

# Relevance Revealed

## How Are CFOs Coping in Turbulent Times?

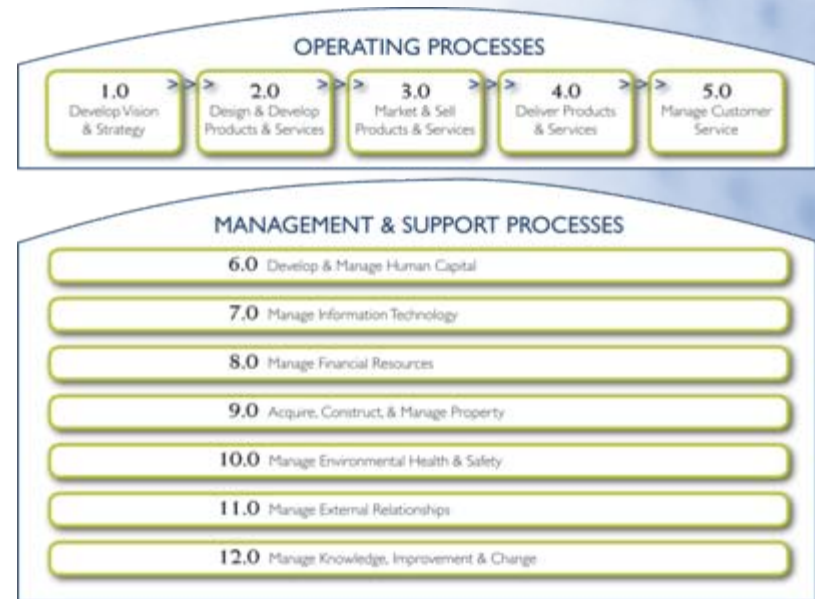
Mary Driscoll – senior research fellow, APQC  
Winter/Spring 2009



# APQC Identifies & Enables World-Class Performance

**Our 2007 finance benchmarks identified over \$930M (USD) in potential savings for more than 115 companies in 22 countries.**

- Enable companies to realize bottom-line results faster and with confidence
- Provide performance assessments through a process framework supported by 1,200 Key Performance Indicators (KPIs) and over 7,000 benchmarks from leading global companies
- Define a road map to world-class status including the drivers and enablers driving performance
- Focus on people, process, and technology and closely examine both effectiveness and efficiency



**Our unique, open standards approach is unmatched in providing business decision support and performance data.**

# Turbulent Times - Macro Picture

- North American and European economies in painful decline
- Credit markets frozen
- Governments bailing out key industries
- Unemployment rates heading towards 10% in U.S. and Europe
- Emerging markets not immune
- Chinese GDP growth slows; factory workers back on the farm
- Political unrest a concern in emerging markets



# The Business Refinancing Crisis of 2009

- U.S. and European banks in distress
- \$700 billion in U.S. commercial bank loans coming due in 2009
- Strong companies paying double for financing vs. a year ago
- Those with weak credit ratings paying 15%-to-20% to borrow, if they can get financing at all
- Bank lines of credit can evaporate if cash flow drops, despite no default
  - Commercial real estate today—what sector next?
- Government bureaucrats avoid blame
  - Examiners forcing lenders to reclassify loans, despite no default

**Can existing business models support  
the loss of liquidity?**

# Five Steps to Make Finance Highly Relevant

Cash is oxygen, and driver-based forecasting is key!

- (1) Understand what drives the speed of cash conversion—and steer around obstacles that impede the cash cycle
- (2) Boost speed and accuracy in financial management processes that hold cash hostage
- (3) Redirect finance talent to analyze how to liberate cash and help business managers do likewise
- (4) Look around corners: Make performance planning, forecasting, and management relevant
- (5) Deliver financial intelligence to business decision makers to boost liquidity and protect revenue and margin performance



(1) Understand what drives the speed of cash conversion— and steer around obstacles that impede the cash cycle



APQC.

# Turbulent Rivers Pose Greater Risks

## Risks in the Revenue Stream

- Look at viability of your customer's customers
- Unexpected declines in demand for products/services
- Competitors get desperate and start price wars
- Possible channel disruption (e.g., Circuit City)

## Risks in the Cost Structure

- Suppliers disappear, prices skyrocket
- Increasing cost of capital, FX volatility
- State and local taxes increase

## Risks to the Cash Conversion Cycle

- No access to external financing
- Suppliers tighten terms
- Can't move inventory
- Can't remove obsolete stock quickly enough
- Customers slow pay or no pay

# Case Study: Liberating Cash Trapped in Operations

Large manufacturer of highly engineered electronics (e.g. command and control aviation systems)

- \$1.2 billion in sales and net income of \$136 million
- Accounts receivable of \$250 million (76 DSO)
- Inventories of \$200 million (3.0 turns)

Reduce receivables to \$200 million (60.8 DSO) and reduce inventories to \$160 million (3.8 turns)

- \$90 million in additional cash was generated
- Extra cash was used to pay down debt, cutting annual interest expense
- Net income increased from \$135.6 million to \$139.4 million
- Asset turnover increased from 1.85 to 2.14
- Return on Invested Capital (ROIC) increased from 27.4 % to 33.1%

Source: Jack Alexander. *Performance Dashboards and Analysis for Value Creation*, John Wiley & Sons, 2007.



# Relevant Questions

## Don't ask:

- Who should be punished for the weak sales pipeline?
- What is the size of T&E expenditure vs. run rate allocated 6 months ago?
- How do we make up revenue shortfall vs. plan set 9 months ago?

## Do ask:

- Why is demand fluctuating?
- What should we expect in future demand patterns?
- How can we improve the reliability of our sales forecasts?
- How much cash is needed now, in 3 months, in 6 months?
- Which customers should be put on payment watch?
- Are we taking all available payment discounts?
- How can we align inventory and A/R and A/P vs. current forecast?

(2) Boost speed and accuracy in financial management processes that hold cash hostage



APQC.

# Revenue Management Process

## Identify high-leverage improvement opportunities

### Order taking and order placement

- Order-taking accuracy
- Cycle speed of order placements

### Trade credit allocations and terms

- **Cycle speed of credit approvals**
- Customer value vs. terms granted
- Customer-segment DSO analysis
- Accuracy of customers' demand forecasts
- Negotiate win-win terms

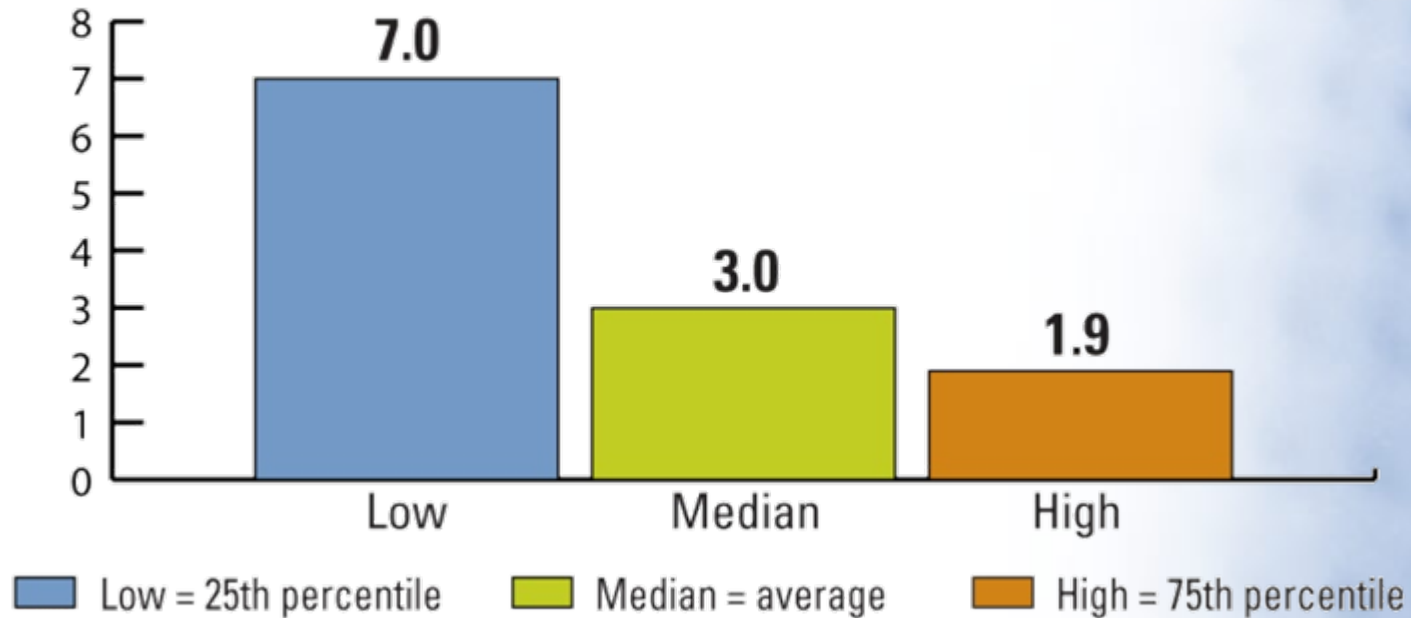
### Invoicing

- Cycle time to create accurate invoices
  - **Cycle time to deliver accurate invoices**
  - Communicate with high-dollar customers—all ok?
- 

### Metrics to manage trends in collections

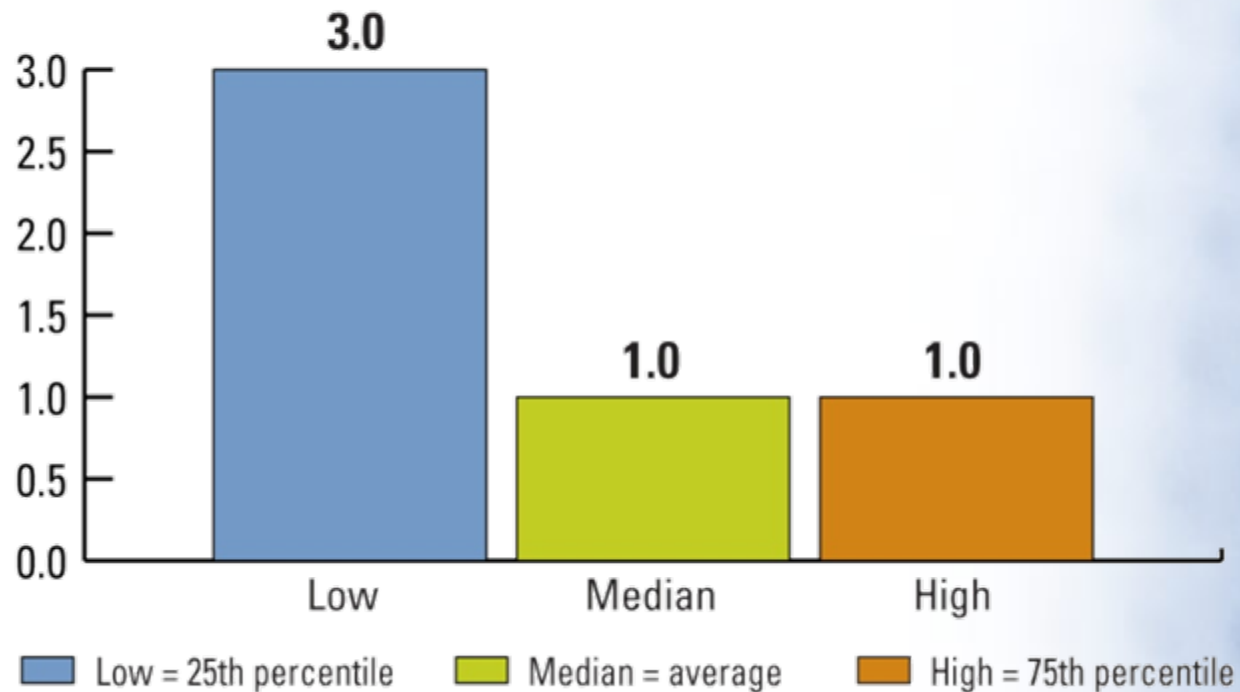
- On-time payments vs. customer segments
- Dunning speed

## Cycle Time in Days for Credit Approval



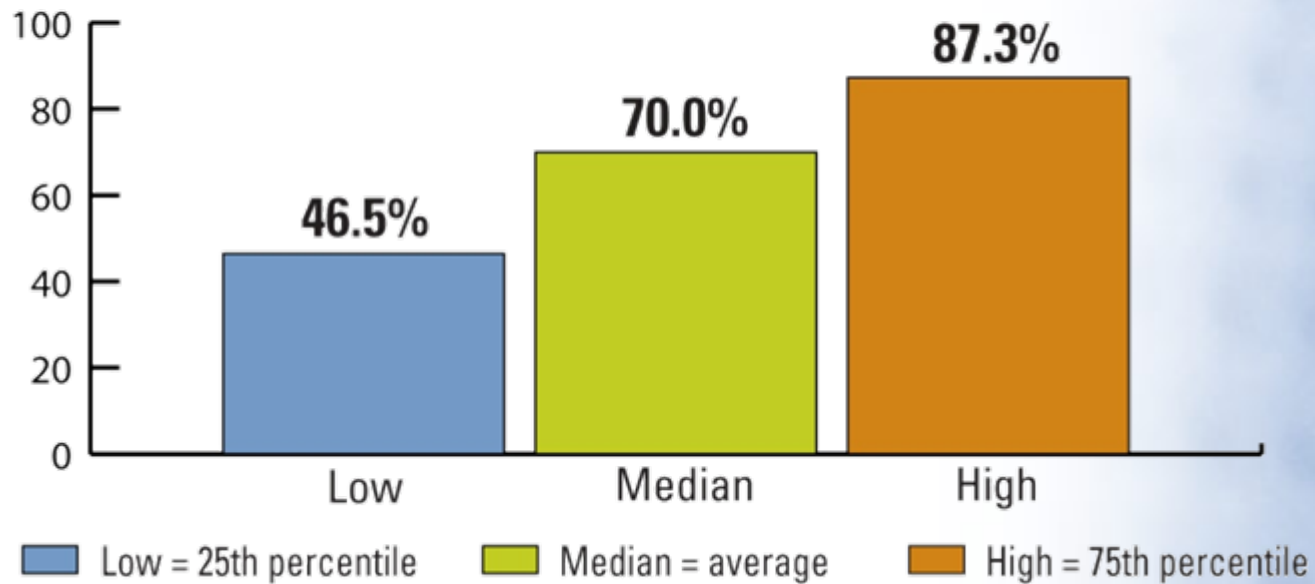
N = 108

## Cycle Time in Days to Generate Complete and Correct Billing Data



N = 42

## Percentage of Line Items Billed/Invoiced Paid on Time



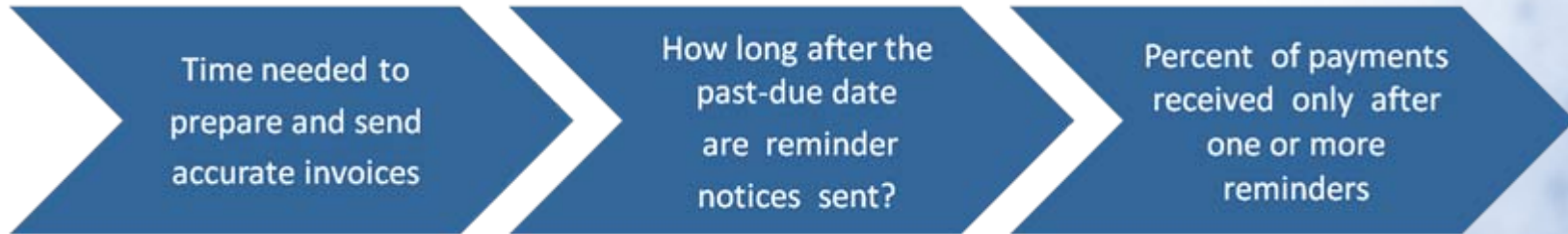
N = 51



## A Quick Poll

- Answer brief questions on blue handout
  - You can answer anonymously
  - This will take just one minute
- We'll collect these and see if we can spot some trends
- More structured analysis to follow
  - If you provide your contact information, we'll share the results with you.
- All the names of those that complete a poll will go into a drawing for an iPod Touch later this Spring.

# Root Causes: Obstacles to DSO Reduction

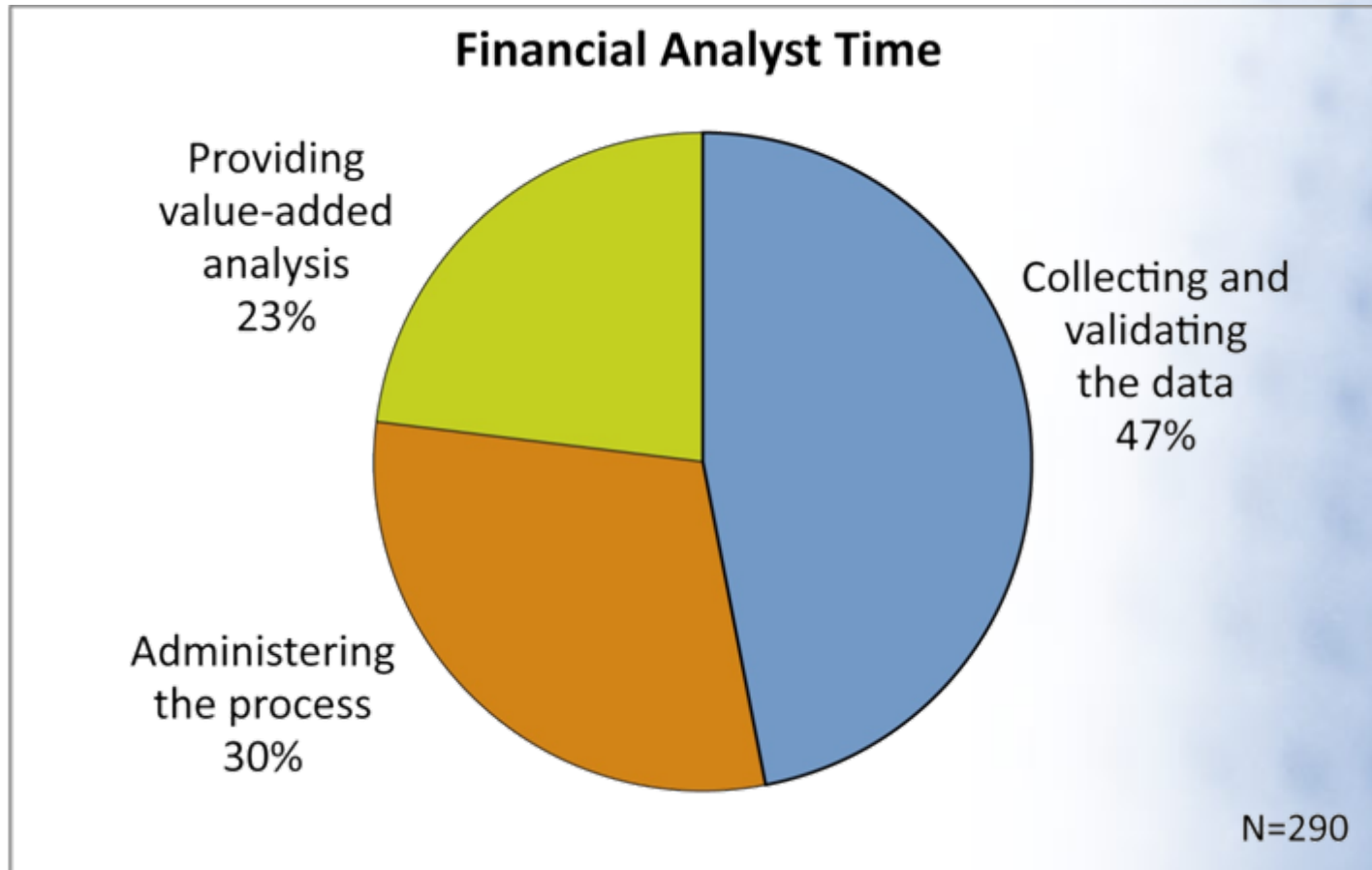


- Given the annual volume of invoices, are you too slow?
- Is the process sufficiently automated?
- Average number of invoices needing individual intervention due to errors?
- What causes the errors?
  - Bad addresses?
  - Bad order entry?
- Is policy formalized?
- Is performance tracked?
- Is accountability assigned?
- Does finance staff focus on this only “when time permits”?
- If payment amount is significant, are you starting reminders earlier?
- Are you strictly enforcing payment terms?
- Are you offering faster-pay incentives where appropriate?
- Are you considering electronic collections?

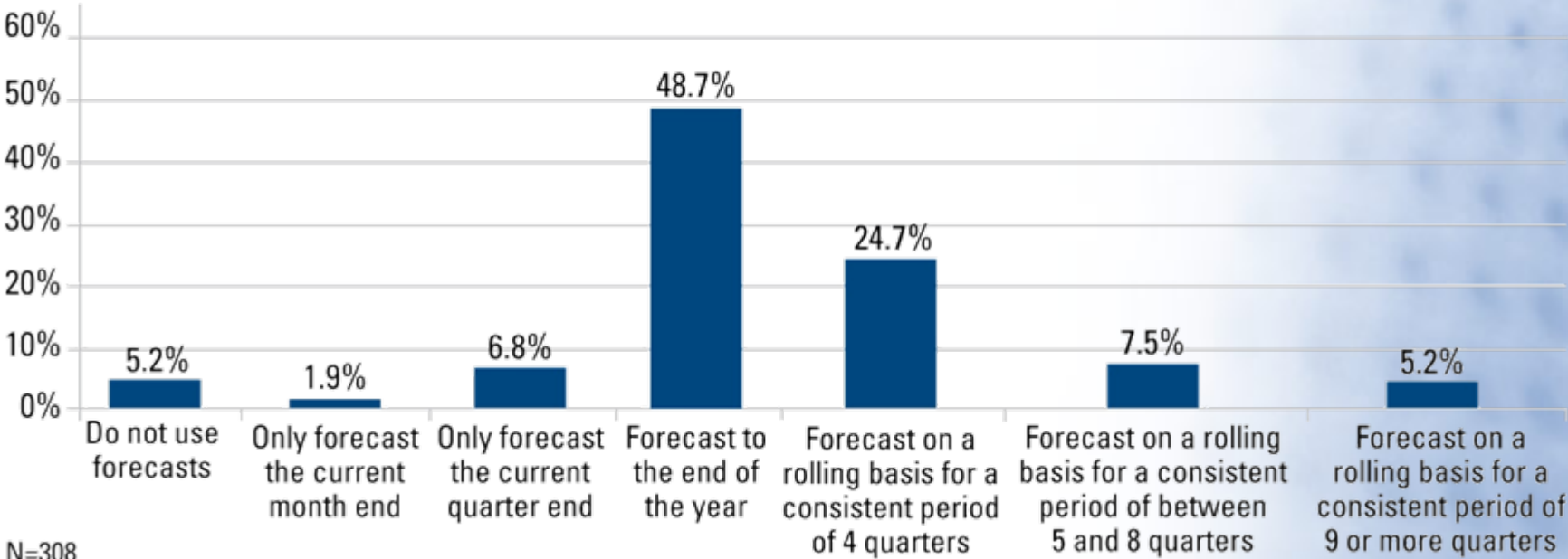
(3) Redirect finance talent to analyze how to liberate cash and help business managers do likewise



# Simplify and Eliminate Redundancy



### Extent of Forecast Use

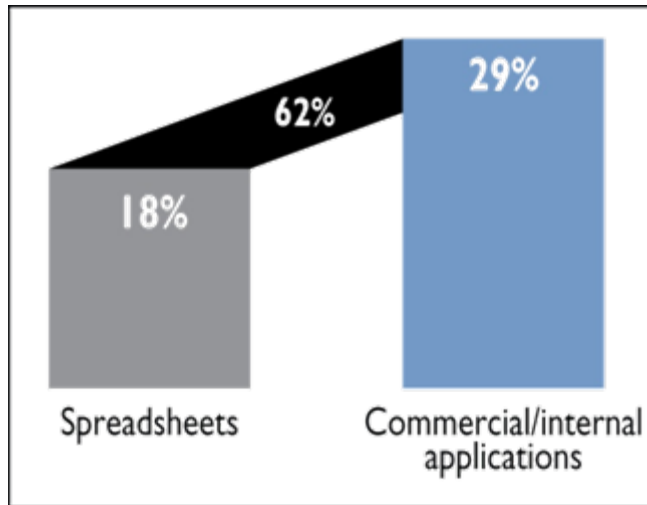


N=308

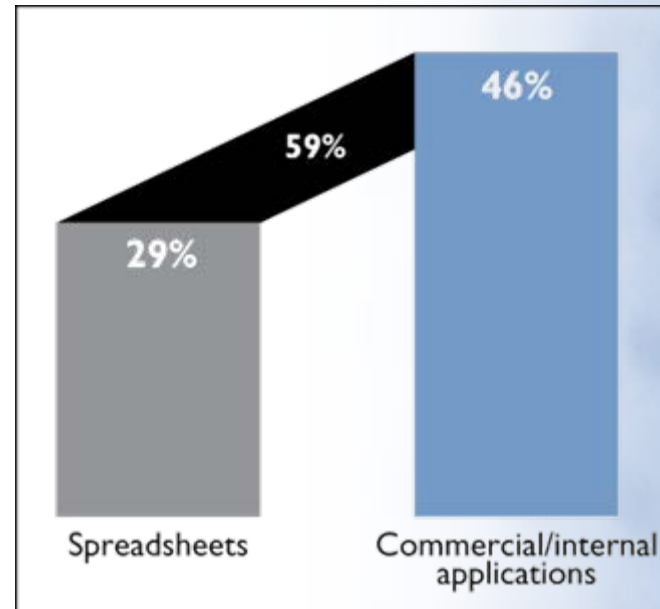
# Simplify and Eliminate Redundancy

- Trim the number of budget iterations
  - More than half the participants are doing 3 or more budget iterations, some as many as 6 per year.
  - No correlation between number of iterations and accuracy.
  - Simplify process to decrease iterations and increase satisfaction.
- Technology can help cut down iterations and increase accuracy.

**Complete a budget in 2 or fewer iterations**

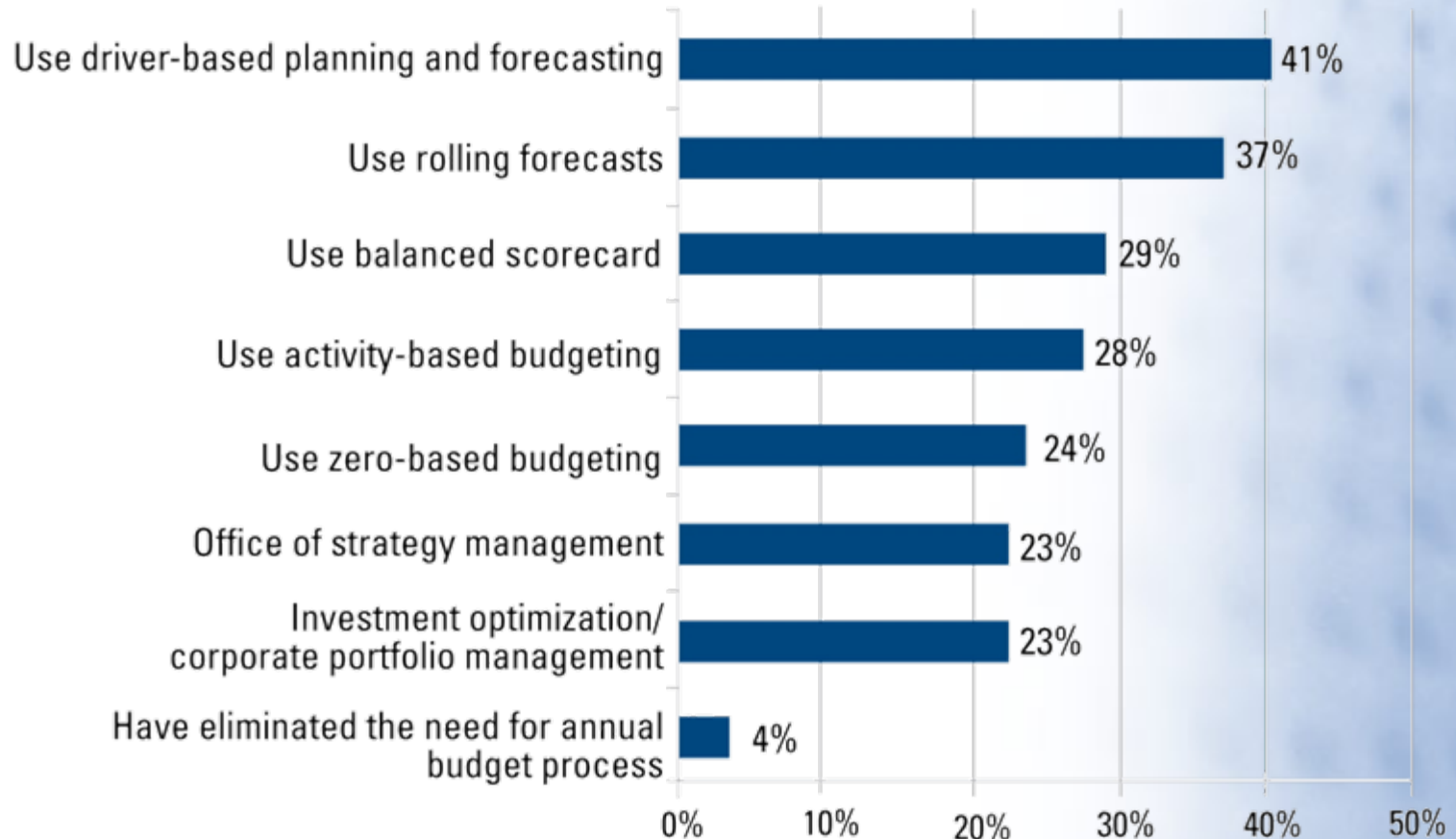


**Planning accuracy within +/- 5%**



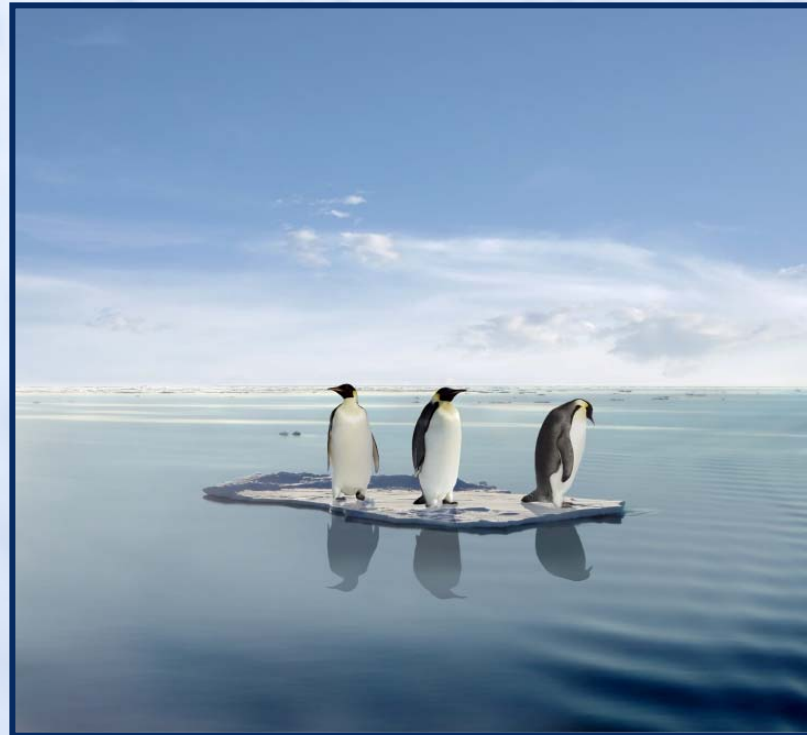


## Advanced Practices



N=290

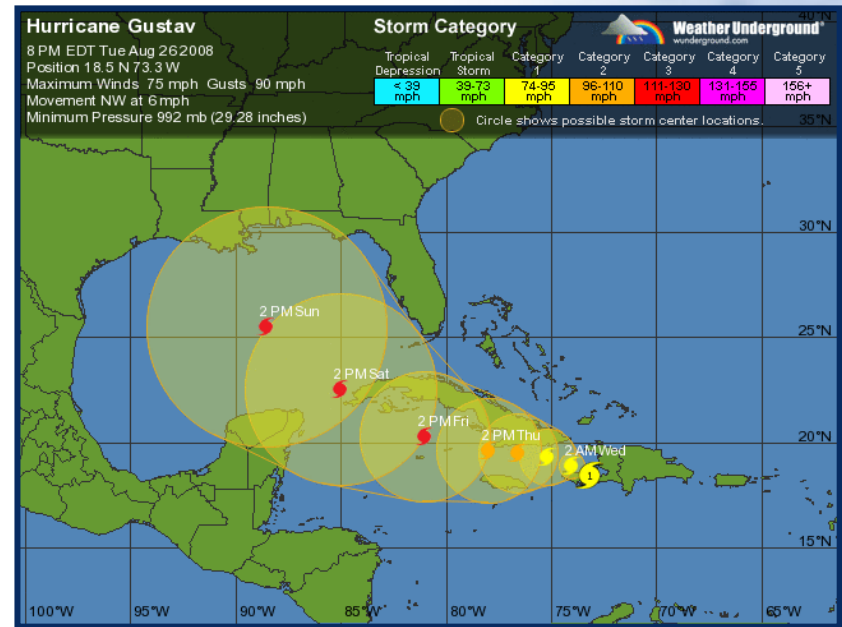
(4) Look around corners: Make performance planning, forecasting, and management relevant



APQC.

# Think like the mayor of a city about to be hit by a major storm

- Move into adaptive mode in an emergency
- Track and communicate the likely trajectory of the threat
- Take down preconceived scenario analyses
- Activate contingency plans to minimize risk of damage
- Transform finance into a “danger control center”



# Stop / Start / Continue

## Stop:

- Eliminate excessive detail on forecasts looking out more than 3 quarters
- Lose spreadsheets – they are poor tools when collaborating on forecasts

## Start:

- Find high-leverage opportunities to reduce DSO
- Forecast the drivers of revenue and capture “actuals” in a timely manner
- Review promotions frequently and model impacts on sales, profits, liquidity
- Model the impact of declining revenues and/or rising costs on margins and cash flow
- Motivate sales force to increase reliability of revenue forecasting
- Manage op-ex as a portfolio, continually trimming, delaying, reassessing

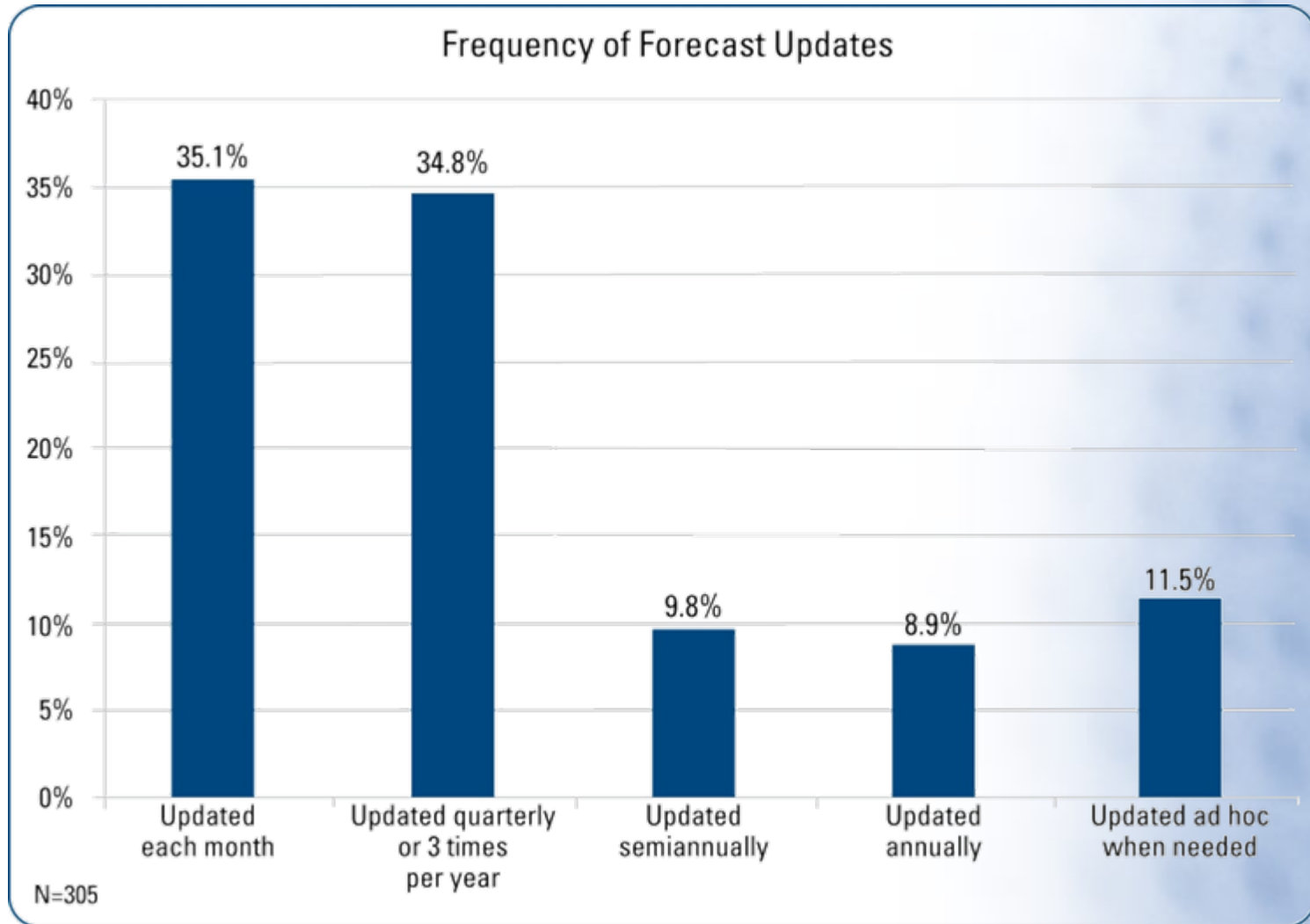
## Continue:

- Invest in financial talent and skill-building
- Look for creative solutions with your trading partners to keep cash moving
- Hunt for lower-cost ways to process transactions

## Summary:

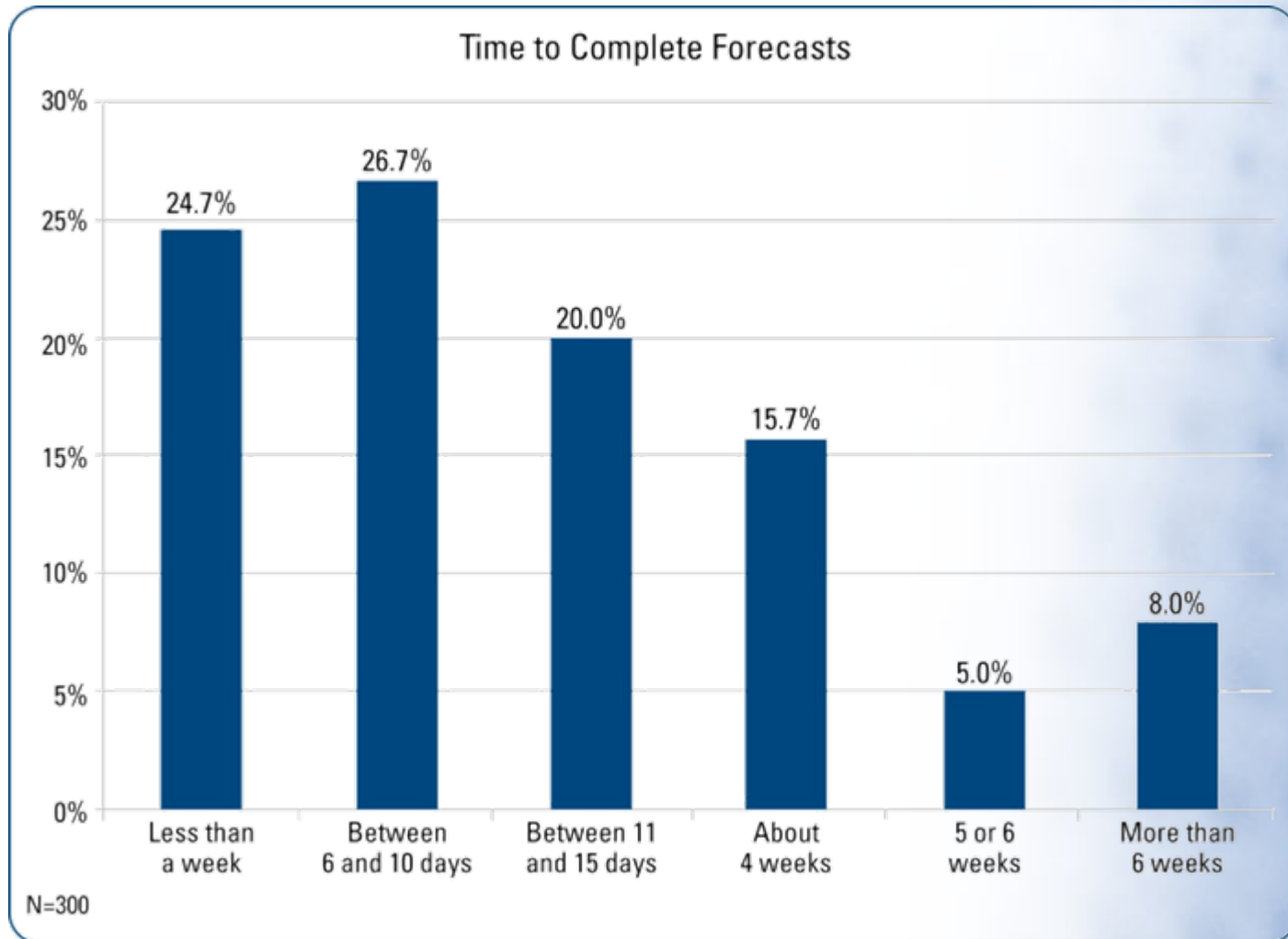
- Find ways to release cash during tough times
- ✓ Benchmark and track the underlying processes in the finance function that might be unnecessarily swelling DSO
- ✓ Segment customers based on their value and risk
- ✓ Use predictive analyses and tools to monitor cash flow drivers
- Assess whether you can negotiate better terms via early payments
- Monitor the financial strength of key suppliers
- Use financial analytics and tools to monitor current/future demand trends and learn how to align inventory levels in accordance
- Avoid “too lean” or “too fat” inventory levels
- Do the math for all players!
- Tie incentive pay to achievement of WCM improvement goals

# APQC Benchmarks – See How You Stack Up!





# APQC Benchmarks – See How You Stack Up!



# Resource Links

**Mary Driscoll – senior research fellow, APQC**

Voice:

- Office 713-685-7250
- Mobile 857-207-5513

E-mail:

- [mdriscoll@apqc.org](mailto:mdriscoll@apqc.org)

**Would you like to benchmark any or all of your financial management processes?**

- [www.apqc.org/fm](http://www.apqc.org/fm)

