team so that individual functions "disappear" as issues.
- Drive a worldwide effort to reduce costs and improve margins eliminating redundancy and waste across the board in line with the long-term plan and corporate growth and performance goals as set by the CEO.

Ensuring The Success of a BPM Initiative

In no certain order, here are a few recommendations that I would encourage any organization to consider to ensure a BPM initiative's success:

- Ensure the project has multiple champions, especially at least one from the most senior-level management.
- Plan for rapid change if resources are short and staffers are already stretched thin.
- Replace old systems and minimize phasing. Don't hang on to old, antiquated systems and processes.
- Integrate your data and extend BPM disciplines beyond a single function such as finance, operations, or sales.
- Follow a KISS (keep it simple, stupid) vision. Resist the tendency to overcomplicate a process to consider every last detail or possibility.
- Acknowledge the need for outside help, particularly a change management consultant who knows how to overcome resistance.
- Adhere to the timetable established in the beginning of the project to keep the energy and the interest level in the project on track.