Using Corporate Performance Management to Deliver the CEO's Strategic Vision

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Corporate performance management (CPM) applications offer advanced capabilities to enable CEOs and management teams to better execute on their strategic visions. However, few organizations take advantage of these capabilities, and CFOs have the opportunity to become true strategic advisors to the business by leveraging this functionality.

Key Findings

- CEOs are under increasing pressure to deliver on their strategic visions. However, most still struggle to link strategy with execution.
- Strategy management is usually approached in an unstructured way, with over-reliance on spreadsheets. This is not an effective way to manage the strategy of a complex organization.
- CPM applications can support a much more sophisticated approach to strategy management, but are rarely deployed in this way.

Recommendations

- CIOs and CFOs must help the management team understand the inadequacies of an informal, spreadsheet-based approach to strategy management.
- CFOs must appreciate the scope of CPM applications and the way in which they can link strategy management, financial budgeting and operational planning. This is one of the most underused aspects of CPM, which makes it a key enabler for the CFO to become a strategic advisor to the business.

ANALYSIS

We are witnessing a time when the power of the CEO in business and government is under attack. It is the result of a period of abuse of executive power that was exemplified by Enron and others. A new breed of board member has emerged that is more risk-averse as a result of Sarbanes-Oxley, or more demanding and an activist about results. The consequence of this change is less patience with a CEO who is not producing, and we are seeing some of the highest levels of CEO turnover in 30 years. According to a Booz Allen Hamilton 2007 survey, CEO turnover grew 59% from 1995 to 2006. In 1995, one in eight departing CEOs was pushed, but by 2006, nearly one in three departed involuntarily. The most common answer to the question, "Why did the board fire the CEO?" was related to the inability of the CEO to manage strategic change. Shareholders understand this, as they can see how well a management team is executing via the quality of their earnings. The increasingly uncertain economic climate will only add to this pressure.

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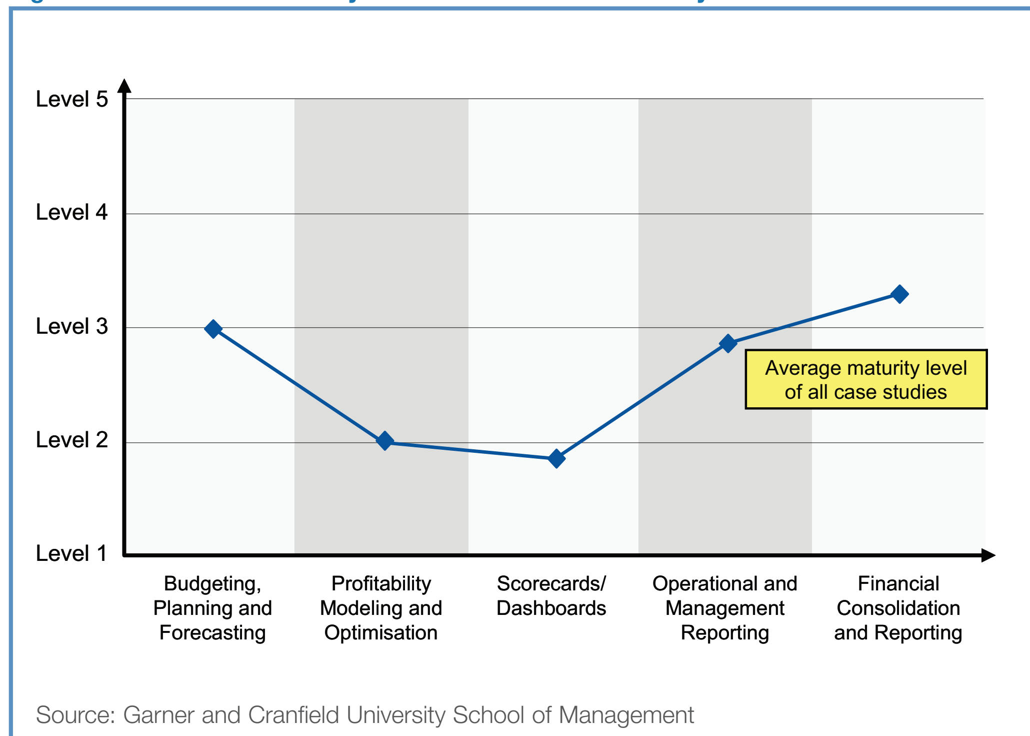
Despite the emergence of methodologies such as the Balanced Scorecard to help manage strategic change, it's clear that these have not addressed the fundamental issue that many CEOs struggle to connect their strategic vision with operational execution. According to Robert S. Kaplan and David P. Norton, failure rates in strategy execution are in the 70% to 90% range. The challenge is that too many CEOs see strategy as something "special" or "unique" that only they are equipped to understand and manage. This means they rarely apply a structured approach to the processes of creating, planning and managing strategy, instead relying on informal approaches and spreadsheets. This is disappointing, because CPM applications have sophisticated capabilities in all areas of strategy management; however, they are rarely deployed by organizations that implement CPM. Gartner carried out a joint study in 2007 with the U.K.-based Cranfield School of Management into the overall maturity of organizations that had implemented CPM (see Note 1) and found that the area of scorecards/dashboards (which covers some of the key functionality required to support strategy management, see Note 2) was the least mature of all aspects of CPM (see Figure 1).

The study also revealed some worrying insights into the attitude of CEOs to strategy management. Strategy was too often something that happened "offline" and was not connected to other performance management systems, particularly the CPM applications. One of the case studies revealed that "strategy

Note 1
Scorecards and Dashboards in CPM
A dashboard (or cockpit) is a reporting mechanism that aggregates and displays metrics and KPIs, enabling them to be examined at a glance before further exploration via additional business intelligence tools, whereas a scorecard is an application that helps organizations measure and align the strategic and tactical aspects of businesses, processes and individuals via goals and targets. These are fundamental to strategy management – they enable organizations to express their strategies in the form of "strategy maps" (popularized by Kaplan and Norton in their Balanced Scorecard methodology) that represent the cause-and-effect links between different metrics and their impact on achievement of strategic goals. Increasingly, CPM applications include other aspects of strategy management (such as tracking and managing strategic initiatives) and link these capabilities to their planning and profitability modeling capabilities to provide an integrated strategy management solution.

Figure 1. Overall CPM Maturity From Gartner/Cranfield Study



Source: Garner and Cranfield University School of Management

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Note 2

Tollpost Globe, a Leading Example of Effective Performance Management

Tollpost Globe, a European transportation company based in Oslo, Norway, implemented a comprehensive performance management system that integrates strategy management (using the CEO's own venison of the Balanced Scorecard methodology) with financial reporting, budgeting planning and forecasting (covering financial and nonfinancial data), sales volume and revenue reporting by salesperson, customer profitability analysis and customer quality metrics, employee satisfaction analysis, and cost and activity analysis by vehicle driver, along with cost analysis for container transport and customer satisfaction. Tollpost also implemented a linked set of scorecards to give strategic-, tactical-, operational- and employee-level views of performance. This is an interactive and integrated solution that is updated in near real time with the latest performance data, which is used in management meetings at all levels to track and manage the success of various initiatives.

The results were impressive – this system has been fundamental in Tollpost's turnaround. Tollpost went from making a loss of $13 million to becoming Europe's most profitable transportation company in four years. This was accompanied by increases in quality from levels of 88% to 96% (the ultimate target is 98%) and in market share (an average annual increase of around 6% for the past four years). Significant intangible benefits have also been achieved. Tollpost is now a performance-focused organization, with a healthy attitude toward internal competition that is fostered by the availability of detailed performance information.

formulation is done offline and is not integrated into the CPM system," while another revealed "the organization uses offline spreadsheets to set and communicate strategy, and all scenario analysis is done in spreadsheets." This is evidence of a disconnect between strategy creation and the day-to-day management control systems (which are primarily the financial budgets), and a lack of understanding of the capabilities of CPM applications. Any CEO that thinks that he or she can do scenario planning using spreadsheets is sadly misguided. However, some organizations are achieving notable success in integrating strategy management with other aspects of performance management and delivering significant business benefits. Tollpost Globe is one such organization, and its CPM (and broader performance management) initiative was personally led by the CEO, who from the outset knew that implementing the right applications was key to his vision for transforming the company (see Note 2). CPM applications are becoming increasingly sophisticated in this area, and any executives involved in strategy management need to appreciate what they can deliver.

The challenge with many CPM implementations is that they are driven by the finance team and focus too much on the needs of the finance function. All too often, they miss the opportunity to bring strategy management "in from the cold" and integrate it with the other aspects of CPM. After all, strategy management is the most "corporate" aspect of CPM. Consequently, CIOs and CFOs undertaking a CPM initiative must take the following actions to ensure they do not miss out on one of the key benefits of CPM.

Understand That Strategic Planning Cannot Be Performed In Spreadsheets

Strategic planning is a complex process that is not well-understood. In general terms, a good strategy should clearly define the characteristics of the end-state organization, as well as a set of realistic goals and objectives that are consistent with that mission and are achieved in a defined time frame within the organization's capacity for successful execution. Such strategies are often expressed in the form of strategy maps that show the key metrics that indicate success and the strategic initiatives associated with them. However, one of the key aspects to any strategic plan is the financial outcomes that will result if the strategy is executed. So associated with any strategy map should be a strategic financial plan that reflects the impact of the strategy in terms of profit and loss, balance sheet and cash flow statements for (at least) a three- to five-year period. The trouble is that, because most organizations document their strategy map in stand-alone scorecard tools (or even worse, PowerPoint and Word), they turn to spreadsheets for this aspect of strategic planning. This is wholly inadequate.

Many CPM budgeting, planning and forecasting applications provide sophisticated strategic planning capabilities to model the effect of strategic initiatives in combination with each other or against an overall "base case" scenario that represents ongoing operations. These can be linked to the scorecard/strategy map part of the system and also linked to the underlying financial modeling engine so that the financial outcomes of the proposed strategy can be expressed in terms of the key financial indicators that matter to shareholders (and thus to the CEO): revenue growth, profitability, earnings per share and so on. Although it may be possible to emulate this functionality at a high level in spreadsheets, there is no way that a complex business environment can be modeled with the same degree of rigor and auditability that CPM applications provide. Spreadsheets also lack the ability to perform sophisticated scenario analysis and forecasting. This is an area where CPM applications are strong and enable management teams to model the impact of different strategies quickly and easily in multiple scenarios. CPM applications also offer powerful forecasting capabilities that enable users to predict the impact of changes in the business environment and the likelihood of achieving goals. Some even apply advanced statistical techniques to assess the strength of the strategy (for example, by validating the relationships in a strategy map based on actual data).

Consequently, CIOs should work with the CFO to engage the management team to understand the value of using CPM applications to support true strategic planning. Any use of

spreadsheets for such a complex and important task should be questioned, and CPM applications should be evaluated as a more robust alternative.

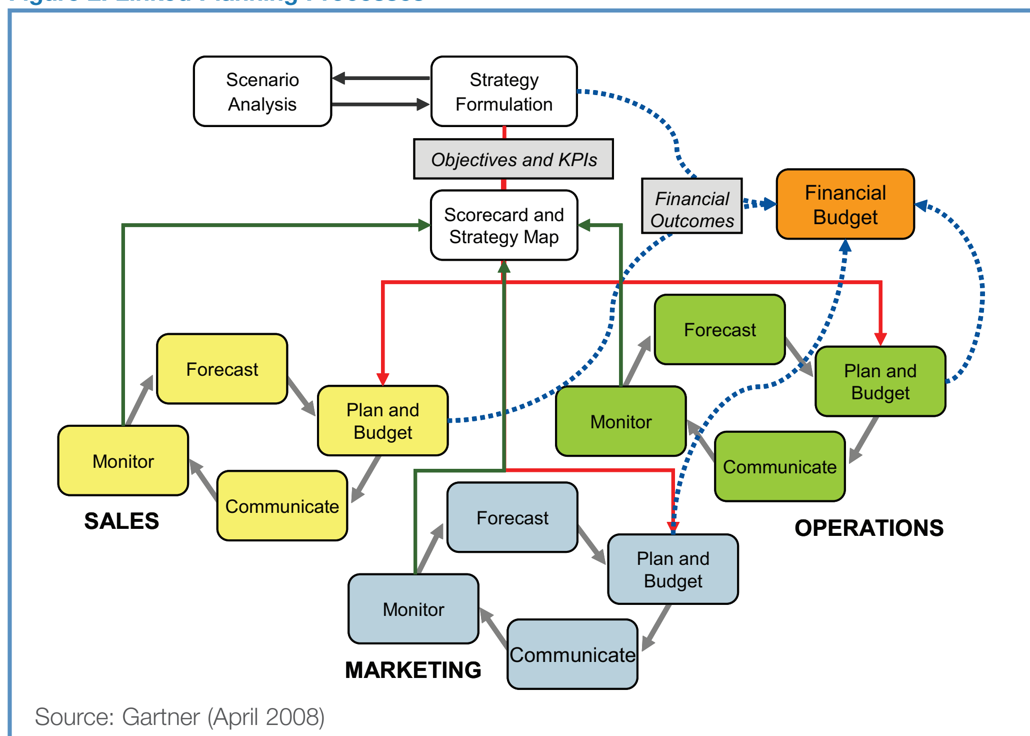
Link Strategy Management With Financial Budgets

It is clear that the weakest link in most plans is the relationship among specific business objectives, the strategy to get there, and the operational or execution plan. Many strategic plans are nothing more than a compilation of projects aggregated for the upcoming year. A high-level enterprise strategy needs to be linked to lower-level goals and objectives, which is where the concept of a strategy map is powerful. Many CPM scorecarding applications provide this functionality and increasingly offer strategy management capabilities for tracking and implementing strategic initiatives. However, we see many projects where organizations implement scorecard software on a stand-alone basis. Although this may improve the communication of the strategic intent, it is not enough to imbed the strategy in employees' day jobs. This creates a silo of strategy management that is separate from the real command-and-control mechanism in most organizations – the financial budget.

Financial budgets are short-term financially oriented plans. They usually have a one-year time horizon and are used to set short-term targets for revenue, expenditures and cash generation. These budgets typically use financial classifications found in the general ledger to classify financial goals and targets. The budget (and the budgeting process) is usually owned and controlled by the CFO and the finance function, and in most organizations, the financial budget is the ultimate control mechanism because it represents the plan for achieving short-term quarterly and annual financial targets. In too many cases, the financial budget is what managers and employees manage to on a weekly and monthly basis. Thus, if the strategic plan is not linked to the financial budget, when it looks like the "numbers" may not be made in a quarter, the strategic plan gets ignored, and managers try their utmost to make the financial targets.

It is vital to link personal incentives to strategic objectives to help address this issue, but it is also vital to link strategic planning with the financial budget and also to operational plans. This involves a significant change in attitude by the CFOs and in the finance function about how they approach the budgeting process. Most finance teams start the planning process with the financial budget by asking managers to submit their financial estimates for revenue and expenses. This approach is fundamentally flawed because the aggregation by financial classifications, such as "marketing expenses" or "product revenue," hides the underlying detail of operational activities. Also, the budget revolves around financial reporting periods (months, quarters, years), rather than the business activity timeline, masking the visibility of longer-term activities and associated cash inflows and outflows. Most strategic initiatives don't fall neatly into a quarter or a year for planning purposes, but the financial budgeting process can't accommodate that. Consequently, finance teams must shift their mind-set to think of the financial budget as the outcome of the planning process, rather than the starting point. So the financial budget should flow from a combination of the strategic plan and lower-level operational plans (see Figure 2).

Figure 2. Linked Planning Processes



Source: Gartner (April 2008)

Most strategy management methodologies tend to evaluate strategic options purely in terms of their impact on key metrics and ignore the detailed financial implications. What is missing from this approach is an understanding of the cause-and-effect relationships between the key metrics and financial outcomes. Correlating key performance indicators (KPIs) with financial outcomes is necessary to integrate strategic and financial planning. In a linked planning environment, the strategic plan will reflect the planned costs and anticipated revenue associated with each strategic initiative. By linking strategic planning with a financial modeling engine, it is possible to create a strategic plan that will also have a related financial plan, although typically at a more aggregated level than a financial budget. This will also link a financial plan with the KPIs that will be used to measure the success of the strategy. Furthermore, this enables proper scenario analysis, where the impact of different strategies can be assessed from a financial perspective.

If a strategic plan is created in this way, the KPIs associated with the chosen strategy can be communicated in a strategy map. This should cascade down to business units and functional areas so they can create their operational plans that show how they will achieve their KPI targets. These plans should be based around business drivers, such as price, volume and discounts, rather than financial budget line items. These business drivers can then be used to create the financial budgets based on a set of business assumptions (such as exchange rates, pricing levels and cost ratios). Finance can then compare the financial view of the strategic plan with the “bottom up” driver-based business plans from operational functions to see if there is alignment. If not, they will need to go through an iterative “what if” process to see how the strategic and operational plans can be reconciled.

The good news is that CPM applications can deliver all this functionality. They provide an integrated modeling environment in which strategic plans and driver-based operational plans can be modeled and reconciled. They enable common KPIs to be shared across different plans, and some vendors (for example, SAS and Business Objects) can link these capabilities with profitability modeling tools. It is also possible to apply correlation and other statistical techniques in some CPM applications to validate the real impact on KPIs on financial performance. The bad news is that few finance functions have the skills and knowledge to deploy CPM applications in this way, and few senior executives and management teams have the awareness of such applications. There is a real opportunity for CFOs to show vision in this area and use CPM applications to support effective strategy execution, and there is also a role for CIOs to help educate CFOs and other finance users about the capabilities of software to enable this vision. External service providers also have a role to play here. Although their CPM capabilities are still evolving, they can help bring fresh thinking to the way that organizations approach strategy management, and this can help CFOs create the right vision for leveraging CPM applications.