Balancing Risk and Performance with an Integrated Finance Organization

The Global CFO Study 2008
Executive Summary

In cooperation with The Wharton School and Economist Intelligence Unit
Balancing Risk and Performance with an Integrated Finance Organization
The interdependent global marketplace brings the promise of new opportunities. We certainly see that at IBM.

Last year, our Chairman laid out his vision for the 21st century successor to the multinational corporation, the globally integrated enterprise. This corporate evolution will spur new innovative business models focused on operations and functions anywhere in the world based on the right cost, the right skills and the right business environment. But what does it mean for the Finance discipline? Do we have the flexibility to not only accommodate, but also enable this innovation?

The Integrated Finance Organization journey mapped out in our Global CFO Study 2008 findings resonates with me. Over a decade ago, IBM Finance set out to create a more effective and efficient organization. At the time, many on Wall Street were calling for the break up of our business into its component parts, and we needed the facts to prove them wrong. However, the facts were hard to come by. Inconsistent measurements across various operating units made an aggregate picture of the potential synergies difficult, if not impossible. Along our journey, we established a common Chart of Accounts, data consistency, greater flexibility, a faster month-end financial close and a focus on analytic and business issues while reducing the overall cost of Finance. As proposed in the study, we have shifted our stance from providing taillights to headlights for our firm. Today, our financial management system guides the operations of the company by providing relevant information and insights. In the spirit of continuous improvement, we continue the journey.

In the global market, our Financial Management consulting practice and Managed Business Process Services can leverage our internal experience, as well as our deep domain expertise to help clients optimize their performance. We have over 10,000 financial management specialists who can help you in your efforts to identify, create and deliver lasting business value to your organization.

We would like to take this opportunity to thank each of the participating CFOs and financial executives for their time and their insights that are stimulating new thinking inside IBM about how we can better help our clients innovate and grow. My colleagues and I look forward to continuing this conversation – and this journey – with you.
In the globally interdependent marketplace, CFOs need their organizations to perform well and want to outperform their peers with consistently strong growth and big profits. They want to be superbly agile with change, tenacious with unexpected opportunities and resilient to risk. Most try to do so by letting their business units and geographies conduct Finance activities according to specialized standards and provincial preferences. But, according to a new IBM study of more than 1,200 CFOs and senior Finance professionals, this is usually the wrong approach.

Rethinking business models, operations and the impact of risk

The notion of being “global” is evolving beyond a multinational structure or mere presence in different countries toward establishing an interdependent network of worldwide assets with the ability to optimize resources horizontally and vertically. Current enterprise management structures (for example, holding companies, decentralized operating companies and integrated operating companies) show little differentiation in revenue and stock price growth. Therefore, enterprises will transform their business models to take advantage of this new way of defining a global presence. To make a strategic transformation, enterprises must also transform their operations. The key question is do current financial management models have the necessary flexibility, not only to accommodate, but to enable this transformation?

What’s more, the world is undeniably risky. Two out of three (62 percent) enterprises with revenues over US$5 billion have encountered material risk events in the last three years. Of those, nearly half (42 percent) were not well prepared for it. Moreover, risk comes in many flavors besides financial. Eighty-seven percent of risk events were strategic, geopolitical, environmental, operational or legal. Despite the prevalent exposure to risks, only about half (52 percent) of our survey participants acknowledge having any sort of formalized risk management program.

What is important to the CFO? Everything. Globalization and the prevalence of risk place an additional burden on the already full Finance agenda. When asked what areas topped their agenda, CFOs had a difficult time prioritizing – nearly every Finance activity in our survey was categorized as very important. Curiously, the study finds that two agenda items ranking lowest in importance, supporting / managing / mitigating enterprise risk (66 percent) and driving integration of information across the enterprise (62 percent), are key differentiators for outperformers in revenue and stock price growth.

So what are the drivers of information integration across the enterprise? Our interviews and statistical analysis point to enterprisewide common data definitions, a standard Chart of Accounts, standard common processes and globally mandated standards. Fewer than one in seven enterprises govern and manage the integration of their Finance organizations by the combination of these four criteria. These are the components of good governance and what we are calling the Integrated Finance Organization (IFO). IFOs help their enterprises perform better than non-IFOs. In fact, enterprises with IFOs in our study had revenue growth rates nearly double that of their industry peers. IFOs can be more prepared for risk because they are more aware of risk.

Successful CFOs are providing the truth and taking a lead in risk management

Providing “the truth.” At their core, outperformance and risk management are about getting to the truth. By “the truth,” we are referring to a single set of facts about the business that reflects the reality of the enterprise’s performance generated by hard data. Process and data
commonality enable the truth to be told. Enterprise standardization opens up new dimensions (for example, customers, channels and suppliers) and new ways to view volumes, revenues and profits. Data standards allow the organization to define critical items consistently across the enterprise, such as the components of gross margin.

Enabling such consistency shifts the conversation from “Are these numbers right?” to “How do we use these numbers to better our business?” It is the shift from the transactional to the analytical. With data turned into information then turned into insight, Finance moves beyond “taillights” – historical reporting – to a keener sense of “headlights” with which to illuminate the future direction of the enterprise.

As truth owner, the CFO can help shape operational decisions and strategic direction. CFOs with an Integrated Finance Organization understand this relationship with the truth. IFOs can build new flexibility and agility by being more disciplined, and improve speed by being organized and connected. Two actions are essential to providing the truth: establishing global standards through process ownership and simplifying the enabling systems and organizational structures.

- **Establishing global standards through process ownership** – Global process ownership (as opposed to process enforcement or process participation) is a key enabler to getting past organizational and cultural boundaries and barriers. IFOs are 3.5 times more likely to employ global process ownership enterprise-wide. Organizations with strict adherence to global process ownership are much more likely to have adopted process and data improvements enterprise-wide. Global process ownership establishes responsibility and accountability for the consistent design and deployment of processes.

- **Simplifying** – Enterprise-wide process and data standards provide greater opportunity to simplify enabling systems and organizational structures. IFOs remove structural roadblocks in an effort to increase the speed of deployment and execution of Finance activities. Moreover, enabling technologies and delivery models help to maintain global standards while providing Finance with greater flexibility to adjust to changing business models. Again, global process ownership is an enabler.

**Managing risk.** Findings suggest that enterprises are looking to the CFO for leadership in risk management. Risk management is about orchestration from the Board level to middle management. Currently, enterprises are struggling to understand their holistic enterprise risk profile. Moreover, the simple risk / reward equation means that all performance is intrinsically linked to risk. Two actions are key to managing risk: the CFO’s orchestration of risk management and the convergence with performance management.

- **Orchestrating risk management** – CFOs are uniquely positioned to determine and guide the overall enterprise risk profile. CFOs executing effective risk management are more likely to have risk management reporting directly to them. Effective organizations are also more likely to provide greater top-down direction about the enterprise’s official position on risk appetite and tolerance from the Board level to middle management.

- **Converging performance and risk management** – Effective organizations proactively manage risks to close performance gaps. Across the board, it is clear that they engage in more formal risk management activities than less effective organizations, including the use of monitoring, reporting, historical comparisons, evaluation tools, predictive analytics, risk-adjusted forecasts and process controls.
For this report, the IBM Global CFO Study 2008, we conducted extensive primary research to discover how CFOs and senior Finance professionals are affected by and deal with performance, risks, operational levers and governance. The primary thrust of the research focused on hypotheses about the CFOs’ choice to use differing financial management governance models, and their role and effectiveness in risk management.

This research is part of a series on executive issues, which includes the IBM 2003 Global CFO Survey, the IBM 2004 Global CEO Study, the IBM 2005 Human Capital Management Study, the IBM Global 2005 CFO Study, the IBM Global CEO Study 2006 and the IBM Global Human Capital Management Study 2008.

**Interviews of more than 1,200 CFOs and senior Finance professionals**

The primary survey instrument was developed through extensive workshops with Finance professionals, the Economist Intelligence Unit, Wharton School professors and other subject matter specialists. Thirty-four questions were developed and delivered to more than 1,200 CFOs and senior-level Finance professionals in five major sectors and 79 countries across the spectrum of enterprise revenue size.

Experienced IBM financial management practitioners conducted 619 surveys via in-person interviews and 611 were administered by the Economist Intelligence Unit via an online survey tool. Analysis of the data was completed by IBM Institute for Business Value analysts. Final findings and implications were analyzed and vetted by Finance professionals from IBM Global Business Services, IBM operational leadership in Finance, two Wharton School professors and other external experts. The primary research was conducted throughout the spring and summer of 2007, and final analysis was completed in the third quarter of 2007. Figure 1 shows a breakdown of the study demographics.

In this report, the term *outperformers* refers to the study participants that scored at least one-half standard deviation above the mean for the selected financial metric. Therefore, the term outperformers refers to the study participants that are in the top 50 percent based on this competitive comparison, whereas underperformers are those that fall in the bottom 50 percent.

In addition to analyzing the survey responses, we wanted to ascertain the difference between choices and approaches made by financial outperformers and underperformers in our study. To perform this additional analysis, we looked at a subset of our sample where publicly reported financial information was available. By taking a five-year view, we were able...
to identify which companies outperformed and underperformed the average compound annual growth rate (CAGR) for revenue and stock price appreciation across our sample. For this subset, we normalized stock price growth rates by analyzing the difference between the company stock price and the relevant industry index.

Compare your enterprise to this global data set through our online assessment tool located at ibm.com/gbs/2008cfostudy
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• The Economist Intelligence Unit for valuable methodological guidance, contribution to the design of the survey questions, and collecting survey responses
• The IBM Institute for Business Value for methodological guidance and subject matter expertise.
About IBM Global Business Services
With business experts in more than 160 countries, IBM Global Business Services provides clients with deep business process and industry expertise across 17 industries, using innovation to identify, create and deliver value faster. We draw on the full breadth of IBM capabilities, standing behind our advice to help clients implement solutions designed to deliver business outcomes with far-reaching impact and sustainable results.

The IBM Institute for Business Value, part of IBM Global Services, develops fact-based strategic insights for senior business executives around critical industry specific and cross-industry issues.

About IBM Global Business Services’ Financial Management
IBM Global Business Services’ Financial Management focuses on enabling enterprise innovation and performance through improved Finance organization efficiency and effectiveness. With more than 4,000 practitioners, Financial Management has a full suite of end-to-end capabilities to address a client’s challenges. Our capabilities include Finance Transformation, Finance Operations Improvement, Business Performance Management, Business Risk Management and Finance Enterprise Applications.

Further Information
To find out more about this study or to speak to a Financial Management leader, please see the contacts below or visit ibm.com/bcs/financialmanagement

Global and Americas
Steve Lukens
Global and Americas Financial Management Leader
steve.lukens@us.ibm.com
+1 917 472 3268

Americas
Tom Whelan
Canada Financial Management Leader
tom.whelan@ca.ibm.com
+1 416 478 3152

Fermin Marquez
Latin America Financial Management Leader
fermin.marquez@ar.ibm.com
+ 54 11 5070 1738

Asia Pacific
Colin Powell
Asia Pacific Financial Management Leader
colin.powell@au1.ibm.com
+61 3 8646 5662

Tatsuo Watanabe
Japan Financial Management Leader
tatsuow@jp.ibm.com
+81 3 6250 8664

Europe, Middle East and Africa
Phil Berrington
Northeast EMEA Financial Management Leader
phil.j.berrington@uk.ibm.com
+44 1926 880833

Luigi Padovani
Southwest EMEA Financial Management Leader
luigi.padovani@it.ibm.com
+ 39 02 5962 9705

IBM Institute for Business Value
Steve Rogers
Associate Partner
Global Financial Management Lead
rogers.s@us.ibm.com
+1 917 472 3414

Edwina Jon
Senior Managing Consultant
edwina.jon@us.ibm.com
+1 312 635 1096
REFERENCES AND NOTES

1 Executives asked: How effectively do you think your Finance organization is performing in each of the following areas of responsibility? Effective organizations are respondents who answered “Very effective” or “Effective” in supporting / managing / mitigating enterprise risk versus those who responded “moderately effective,” “slightly ineffective” and “ineffective.”

2 Analysis used five-year compound annual growth rate for respondents’ stock price and revenue from Thomson Financial. To normalize industry differences, the stock price compound annual growth rates (CAGRs) are the differences between an individual company stock price CAGR and the appropriate industry CAGR from the 2007 Wall Street Journal “Annual Industry Report.”