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CORPORATE FINANCE

DRIVING PERFORMANCE AND VALUE WITH FP&A

A Structured Approach to Business Performance Management

ABSTRACT

Doing business has never been more complex than in today's business environments. Uncertain worldwide growth, technological disruption, political unrest, and an increasingly complex regulatory environment challenges even the best decision-makers. Business success means navigating these challenges while executing strategy that drives enterprise value. Decision-makers require precise, timely information about their business to accomplish this.

Implementing a robust program of business performance management ("BPM") is a powerful way for finance teams to contribute to decision-making effectiveness and the success of their organization. A well-designed BPM program should include processes for budgeting, forecasting, analysis, and reporting, and should incorporate financial and non-financial measures. Done right, these activities empower decision-makers with the tools they need to successfully manage the business.

In this paper, we present a phased, principles-based approach to implementing BPM for your business. Following these principles throughout each phase of the BPM implementation cycle will ensure your finance team can perform meaningful analysis and provide impactful, actionable insight to their business partners.

It's time to transform the way your finance team approaches BPM.

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INTRODUCTION

Your business is growing. Revenues are recurring. You're doing things at scale and margins are expanding. You've grown into new market demographics, geographies, and lines of business. Constantly changing economic conditions, introduction of market disruptors, and new regulations are making it difficult to sustain growth in an increasingly complex marketplace.

The financial stakes are high. Capital injected from creditors and shareholders has fueled your growth and their focus on business performance is putting pressure on your decision-makers. You now need to demonstrate greater executional accountability and fiduciary rigor. While the information needs of decision-makers are becoming more acute, you still find yourself struggling to get timely, actionable information about your business from across your organization.

As businesses grow, executives and decision-makers need insightful, actionable business intelligence. The precision, reliability, and timeliness of financial information is vital. Growth, profitability, and returns on invested capital are closely-scrutinized. This requires decision-makers to understand what is happening throughout the business, all the time. Performance management is critical. Effective decision-making is paramount.

Your legacy analysis and reporting activities are no longer sufficient to support your business partners – they are just too weak. Your decision-makers need better, faster data about the business to continue executing. You need a robust program of business performance management.

Each business is unique. There is no "one-size-fits-all" approach to building effective BPM activities within your corporate finance team. We believe in a practical, principles-based approach that allows for planning, analysis, and reporting activities most suitable for your business performance management needs.

This paper lays out a framework and principles to follow when enhancing your corporate finance capabilities.

EXECUTIVE SUMMARY

- Corporate financial planning and analysis (FP&A) capabilities must be introduced or enhanced as part of a "phased approach," with each phase building on the successes of the previous ones.
- Corporate finance teams must empower decision-makers with precise, timely, and discrete information, employing tools like executive dashboards and extensive KPI reporting.
- The most effective phased approach can be split into three broad areas: implement the basics, enable performance management, create business intelligence.
- Business intelligence must include a mix of financial and non-financial metrics and analysis. FP&A must develop partnerships across the business to provide a complete picture to decision-makers.
- You need robust governance over data inputs, including rules for transaction processing and data aggregation. This is a critical first step to enabling performance management and business intelligence.
- True business intelligence leverages vast and disparate data about a business to answer the most critical "why?" and "what now?" questions from decision makers.
- Best-practice budgeting and forecasting activities engage the entire organization, ground decision makers in financial and operational realities, and tightly align with business strategy.
- Technological solutions are important tools for advancing BPM to the next level but they are not a silver-bullet solution. Technology should complement an already effective program.

BUSINESS PERFORMANCE MANAGEMENT

Business performance management is only as strong as the core finance process that supports it. Effective BPM activities provide decision-makers with relevant, timely, precise, and actionable insights about their business and contribute directly to execution of strategy and creation of enterprise value.

With improved data quality and enhanced process, finance teams can gradually build more advanced analytical capabilities. While achieving highly advanced capabilities like application-driven predictive and prescriptive analytics is an appropriate goal, it is unlikely these can be effectively implemented without first addressing upstream process elements.

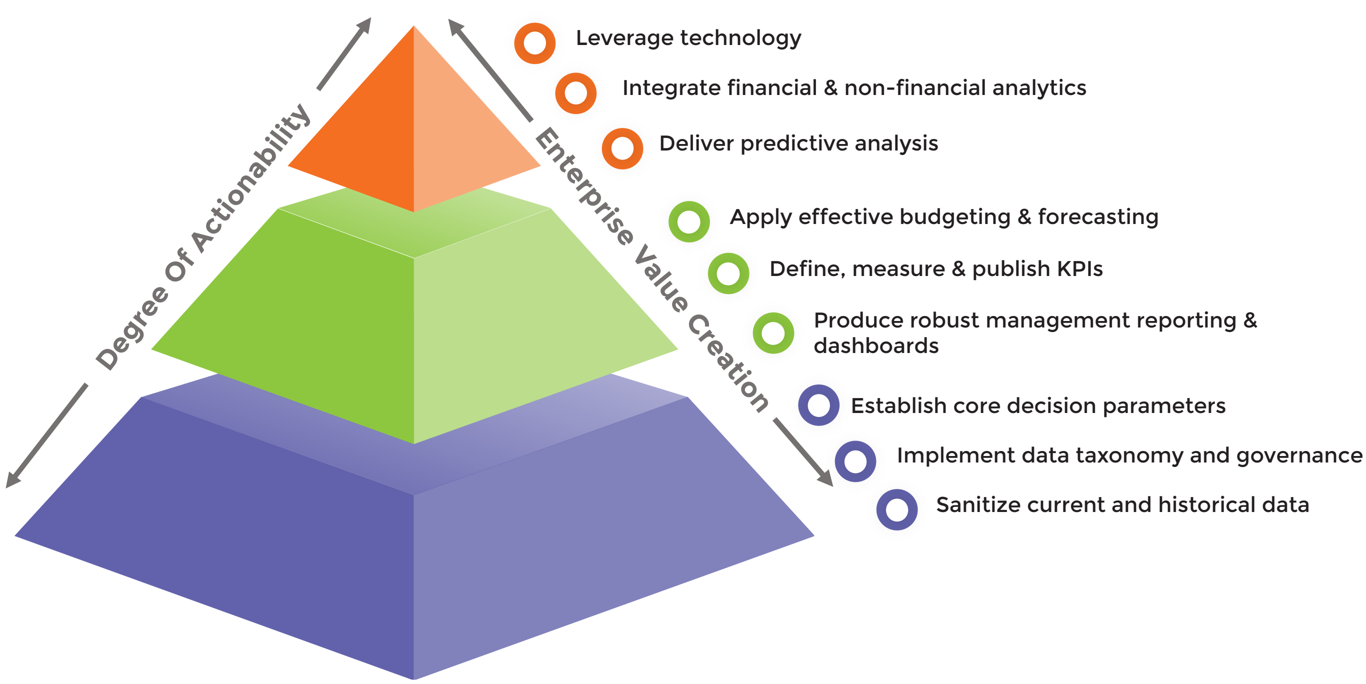
We recommend a three-phased approach designed to build progressively more advanced finance processes with each subsequent phase building on the successes of the phases precedent:

Phase 1:
Implement the Basics

Phase 2:
Enable Performance Management

Phase 3:
Create Business Intelligence

THE BUSINESS PERFORMANCE MANAGEMENT PYRAMID



PHASE 1: THE BASICS

It's easy to overlook the most basic elements of your finance processes, but they are the foundation on which more advanced capabilities are built. You need to ensure quality throughout:

- Data gathering: Identifying and obtaining relevant data from appropriate (likely disparate) sources.
- Data organization: Cleaning and structuring data for analysis.
- Data analysis: Processing and evaluation of financial and non-financial data for trends and insights.
- Data sharing: Conversion data and analysis into information that informs and drives business decisions.

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It's worth spending extra time and resources to ensure high-quality inputs.

Remember that the outputs from these processes are only as good as the inputs – Garbage In = Garbage Out. One of your primary goals in enhancing finance process is to spend less time sanity-checking data and more time performing meaningful analysis.

Weakness in these fundamental processes will ultimately detract from the quality and decision-value of information derived in downstream components of the BPM process.

Remember that having lots of data is simply a means to an end, not an end itself. Decision-makers are interested in information with high decision-value – things like forecasts, KPIs, analytics, and various other financial and non-financial metrics. In this context, you will likely need to improve several areas of your existing FP&A processes.

USING FINANCIAL DATA TO MAKE BUSINESS DECISIONS

Ultimately, output from FP&A teams should be used to inform business decisions by providing actionable insights. When you're refining and optimizing your financial processes, start by understanding what those decisions are, who makes them, and the type of information they need – these are the decision-parameters around which your subsequent data governance activities will be based.

One of the more common problems we see with suboptimal finance process is the misalignment of the information supplied by FP&A teams and the decision-making needs of management. We often see budgets and forecasts prepared in a finance silo. These tend to become disconnected from the core strategy of the business. Also, it is not uncommon for finance teams to lack deep-rooted understanding of core elements of the business. While resource and capability constraints are contributing factors, often this is the result of a failure to capture relevant business data and develop the requisite business knowledge.

PHASE 1: THE BASICS

Aligning FP&A activities and decision-making needs is a critical first step in effecting meaningful BPM. You need to create a data and analysis baseline by establishing the most critical and useful finance team outputs for use in decision-making. This will help you refine the fundamental processes of data gathering and organization, analysis, and reporting.

At a minimum, finance teams should be able to answer the following questions about their business:

- What are our core markets, and how do we define them?
- How do we manage our product lines and services – at the discrete product level or in broader product families?
- Do we operate in discrete line-of-business silos (e.g., product, geographical, customer type, etc.) or are we a matrixed organization, leveraging core functions across products, geographies, and customers?
- Who are our customers, and can they be organized in multiple discrete groups?
- What are our core business capabilities and how are they organized and managed?
- What functions are critical to conducting business and are they discretely identifiable?
- What are the mission critical financial inputs and outputs for conducting business?
- Are there opportunities to work cross-functionally to create internal synergies?

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Answering these questions prior to adjusting your data governance processes is critical.

Effective downstream activities are heavily dependent on the quality of the upstream activities.

A well-defined data taxonomy and robust input data governance may be designed in consideration of the answers to these questions.

This will inform critical upstream processes, including the way transactions are processed into your ERP.

DESIGNING ENHANCED DATA GOVERNANCE ACTIVITIES

With an understanding of how stakeholders use financial and non-financial information to make decisions, and any gaps in the data your FP&A team is already collecting, you need to dig into how you're collecting and aggregating financial data, including:

PHASE 1: THE BASICS

- Nature, volume, and disparity of data sources and types.
- Degree of technological integration between data sources (e.g. does your ERP talk to your reporting system?).
- Structure and content of historical data (e.g. is everything in spreadsheets?).
- Capabilities of existing financial systems, ERP, etc. (e.g. what type of data architecture does your general ledger software leverage?).

Each of these considerations will drive your early-phase implementation work and will impact your core finance processes. Areas where you can expect adjustment include:

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> Getting data governance right from the outset is critical.
>
> The data you gather and aggregate are the raw materials for all your future analysis and decision-making. The accuracy, precision, and overall quality of more advanced FP&A activities are constrained by the quality of the input data. While this part of the process will be tedious, the right amount of diligence and effort will bolster BPM capabilities developed in later phases.

- General ledger structuring and reporting system integration.
- Rules for financial transaction processing and recording.
- Nature, timing, and extent of management reporting.

The rules and activities established for transaction recording and data aggregation, in the context of the decision-parameters identified, will comprise your data governance activities for financial analysis and reporting.

CREATING EFFECTIVE BASELINE FINANCIAL REPORTING

As a final foundational step, you will need to develop a baseline for your financial analysis and reporting capabilities. Your financial reporting baseline will vary depending on business strategy and needs. For example, if management wants to look at financial data by product lines, you can create reporting that drills into the financial and non-financial data at the product level. If management is interested in the cost of core functions, you can create functional P&Ls to understand how your resources are consumed.

Whatever the content, your financial analysis and reporting baseline will allow you to:

- Confirm the effectiveness of your new data gathering and aggregation activities.
- Ensure you can provide basic information that feeds into effective decision-making.

- Allow you to close any gaps and properly align data governance, financial analysis, and decision-making activities.

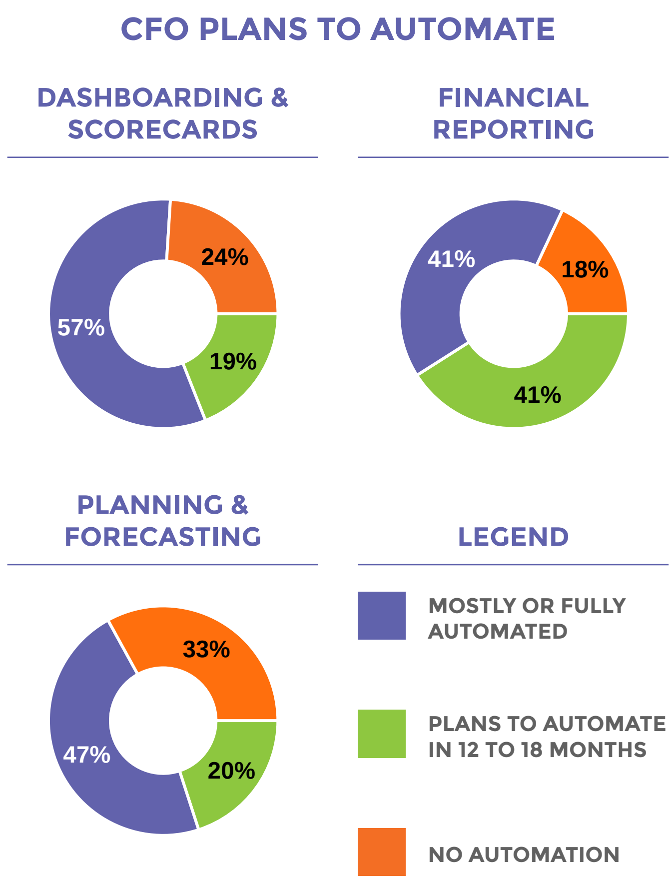
Weakness in your baseline financial analysis and reporting capabilities, including data governance, will marginalize any subsequent work done on the performance management and business intelligence fronts. As a rule, ineffective upstream process will compound into downstream issues.

THE CASE FOR AUTOMATION

Data quality is the biggest challenge FP&A teams face. Harvard Business Review estimates as much as 80% of FP&A time is spent on data discovery and preparation versus performing meaningful analysis. The only way to address this is by adding capacity – more resources or more efficient process.

One way to achieve efficiency and add capacity is to automate elements of your FP&A process. According to a study prepared by the McKinsey Global Institute in 2018, 56% of all FP&A activities are mostly or fully automatable.

We agree with this, especially with respect to data gathering, cleansing, and aggregation. We also see opportunities to automate elements of ongoing reporting as well as certain types of financial analysis. We are seeing some traction in the case for automation in the marketplace.



PHASE 2: PERFORMANCE MANAGEMENT

Once you have the basics in place, you can focus on more robust business performance management capabilities. These are activities traditionally associated with a typical FP&A function and include:

- Strategic financial planning.
- Performance reporting and analysis.
- Forecasting and revision.

Activities like budgeting, forecasting, and performance reporting allow decision-makers to:

- Ensure activities are aligned with business strategy and goals.
- Communicate effectively to internal and external stakeholders.
- Measure the effectiveness of activity and execution.
- Hold managers accountable.
- Make changes to optimize enterprise value creation.

Let's explore how performance management activities enable these priorities.

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Finance activities must be designed to create accountability for execution and performance.

The focus on results intensifies as a business grows and matures. With increases in the performance demands of creditors and shareholders, companies must be able to justify business strategy and measure effectiveness of execution. Your FP&A activities must support this requirement.

IMPLEMENTING STRATEGIC FINANCIAL PLANNING

Good strategic financial planning is essential to financial performance management. This process aligns strategic plans with financial outcomes. Because capital is scarce, companies must set meaningful business and financial goals and allocate resources to the initiatives most likely to enhance enterprise value.

Annual budgeting is the most basic and, arguably, the most important strategic financial planning tool. The lynchpin of any BPM program, the budgeting process impacts an organization by:

- Causing management to calibrate business strategy and plan for growth.
- Setting financial thresholds that guide management's execution of business strategy.

PHASE 2: PERFORMANCE MANAGEMENT

- Establishing financial benchmarks and expectations for measuring business performance.

When running the budgeting process, keep in mind the following principles:

- Be realistic – carefully balance probability of achievement with optimism when goal setting.
- Build bottoms-up and top-down – this will reveal gaps between high-level performance goals and operational realities, allowing for reconciliation of the two.
- Engage the entire organization – budgeting cannot be done in a finance silo or with the input of only the top decision-makers.
- Adhere tightly to business strategy – select initiatives that are aligned with the forward direction of the company and that contribute favorably to financial results.
- Expect the unexpected – circumstances change rapidly. Create flexibility and contingency where possible.

Ultimately, you want your budget to serve as the roadmap for achieving your performance goals in a given year. Following these principles will ensure this by capturing strategically important items, acknowledging operational and environmental complexities, and incorporating the goals of the top-decision makers.

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Remember, budgeting is essentially goal setting – budgets should be SMART (specific, measurable, achievable, relevant, and timely), with an emphasis on measurable and achievable.

When you create financial performance benchmarks like this, companies, teams, and individuals are better equipped to create a culture of accountability, to identify opportunities for growth, and to drive strong financial performance.

MID- AND LONG-RANGE FINANCIAL PLANNING

Mid- and long-term strategic financial planning should follow the same guidelines. The longer the time frame, the more likely you will need to build more flexibility and contingency into the budget. Longer-term financial plans will experience more volatility and risk.

Decision makers should take account of volatility in longer-range projections by making conservative estimates for revenue growth, profit margins, and costs. Most critical is that the longer-term strategic view is captured in your financial planning and that any projections represent a reasonable prediction of financial results. In other words, focus more on strategy and less on precision when thinking long-term.

PHASE 2: PERFORMANCE MANAGEMENT

ENHANCING PERFORMANCE REPORTING AND ANALYSIS

If budgeting is the beginning of the business performance management cycle, reporting and analysis are right in the middle. A budget is simply a snapshot of plans and expectations based on the facts and circumstances at a given point in time.

As your business carries out its strategy, the facts and circumstances underpinning your budget will change. You must have robust processes that identify when things have changed and determine the extent to which they will impact performance. This will tell management whether to stick to plan or change course. This is at the heart of good performance reporting and analysis.

At a minimum, your performance reporting should include the following:

- Variances, risks, and opportunities.
- Key performance indicators (KPIs).
- Executive-level dashboards.

Remember the decision-making parameters and outputs that you defined in phase one? These will form the basis of your periodic performance reporting.

VARIANCES, RISKS, AND OPPORTUNITIES

The most basic form of performance reporting, this is where decision-makers get their first look at how they are performing versus expectations set in the budgeting process. As previously discussed, a strong budget should serve as the roadmap for execution of strategy. Evaluation of budget variances and any risks or opportunities in the forward-looking periods will provide management with insight as to how they should respond. Decisions to reallocate resources, deploy additional capital, or change components of business strategy will be informed by this type of performance reporting.

KEY PERFORMANCE INDICATORS

KPIs are an effective means of performance management as they provide a quick snapshot of performance in a series of easy-to-digest metrics. They should reflect performance in mission-critical areas of the business – sales effectiveness, execution of core competencies, and strategic initiatives. They should include financial, operational, and blended metrics. Decision makers should be able to glance at a set of KPIs and quickly understand how the business is performing against its intended goals.

PHASE 3: ACTIONABLE BUSINESS INTELLIGENCE

WHAT IS BUSINESS INTELLIGENCE?

Advancements in technology and the proliferation of digitization in business have yielded a business environment inundated with data. Most of this is unstructured and of low decision-value. However, when technologies are used to apply analytical methodologies to the data, the results can be powerful – decision-makers can be armed with actionable business intelligence.

Business intelligence ("BI") is a series of processes that aggregate and analyze business-specific data to provide insights that inform business decisions. Increasingly, BI refers to technology-enabled data aggregation, analysis, and reporting capabilities. Tools like Qlik, Microsoft Power BI, and Tableau are evolving to support the growing demand for BI. Data visualization and analytics are quickly becoming the norm for finance teams and decision-makers.

While technology is an important part of BI, without clearly defined decision-parameters, high-quality data, and strong BPM process on the front end, it will be difficult to realize its full potential. This is why we emphasize the activities described in phase one and phase two of our approach to implementing BPM. Well-designed, well-executed manual processes are more effective than haphazardly implemented technological solutions.

EMERGENCE OF ANALYTICS IN FINANCIAL APPLICATIONS

Businesses and CFOs are buying into the importance of analytics in their organization. According to a study prepared by CFO Inc. and Sage, as many as 72% of CFOs acknowledge a need for improved analytics from within the finance function to better facilitate decision-support. Another report from the Hackett Group projects that 54% of organizations will leverage finance as the analytics hub of the entire organization by 2020.

The role of analytics in your organization will depend on a number of factors. Employee skill sets and competencies, degree of technological maturity, and organizational readiness will all play a significant role in determining the pace of adoption and the organizational penetration of analytics within your business.

With so much literature on the topic, it can be difficult to understand the types of analytics and their applications within finance. We have prepared the chart below to help distill this information in plain English.

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Your business needs some form of descriptive analytics as a minimum competency to remain competitive.

Descriptive analytics can typically be managed with existing resources and a small investment in a BI package.

Predictive and prescriptive analytics are highly advanced capabilities and will require investment in technology and data science skill sets. Not to worry - in our opinion, you'll have plenty of time to get there.

PHASE 3: ACTIONABLE BUSINESS INTELLIGENCE

A BRIEF INTRODUCTION TO ANALYTICS

	Descriptive	Predictive	Prescriptive
Tells Us	• Where we are • Where we've been	• Where we could go • What could happen	• Where we *should* go
Data Required	• ERP data • Internal process data • Financial performance data	• Descriptive + • Rules & algorithms • Actionable external data	• Predictive + • Real-time feedback from business activities
Technology & Skills Required	• Process automation • BI applications • Core financial analysis	• Descriptive + • Data science & advanced analytical techniques	• Predictive + • Real-time feedback engine • Next-level data science
Prevalence	• Most commonly referred to as "analytics" in current finance applications	• Increasing occurrence with enabling technologies	• Finance applications just beginning to emerge

We have highlighted descriptive analytics as this is where we see the term "analytics" most commonly applied. Descriptive analytics represent baseline capabilities. Typically, they are driven by automated data gathering processes with the analysis and reporting handled by a BI application. Descriptive analytics typically leverage data created within the business – internal process data, financial transactions, customer details, etc. They describe the current state of business-critical information by applying less complex analytical techniques to company data. Descriptive analytics are an important first step in enabling more advanced BI and decision-support capabilities but will not be the end state for many companies.

There is a lot of buzz around predictive and prescriptive analytics and rightfully so. Advances in technology have made it possible to apply advanced data science to huge amounts of data in a short period of time. With machine learning and AI, algorithms can iterate on a real-time basis as new data is produced, deriving analytical approaches with the highest predictive value. Coupled with decision-parameters established by management, the resulting prescriptive analytics can significantly increase the frequency with which decision-makers choose the optimal strategy.

CONCLUSION

Implementing a robust BI framework and creating actionable insights is a difficult but attainable goal for corporate FP&A teams. Developing these capabilities is critical to your business strategy and ongoing success. With the right expertise, experience, and resources, together with a commitment from your stakeholders, any business can reach this advanced state of corporate finance and give themselves a competitive advantage.

Deane has the experience and know-how to help you transform your financial planning and analysis activities and harness the power of business performance management. Get in touch with us today to learn how we can work together to drive strategy, performance, and value with financial planning and analysis.

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