

A Personal Perspective on Business Performance Management

A former CFO of Fortune 500 multinational corporations describes anecdotally where BPM has come from and where it's going.

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Aided by advances in technology, which have helped us achieve more accurate results in less time, executives have built a body of work that has come to be collectively known as business performance management (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 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 Figure 1. During the 1970s and 1980s, mainframe-based multidimensional 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 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 consulting and as a member of boards of directors has tracked the evolution of BPM. Being an accidental pioneer in all of this, I wasn't able to tie it all together - or to understand its significance - until well after the fact.

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 the famous Chicago department store Marshall Field & Co.

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 taped to 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 21 different categories of inventory. 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 action-

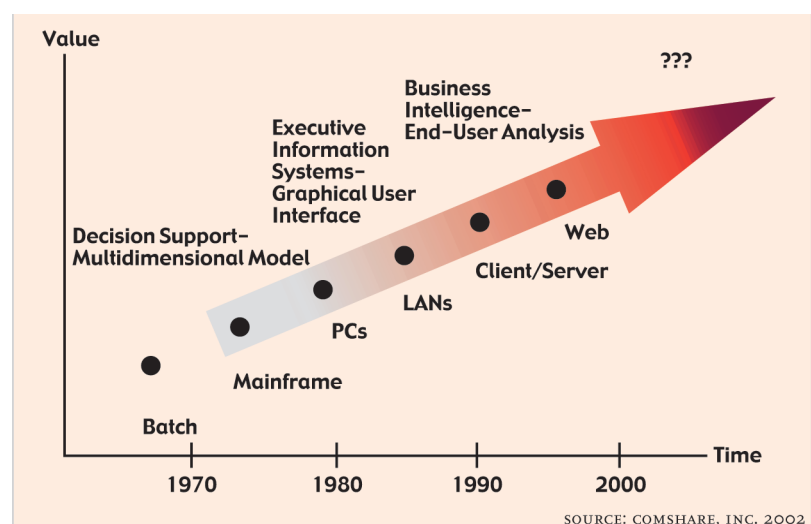


FIGURE 1 Changes in Finance and Accounting Processes

able, strategic information. The millions of sales transactions drove 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 as the company developed and implemented systems to allow management to better track and manage the business. To ensure that the new system accurately compiled information, we tested the computer reports for accuracy. A professional, called a computer, had a special 12-digit machine that allowed her to add volumes of information and data and compare the result with 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.

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Technology is not needed to control and record assets; rather, the value of technology increases as 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 they could use easily and in an actionable way. 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 varying levels of detail, 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. My boss was pleasantly surprised that I could download the information to a PC and manipulate it so the marketing department could view the analysis with familiar descriptions rather than with arcane names known only to analysts.

The historical information easily linked with the forecasts, which supported decision making to improve the profitability of products and customers.

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 problem with being an early adopter was that the more draconian the result of our analysis, the greater was the doubt among decision makers regarding the data itself 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. Therefore, we eliminated only the most blatant 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 to 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 that had been established by management represented Kraft Foods' first gap analysis. It 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 time frame.

It was fascinating to see once-tactical planning and budgeting 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 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 company's overall objectives, the decision to divest of Duracell prompted

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CHAPTER 1 STRATEGIES FOR SUCCESS

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 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. Organizations that are strong in analysis but weak in turning information into action may find that other companies with their own BPM strategies will make decisions for them.

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THE CFO ROLE AND BPM

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 of whether the capital investment would achieve the expected return. 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 meet our expectations consistently. Even today many CFOs admit that the link between capital analysis and budgeting is often weak or nonexistent. Only through consistency is it possible to make the balance sheet and investment decisions as real to operating managers as the P&L.

As the competitive environment required faster, more informed decision making, timely reporting became an important new initiative for empowering line-of-business management. We also realized we needed to improve financial reporting to give managers easier and faster access to monthly results so they could react to the competitive market situation more quickly.

The first step was to replace a 10-year-old general ledger (and its many customized adaptations no longer supportable by the original vendor) with a more flexible, real-time intranet-based system. Some viewed this as a simple general ledger upgrade, but it soon became apparent

that the end result would help others understand the business better and grow it more profitably.

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 customers.

EXTENDING BPM BEYOND FINANCE

As a new CFO in the supermarket business, I quickly realized that a common industry practice for improving profits was to ship items from the warehouse to the store location, i.e., the point of revenue recognition. Most retailers, even with checkout scanning, were unable 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 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 a significant and pioneering BPM initiative dubbed the strategic information project (SIP).

At first, it seemed like an impossible task. When 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. If the project worked, we would have to take a charge to the P&L for any phantom profit that did not exist in the store inventory,

ENSURING THE SUCCESS OF A BPM INITIATIVE

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 by considering 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.

but which had always been assumed. On the other hand, by having more accurate profit data, we would have a better idea of which products needed to be merchandised and at what price.

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 and brought immediate and tangible benefits. For example, many store managers never wanted to offer more exotic and profitable vegetables that, they claimed, never sold. After the SIP was operational, it became evident customers did buy 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. The SIP analysis changed the way the store managers ordered inventory and how they did business.

Moreover, the initial fear of having to adjust for phantom profits never materialized since the rollout impacted a group of stores over an 18-month period, thereby mitigating any big-bang effect.

BUSINESS AND LEGAL IMPLICATIONS

There is much more to BPM than reporting and budgeting. Although its genesis might be the general ledger, its reach should extend far beyond finance.

The fact that BPM is de rigueur in business today was driven home when I read a brief job description for a CFO position

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.

at a Fortune 100 company (see Sidebar, "Requirements of a 21st-Century CFO"), which assumed integrated reporting and budgeting was already in place. It's also 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. A broader and strategic approach is critical at all levels.

The next generation of accidental pioneers in BPM is 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 a complex, fast-changing world. ■