OLIVER WYMAN

VISIBILITY AND CONTROL

IF PREDICTABILITY IS AS IMPORTANT AS PERFORMANCE, WHAT ARE YOU DOING ABOUT IT?

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Predictability of financial performance is critical to a stable share price and the stability of a CEO's tenure. The bottom line: A senior executive's ability to predict future business execution accurately and explain past performance is as important as the results themselves. Moreover, surprising the markets is usually a reflection of a CEO being caught unaware – and uninformed. So how do you reduce the chances of surprise and equip yourself to steer your business on a more predictable course?

Hard-wiring business activities to financial results can be difficult. Our recent survey of 30 CFOs and CEOs of large public and private businesses in North America and Europe suggested that 73 percent of the respondents felt they had "insufficient information to predict and drive their business." CFOs were even more concerned: 87 percent identified issues with the information needed to predict their firms' financial performance.

Without the information to understand business drivers and predict performance (what we refer to as "Visibility"), it becomes hard to steer business actions and outcomes to desired results ("Control").

This weakness is not unique to one function or business area. Generally, the information top managers are given is incomplete, with only partial information in most key operating areas, and at worse information may be conflicting (for example, operational indicators all being green but P&L showing no sign of improvement). More importantly, not only is the information insufficient, but it also has not been sufficiently integrated into a framework that allows management to see and understand what is occurring, and predict financial results. (See Exhibit 1.)

Moreover, our study highlighted the differences in business environments. In the event of a business crisis, top executives were even less confident they would have the right information at hand – just when they most needed it.

Exhibit 1: Given your role, do you feel, overall, that you have "the right information to make the right decisions, at the right time"? Respondents (%)

	BEST IN CLASS INFORMATION	PARTIAL INFORMATION (NOT ALL AREAS COVERED WELL)	IMPROVEMENT NEEDED
Sales	33%	47%	20%
Market & customer information	17%	57%	27%
Cost, profitability & their drivers	37%	53%	10%
Operational indicators	27%	50%	23%
FX impact	40%	40%	20%

ROOT CAUSES

The sources of the poor visibility and lack of control are not based in market dynamics or share price volatility, neither of which can be controlled. Rather, these stumbling blocks are very much within management's purview. The lack of visibility – and subsequent lack of control – is rooted in three failings: insufficient governance and resources, discrepancies in metrics and definitions, and fragmented IT systems. (See Exhibit 2.)

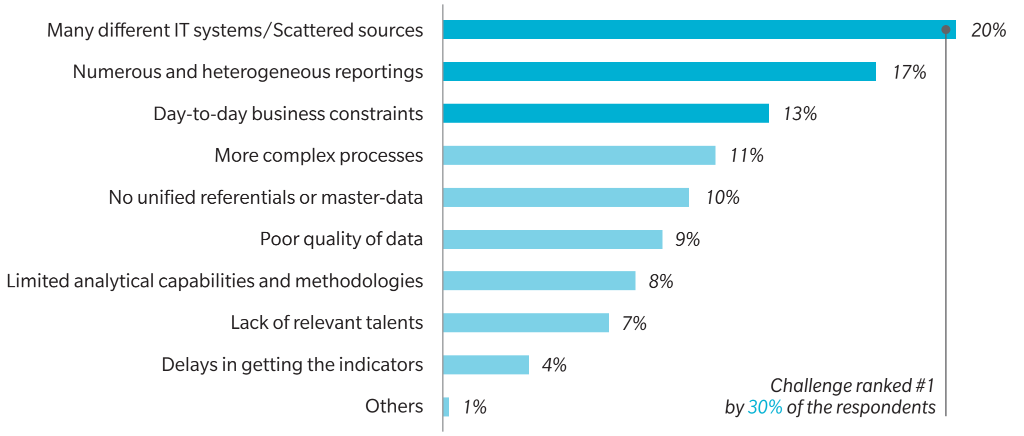
Discrepancies in metrics and definitions result from an organization's different branches developing their own way of understanding the business. While some of the gaps and multiple definitions may be the reasonable responses to specific business challenges, the end result is a kind of corporate "Tower of Babel," with each different business line speaking a different language. Competing metrics with conflicting implications further confuse the situation. As a consequence, senior management lacks a comprehensive view of business drivers and financial performance.

For example, a business service company may have five different definitions of "customer." For sales and marketing, "customer" was a single prospect in the CRM database or a signed contract; for operations, it was each customer's physical site; for financial controllers, it was every invoicing entity; and for the retention team, each retention case. As a result, there was no agreement on numbers, making the business impossible to predict and control.

Fragmented IT systems and data scattered among IT systems, each with different customer and product references, are the biggest stumbling blocks to better visibility and control. Such fragmentation is usually a result of legacy merger and acquisition (M&A) activities. In some cases, it is the outcome of companies determining that the cost of integrating disparate data systems is prohibitive, or else the source data needed does not exist or is of low quality.

Exhibit 2: The most common challenge is to obtain comparable and unified information from different IT systems and reportings

OVER THE PAST 5 YEARS, WHAT HAVE BEEN THE CHALLENGES YOU FACED REGARDING ECONOMIC PERFORMANCE MONITORING?
% OF RESPONDENTS RANKING THIS CHALLENGE AMONG ITS TOP 3



Source: Oliver Wyman Performance Management survey

The consequence of insufficient governance and resources, gaps among metrics and conflicting definitions, and fragmented data systems is that senior management finds itself flying blind, lacking visibility into operational and cost-profitability indicators, as well as sales, market, and customer information.

REMEDIES MIRROR ROOT CAUSES

The critical first step in solving the problem is to recognize it, admit it exists, and establish a hieararchy toward addressing its root causes rather than its effects. This requires committing resources and time on the part of senior management, and developing a set of key performance indicators (KPIs) that link to financial outcomes and provide greater predictability of results. Often, CEOs or CFOs are forced by external events to truly confront the situation: an un-explained performance miss, a simple question on true performance drivers unanswered… Solving such situations typically takes time, so CEOs or CFOs are far better off identifying and recognizing the issue as early as possible. To do so, simple internal surveys of the management committees' level of satisfaction on how equipped they feel to steer their business will give an initial idea of the severity of the problem.

CRACKING THE PERFORMANCE CODE

Tackling the issue of governance and resources, therefore, should take precedence over other root causes, as it takes more time and focused resources to address visibility and control across a business. A full-time team possessing the requisite business, financial, and data expertise should report to the CEO or CFO with a remit to implement consistent definitions, business logic, and forecasting approaches so that predictability and control can follow.

This effort may also require a culture shift around data governance. Leadership needs to emphasize the critical importance of accurate, shared data definitions, encourage teams to discuss business performance from a single, comprehensive account of the data (providing a full view of the company), and avoid using multiple, conflicting, and partial reports.

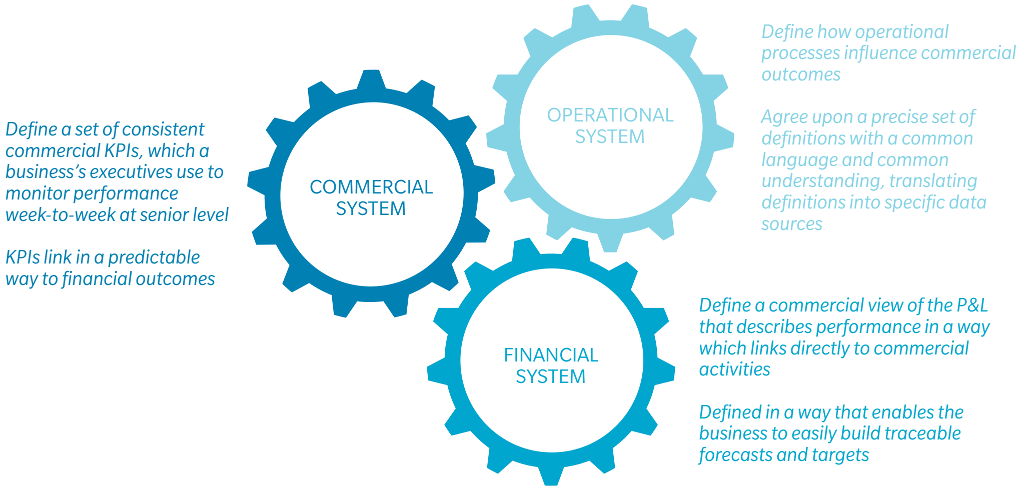
The second element is cracking the metrics and definitions for business drivers used to predict financial performance. We break these drivers down into three common themes: commercial, operational, and financial. (See Exhibit 3.)

Commercial drivers: How day-to-day decisions on pricing, contracts, sales, marketing, product, and customer experience come together to drive value.

Operational drivers: How decisions on supply chain, headcount, procurement, and manufacturing drive value.

Financial outcomes: How the above two elements materialize in the profit and loss account (P&L) and balance sheet when combined with other financial impacts: How much lag time is there between a business event and its materialization in the P&L.

Exhibit 3: Three themes for a typical service or trading business



Often, each of these themes is understood separately, and confronted in isolation, without being integrated into a single outlook. Examples include foreign exchange effects obscuring manufacturing performance, or businesses with substantial recurring revenues where shifts in customer behavior are not well tracked. When growth is good and results are strong, the gaps in understanding these drivers may not be critical (and may be regarded as unnecessary); in weak periods, however, they become significant and costly.

DATA MART SOLUTIONS

Fragmented IT systems cause poor visibility and control over business performance. A sustainable remedy thus involves building a better single view of key data and business drivers, consistently defined. Advances in data management technology mean this no longer has to be an expensive re-platforming exercise.

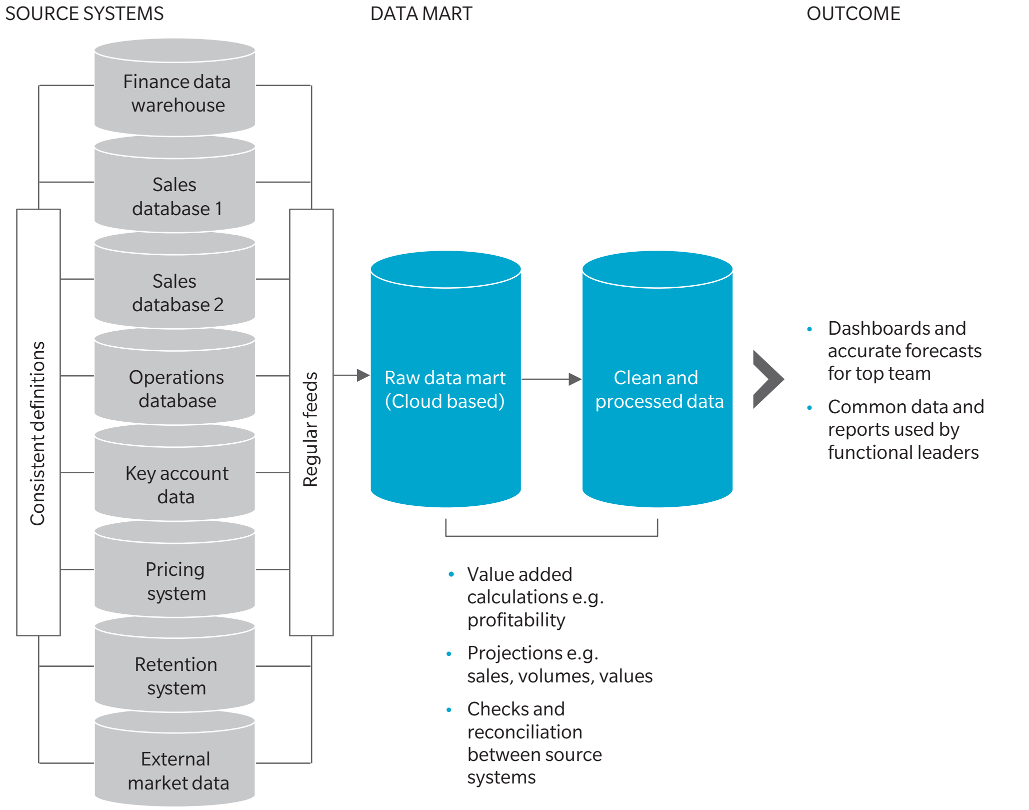
The "data mart" is one such such promising solution. The data mart operates as a simpler, more agile data warehouse, receiving daily, weekly, and monthly feeds from company-wide sources. This enables quick and easy data extraction; cloud-based storage keeps setup costs low; and internally hosted solutions can be quickly implemented. Initially, the data mart will contain messy data. But after transforming and processing the source data into common definitions and reconciling them across the business, a picture emerges of the linkages between commercial, operational, and financial systems. This in turn begins to create value. (See Exhibit 4.)

The last step in this approach is to lock down and manage the information from the source systems and in the data mart. For example, you may have identified an excellent predictive metric of sales performance, only to find out that how it is defined and recorded has changed at source.

Recently, our client, a major global consumer goods business, faced increased scrutiny on P&L metrics. In analyst meetings, the CEO was quizzed on the impact of raw material costs on gross margins. No one in the business could provide him with the relevant information, as the P&Ls were held at 50 local plant levels across the globe. Transfer pricing and foreign exchange movements also made unpacking the P&L impossible without enormous IT re-platforming cost.

Our solution: set up standard definitions across the global manufacturing base; develop a strong central governance function to manage adherence to the data and definitions; and centralize the data in an agile way, allowing executives to identify root causes of variance.

Exhibit 4: Example of a data mart for a business services supplier



IMPACT

The benefits of having good visibility and control are multiple, and are most evident when they are lacking. We have seen corporate transactions fall through because of unpredictable financials, or management spending months and years making poor business choices only to find that those poor choices materialize too late in the balance sheet or P&L. Financial service industries are especially susceptible here.

Greater visibility and control provide management the assets it needs to outperform competitors by allowing for greater insight into the business's activities and the development of new, productive initiatives.

CONCLUSIONS

Unpredictable business results, caused by a lack of visibility and control over business levers, can destroy senior executives' careers and a business' value. However, most CEOs and CFOs say they have only part of the information needed to run their businesses and accurately predict results. Removing the stumbling blocks to data acquisition is within the control of a business.

The solution involves building a central organizational competence on data and definitions, understanding cause-and-effect in the business especially as it relates to financial outcomes, leveraging analytics to detangle the drivers, and putting key data in one place in an agile, low-cost way.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across nearly 30 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm has more than 4,500 professionals around the world who help clients optimize their business, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com. Follow Oliver Wyman on Twitter @OliverWyman.

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