

PROFILES IN PLANNING: FACE HARDWARE



INNOVATION IN ACTION
SERIES

PROFILE BY
VENTANA RESEARCH

PROFILES IN PLANNING:
Ace Hardware

Cognos Enterprise Planning
February 2004



V E N T A N A
R E S E A R C H

Aligning Business and IT to Improve Performance

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Introduction

Ventana Research wrote a series of profiles based on in-depth interviews with Enterprise Planning customers. Budgeting and planning is a core topic on our research agenda because it is a fundamental requirement for effective Performance Management. We find companies that adopt dedicated planning applications are able to transform planning from a time consuming annual ritual with limited business benefits, to a process that takes less time, adds value and improves performance. These profiles are aimed at senior level finance officers who want to increase the effectiveness of their organization, or simply make the budgeting process more efficient.

Ventana Research interviewed eight companies that purchased Cognos Enterprise Planning to improve their planning and budgeting process: Ace Hardware, AmeriPath, Courts plc, Deluxe, Hollister, Lucent Technologies, Manpower and Pilgrim's Pride. All of the companies interviewed wanted to eliminate the inefficiencies and difficulties that go with using spreadsheets in planning and budgeting; all of them achieved additional, substantial benefits. In addition to the important time and labor savings gained by adopting Cognos Enterprise Planning, these eight companies collectively were able to:

- Control expenses more effectively and intelligently during challenging economic times.
- Achieve greater accountability through higher participation in the planning and budgeting process by business managers.
- Increase agility in adapting to changing conditions.
- Deepen visibility into the business to improve decisions.
- Ensure managers use resources effectively by applying internal benchmarking.
- Enhance the accuracy of their planning and budgeting process.

In short, these companies took a time-consuming, nearly universally loathed exercise, and began to transform it into a value-generating process.

Summary of the benefits and business areas deployed:

	Pilgrim's Pride	Hollister	Lucent Technologies	Manpower	Ace Hardware	Courts plc	AmeriPath	Deluxe
Benefits from Planning								
More efficient process	•	•	•	•	•	•	•	•
Deeper visibility; insight	•	•	•	•	•	•	•	•
Higher participation	•	•	•	•	•	•		•
More effective process			•	•	•	•	•	•
Greater accuracy	•	•	•	•	•			•
Improved agility	•					•		
More accountability		•	•	•		•		•
Better coordination	•	•	•					•
Reduced working capital		•	•					
Higher profitability; reduced costs				•	•			

Business Areas Deployed

Finance/Admin	•	•	•	•	•	•	•	•
Marketing/Sales		•	•		•			
Manufacturing/production		•					•	
Distribution		•			•			

The following profile is an excerpt of the entire "Profiles in Planning" report – highlighting how Ace Hardware used Cognos Enterprise Planning and realized demonstrable business value from its investment. The full report with all eight company profiles is available at www.cognos.com/profilesinplanning. The full report provides additional analysis and commentary as well as suggested next steps to get the most value from your budgeting and planning process.

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ACE HARDWARE

Industry: Hardware Stores [SIC 5251 NAICS 44413]

Locations: United States

Initial deployment: 2000

Current users: Approximately 215

Applications:

- Sales and expense budgets; warehouse labor forecasting; sales forecasting; retail programs

Innovations:

- Streamlined budgeting process; quarterly sales forecasting; warehouse center labor requirement forecasting; monthly P&L analysis

Benefits:

- More efficient planning process; enhanced effectiveness through greater field participation in process; more actionable information; improved cost control; more what-if analysis to improve performance; greater accuracy

Company Description

Ace Hardware is a cooperative of more than 4,900 independently owned and operated stores in the United States and its territories and more than 72 countries around the world. It had wholesale sales of \$3.029 billion and retail sales of \$13 billion in 2002. The individual stores (or small chains within the system) own the cooperative and through their representation on the Board of Directors control the governance of the organization. The company has about 5,000 employees servicing the stores.

Ace provides marketing assistance (mainly advertising and merchandising) and 65,000 private label and national brand hardware and home improvement items sourced from third-party suppliers to members of the cooperative. Ace manufactures its own paint because this is dependably a high volume item (painting has long been the most popular do-it-yourself project). According to the company, Ace wants to offer customers products that the company believes are "as good as or better than comparable national brands" at a price that is usually below or comparable to a national brand. Consequently, the other major purpose of the co-op is to leverage the combined purchasing power of its local stores. The stores have minimum purchase commitments they have to make through the co-op, but otherwise are free to sell whatever they wish. The individual stores own and manage their own information systems.

Traditional hardware stores have had to contend with the rise of the larger warehouse chains, as well as by chains/co-ops with larger-store formats that offer a wider assortment of items, sometimes at lower prices. The traditional hardware retailer has responded by offering personalized service and better advice at more convenient locations, particularly for customers looking to buy only a few items. Still, Ace must ensure it minimizes the cost of overhead, sourcing, and distribution to serve member needs while it supports them with competitive advertising and merchandizing assistance to keep them on equal footing with large national or regional competitors. The strategy seems to be working for Ace. In the last three years, Ace has outperformed Home Depot and Lowe's on a weighted average in terms of same store sales increases.

Our Findings

Ventana Research found that by eliminating spreadsheets and deploying Cognos Enterprise Planning, Ace spent less time on the budget process and used this time to do more value-added analysis of the budget and actuals. Consequently, it gained greater control of its expenses through improved visibility of cost drivers. Ace reallocated money it saved by eliminating unnecessary overhead expenses to improve Ace members' marketing. Ace improved the accuracy of its sales forecast and warehouse-center labor headcount requirements allowing it to be more efficient in a tough economic climate. Because Cognos Enterprise Planning streamlined the process, Ace also increased the frequency of its detailed forecasting, improving the accuracy of its planning process and eliminating the problem of using stale projections.

Background

Planning and Budgeting at Ace

We spoke with Joel Jorgensen, who has been at Ace for five years. He was Manager, Financial Planning and Reporting for three years before moving over to general accounting. The budgeting process is run by a Manager, Budget Analyst, and Project Analyst (both analysts have other responsibilities within General Accounting). Ace annual budget preparation takes about three months to complete. It updates its forecast monthly in a process that takes about three weeks. The process of producing the annual budget used to begin in July but with Cognos Enterprise Planning it can now begin a month later, saving the company valuable time and resources. Every area (paint manufacturing, advertising, distribution facilities, etc.) does a budget using Cognos Contributor. Ace consolidates the information and then goes through the budget carefully to identify cost savings.

The Purchasing Decision

Ace purchased Cognos in 1998. Ace was motivated to purchase the software by a desire to get financial information on a timelier basis, to improve budget accuracy, and to allow people in the field to make financial planning decisions. Some key requirements included:

- “Zero footprint” - a web-based system that allowed information to be collected from all participants remotely with nothing to download or upload
- Simplicity - users could be trained quickly
- Security - sensitive information (e.g., payroll) demanded the highest security, and Ace wanted to control access to information through tiered and role-level permissions
- Speed - users can quickly enter data and see the current state of the plan/budget/forecast immediately without waiting for consolidations to be run or paper-based reports to be issued
- Adaptability - the system needed to be used by a variety of organizations, each with its own requirements, and be applied to a wide range of business and finance processes, including the support of rolling forecasts

The competitive assessment took about four months and focused on functionality and the ability of the software to address these requirements.

Implementation and Roll Out

The Financial Planning and Analysis organization “owns” the application. Deployment began in March 2000 and took until July to complete – in time for the 2001 budget. The initial roll out was to the Finance group and all department managers. Ace completed training for the finance group users in a single four-hour session. The part of the application used by the department managers required no formal training, as system instructions were adequate. Ace used four consultants (not all simultaneously), two from the software vendor who helped address some of more complicated aspects of creating the initial models and two from an independent consulting firm to assist with the systems issues. There were two members of Ace’s finance group involved as well as seven from IT (covering databases, network, security, etc.).

There were issues that Ace had to address in rolling out Cognos Contributor. Culturally, the finance organization had to contend with users that had been comfortable with spreadsheets and did not want to lose that functionality. And, as with other companies Ventana Research interviewed, the earliest adopters of the initial release did not have a smooth ride. “It was challenging, to say the least,” commented Joel. But the issues were addressed:

Joel – Occasionally we need to reboot a server or we’ll check capacity, but other than that, the system is maintained through finance without IT support. Finance manages system changes such as new accounts or departments, it doesn’t require IT involvement.

Benefits

Making the Planning and Budgeting Process More Efficient

Before deploying Cognos Enterprise Planning, Ace ran into challenges that spreadsheet users typically face, compounded by the size and scope of Ace's operation. The finance organization spent a large amount of time managing the process of creating the budget – this is a truly value-less activity. Ace used spreadsheets with embedded macros to minimize user errors and to automate the process of completing them. Even so, Ace spent time verifying the information because of errors that might have taken place during data entry. The macros did not always run flawlessly, frustrating users. There were process issues surrounding the consolidation; including manual reconciliations, scheduling IT time to perform the consolidation, etc.

To make matters worse, the files were too large to be e-mailed so hard copies had to be physically distributed to each of the recipients. The logistics of the process were daunting. For example, area managers and store managers in a region would have to get together at a single location for three days to prepare sales budgets. If subsequent issues arose, they were difficult to resolve because the people were back in the field.

Higher Participation Makes Planning More Effective

Not only was the process inefficient and expensive (there are about 220 sales managers), it limited the effectiveness of the process:

Joel – We weren't able to review sales budget in detail because we didn't have a tool that could easily analyze the information. Now they can go online 24 hours a day. If I have a sales manager in Temple, Texas, he can go into the website, upload his information, and his manager can review it immediately without requiring scheduling. The software has an inherent review and approval process. That manager can accept, change or reject all or part of a budget. The sales field no longer has to schedule their time together to complete the budget process.

In the old process, because the amount of time available limited the number of iterations that could be performed, field-level managers were not always able to review the final adjustments made to their budget. We found that this approach – while expedient – undermines the purpose of the budget as a performance management mechanism. Since they have not explicitly had final input on the numbers, managers do not always feel responsible, or (rightly) shift responsibility for the number back to those that created it.

For Ace's finance organization, the most obvious and direct benefit of deploying Cognos Enterprise Planning was slashing the time needed to produce a budget. Ace balanced the budget for 2002 (done in 2001) 15 days earlier than previous years, and completed the 2003 budget 35 days earlier. The time Ace saved in the process was important. However, even more important were the benefits that the time savings made possible for the first time.

Getting Actionable Information

Ventana Research found the true cost of the spreadsheet-driven administrative burden is the time wasted that leaves little or no time for the proper analysis of the information collected; the inability to provide actionable information used to improve decision-making; the absence of what-if scenarios to investigate alternative approaches, and so on. For Ace, the logistics of managing the budget process limited its effectiveness.

Spreadsheets may be “free” in the sense that there are no additional software licenses to buy, but the significant opportunity cost of using them goes unrecognized. Senior financial and operating executives typically do not focus on the substantial time burden that using spreadsheets as the core budgeting tool imposes on the users and those managing the process and how this prevents the organization from using planning and budgeting to improve corporate performance.

Joel – We’ve taken the administrative time out of the budget cycle and focused more on the analysis. We’ve reduced the budget process by over a month. Before we spent the majority of our time setting up historical information and making sure the Excel macros worked correctly. If there was reorganization within the company, it meant that even more time was devoted to setting up the budget. Now we spend very little time with the administrative part of the process. If a department restructures we can respond to it quickly. That is a huge benefit. We’re providing more analytical support and we’re driving operating cost out of the budget.

Our analysis shows that using the budget as a management tool is the key benefit gained by eliminating the substantial administrative overhead from the planning, budgeting, and forecasting process. This comes about because of the elimination of a negative (time used to process the budget) and because Ace, especially the finance organization, now can do things that could not have been attempted before because of the time and administration overhead associated with using spreadsheets.

Joel – We are spending less time going through the mechanics of analyzing the budget. We have a more thorough understanding of budget variances. We have more time to go back to the operational drivers and estimates to see what we had assumed would happen. If it doesn’t happen, we can explain why in more detail to management because we understand it better.

Today, Ace has greater control of its administrative costs. A big part of the reason is the planning and budgeting team has shifted the time once devoted to managing the process, to driving costs out of the system by challenging expenses.

Using Internal Benchmarking to Control Costs

Ace used Cognos Enterprise Planning to obtain better control of its spending. To optimize corporate performance, CFOs must have a clearer understanding of where spending increases will produce results and how to cut costs optimally when the need arises. The other reason behind greater control of costs is the basic design concept underlying Cognos Enterprise Planning. The models that users create explicitly lay out the relationship between operational drivers and expenses.

For example, rather than simply entering headcount expense for merchandizing assistance, the manager indicates the roles and numbers of people needed for that process. The budgeted amounts for those people are calculated using salary and benefit numbers that are associated with employees in those roles. This approach to building budgets also enables the finance team to examine the relationship between the sales forecast for that manager's territory and their budget for merchandizing people. The team can benchmark the relationship between the number of people in this activity and sales volumes to determine if an increase in headcount is justified.

Joel - We know what the operational drivers are behind the numbers and we're making the departments accountable to show how an increase in their expenses is going to produce higher sales. The system also gives HR the ability to look at individuals to see if the budgeted increase and the merit increase are consistent.

Our research shows that Cognos Enterprise Planning makes it easier to assign appropriate responsibility for parts of the budget. In creating plans, human resources typically will determine the salary level and benefit assumptions for roles and locations. Managers, therefore, can focus on what they know: the number of people they will need to perform their plan. This approach also makes it possible to quickly and accurately reflect changes to benefits and cost assumptions in the enterprise-wide budget.

Enabling What-If Analysis to Improve Performance

Cognos Enterprise Planning has improved Ace's planning and budgeting process. Much of the opportunity lost in the traditional planning and budgeting process occurs just before the budget is completed and after actual results are in. Some believe that "best practices" in budgeting involves limiting the number of iterations organizations perform in setting the final budget. Ventana Research agrees, especially in the case of the standard annual budget pulled together using manual methods or spreadsheets.

Unfortunately, refining the results of a fundamentally flawed process amounts to "putting lipstick on a pig." In keeping with our view that planning and budgeting ought to be a structured dialog, companies must focus on doing what-if analysis in areas where this would be useful. One of the benefits that Ace gained was the ability to perform detailed simulations to investigate ways of changing operations to improve profitability.

Analyzing variances is another area of the planning and review process often viewed as a waste of time. The issue comes down to determining what variances to analyze and then what to do with the information. In the past, the difficulty of creating and modifying management reports resulted in shotgun approaches to designing them, with every possible number and ratio being listed. This obscured important and actionable items and led to wasted discussions of items that were neither. Also in the past, management reports appeared many days or even weeks after the month or quarter closed – too late to correct an operational error quickly. With some of the newer additions to Planning's reporting capabilities, Ace can generate exception reports faster and more easily.

Increasing Frequency to Improve Accuracy

Ventana Research found that increasing forecasting frequency is best practices because it improves forecasting accuracy. Ace found that by eliminating the administrative overhead associated with spreadsheets, it could use Cognos Enterprise Planning to increase its forecasting frequency. This has been beneficial particularly during a difficult economic period when demand patterns have been less predictable. Ace started by doing monthly income statement forecasts in 2002, and in 2003 added a monthly projection process for sales:

Joel – We can quickly respond to unfavorable results compared to the budget because we understand the controllable expenses within the budget. For example, if we lower the sales forecast we can decide what areas to change in our operating expenses to control the bottom line. Managers are being challenged on what they spend so it forces them to maintain cost controls. It has been a challenging year from a sales perspective, but we've maintained a strong bottom line because we know where we can make expense reductions and still make our bottom line results.

It is not just the bottom line that has benefited. Ace has been able to better allocate its resources to address the economic and competitive environment. Here too, the benefits of a model-based approach to planning and budgeting become apparent. For Ace Hardware, it has meant that it can nimbly shift expenses to achieve its operational goals.

Joel – By driving unnecessary costs out of our results, we've been able to increase our spending on retail areas that we believe will promote sales growth. For example, we've offered additional merchandizing services to our best retailers.

The classic complaint about the annual budget is that it is obsolete almost from the moment it is completed. Often this is because even the best-reasoned revenue outlook in September or October for the following year will change when January's results come in. The outlook will change because markets change, the economic outlook shifts, currency rates will be different, the weather will be colder (or warmer) than average. In other words, because companies cannot control their environment they must adapt to changing conditions. There is no longer any reason to run an organization using an obsolete plan.

Joel – We’re continuously reforecast sales to provide more realistic targets. We continue to consolidate an annual budget but now we forecast quarterly so we’re using the most current information. If our fourth quarter number falls short, we’re not going into the next year with a bad number. We can revise it each quarter.

More Accurate Warehouse Labor Forecasting

We found that Cognos Enterprise Planning improved Ace’s efficiency. A large part of Ace’s operations is handling the distribution of goods to member stores. A significant percentage of the total cost associated with that activity is warehouse labor. Sales volume in turn, drives warehouse labor requirements. In building the expense forecast by month for each warehouse center, Ace uses Cognos Enterprise Planning to calculate labor expense more consistently and accurately than it had been able to do using spreadsheets:

Joel – We budget our warehouse wage dollars using labor productivity calculations within Cognos to determine how much labor is required to fill that order. Before, there was a disconnect between our sales manager and our warehouse manager for sales because of the logistics of using spreadsheets. The allocation of store volumes to warehouses used to be a guesstimate. Now it is based on budgeted sales by store. We now know what stores that center is supporting and we allocate that out by store. We couldn’t roll up in time to do an expense budget. We now have built that consistency into the budgeting model.

A related benefit Ace achieved using Cognos Enterprise Planning is managing its labor force with greater precision and agility. Accuracy matters: if there are too few employees then fulfillment rates suffer (i.e., stores do not get the merchandise they need on schedule and could lose sales); if there are too many people distribution costs are needlessly high.

Joel – If our sales forecasts are correct then we are anticipating the right amount of labor required for our HR managers in the field to hire the right amount of staff. Since we’re reforecasting our sales on a quarterly basis, we can change our plans accordingly. If we see sales are going to increase or decrease from our previous budget we can respond more quickly.

Future Plans

Ace’s most immediate goal is to transition to a rolling forecast. Ventana Research views rolling forecasts as a core discipline for effective finance organizations. Static annual plans/budgets do not provide useful, actionable information with which to manage or evaluate. They may at best be adequate at the start of the annual period but grow increasingly obsolete as the year progresses.

Joel – Our ultimate goal is to move to rolling forecast. We are planning to do that in 2004. It's a challenge because at a given point, you have to stop, and take a picture and present that as the annual budget to be approved by the Board of Directors. We weren't able to consider a rolling forecast as it would have been a logistical nightmare.

Ventana Research advocates rolling forecasts as best practices for any organization because they are more accurate and promote organizational agility.

Joel – We want to build as much confidence as we can into our sales projections and capital requirement forecasts, and alter expense forecasts as we go along. Right now [August/September 2003] we are building a budget for 2004. By the time you hit December 2004, the budget we're comparing actuals to will be 16 months old. With a rolling forecast, we're trying to challenge our managers to achieve feasible results instead of focusing on an out-of-date budget. Too much can happen to make the annual budget outdated. If we focus on reforecasting, projecting and planning on a continuous basis, we need to go through the struggle of pulling together an annual budget and we'll be comparing ourselves against information that is more reliable.

The Bottom Line

Ventana Research found that Ace Hardware achieved important benefits from deploying Cognos Enterprise Planning – benefits that justify the investment.

- Improving its performance in a difficult economic climate. Eliminating time wasted managing spreadsheets allowed it to focus on forecasting its sales and labor requirements more accurately.
- Simplifying the planning and budgeting process has enabled the company to reforecast more often improving the agility of the business.
- Focusing on what the numbers mean and not just on getting the numbers rolled up, allowed Ace to eliminate unnecessary corporate overhead and reallocate these dollars to targeted marketing programs.

Moreover, by deploying Cognos Enterprise Planning, Ace's finance department enabled managers to save hours once spent on the process and devote that time to doing what they know best: minding the store.

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