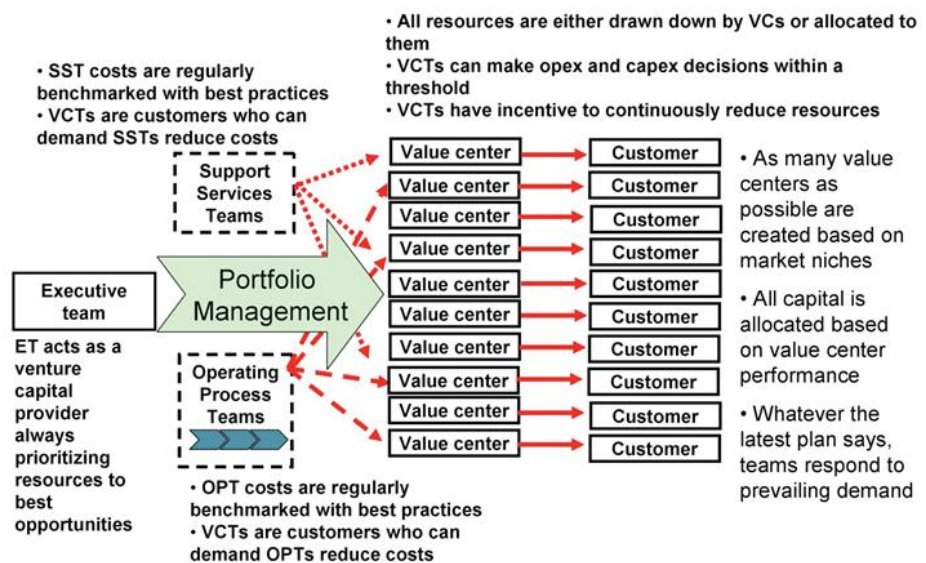


EUROPARTNERSHIP WHITE PAPER
DIGEST

Weather economic turbulence using
Enterprise Performance Management



How leading organisations are deploying
Venture Capital thinking and analytics to
weather economic uncertainty

Contents

Summary

Investing in the best value propositions

What can you do differently?

Six step guideline for assessing business value creation

Improving project investment criteria

Summary

We have previously discussed how Enterprise Performance Management (EPM) can take you “Beyond the Budget” in order to underpin delivery of strategic goals. In this paper we look at how EPM can be used to weather economic turbulence by viewing your organisation through the eyes of a venture capitalist whose goal is significant growth, profitability and cash flow by enabling and encouraging “new” ventures.

EPM, as deployed by Venture Capital analysts, ensures that you:

- know which elements of your business - brands, product lines, distribution channels, regions, branches and even individual customers - are strategic and profitable, and which should be terminated;
- have an effective and consistent way of approving new ventures and new projects, applied at every level and encouraging innovation; and
- are able to track the performance of individual investments as well as the whole investment portfolio at any time.

What would be the value of resources you could save and re-direct to priorities? How much more innovation and growth could you encourage? Recent McKinsey research across large organisations found that 25 percent of ‘business segments’ added 75 percent of value. The next 50 percent added 25 percent of value - and the remaining 25 percent added no value at all!

‘Strategy mapping’ is an integral part of EPM. A variation to help overcome the traditional resource allocation system is to look at the organisation using a horizontal accountability map – identifying which teams are accountable for creating value and justifying their capital usage. This is illustrated on the front cover and detailed in the body text below.

One organisation that uses Venture Capital thinking within an EPM approach is Toyota. They display the 5 characteristics found in all World class agile and sustainable value creating companies when it comes to decision making:

1. Find out what’s really going on;
2. Understand the underlying cause and effect on results – ask “Why?” time and again;
3. Consider alternative solutions and develop a convincing rationale for the one preferred;
4. Build consensus within the team;
5. Use simple, efficient methods of communication.

This digest is one of a series aimed at optimising use of SAP Enterprise Performance Management.

Order the full White Paper, including case studies, and a list of others in the SAP EPM Implementation Toolbox series from: john.shuttleworth@europartnership.com

EUROPARTNERSHIP: Using VC thinking and analytics within EPM

Investing in the best value propositions

How much to spend on one programme or another; forecasting return on investment in new products; and facts based evaluation of your strategic portfolio underpin financial 'life and death' decisions. Yet many companies waste capital on failed ventures and projects, or in trying to shore up divisions and sectors that are not profitable.

Enterprise Performance Management (EPM) allows all organisations to continuously monitor brands, product lines, distribution channels, regions, branches and even individual customers that are strategic and profitable. It simultaneously monitors and analyses individual investments against the whole investment portfolio in real time.

The McKinsey research findings showed that most organisations spend and waste significant amounts on the wrong businesses, products and projects and in specifically that:

- it is not easy to identify which segments are in which category. Accounting systems typically work vertically rather than horizontally, making it difficult to relate investment and support costs to independent business segments – and something that hasn't materially changed over the decades;
- investment capital is often allocated without effective scrutiny. Around 50 percent of investments did not pass a 'strategic impact' test - and only one in seven projects added value beyond 'break even'.
- most organisations don't track investments effectively. 75% of IT organisations had little oversight over their project portfolios and employed non-repeatable, chaotic planning processes.

McKinsey conclude that decisions are often made by people without all the salient facts to hand. Whilst operating through a small number of directorates limits the direct reports, divisions make it difficult for CEOs to see clearly where value is created or destroyed. Division heads decide whether and where to invest – with a bias is toward meeting short-term demands. Only 59 percent of financial executives would pursue a positive net present value if it meant missing quarterly earnings targets; and, even worse, 78 percent said they would sacrifice value in order to smooth earnings.

The outcome is missed opportunities and a blind spot as high performing units mask poor performing ones. Senior executives are often unaware of decisions taken and there is little transparency in decision-making about value creation.

What can you do differently?

CEO's who see their organisations as communities of teams delivering 'customer value', recognise the value of a hierarchy (although they tend to have less of it). Instead, they work with a multitude of small teams, each fully accountable for profit or value generation. This is illustrated by leaders such as Ohno (Toyota), Wallander (Handelsbanken), Iverson (Nucor Steel) and Kelleher (Southwest Airlines).

Each Toyota plant is full of workstation teams that are responsible for continuously improving their performance. At Handelsbanken, each branch team is a profit centre scope and authority to run its own business (there are around 600 profit centres). Nucor Steel operates through hundreds of self-directed teams with just four layers of management between the CEO and the floor worker - and only 66 people in the head office. At Southwest, each "route" and each airport "station" is a team. In the retail sector, Whole Foods Markets stores comprise multiple teams (e.g., fresh fruit) that are accountable for their results and that have the authority to appoint their own team members.

To facilitate these changes the performance management system is realigned using "horizontal" data flows to cope with multiple "profit and loss" accounts. It should also be able to maintain the views of Key Performance Indicators; outcomes such as economic profit; trends; and forecasts.

American Express standardized models and assumptions, since when tens of millions of dollars reallocated between business units to optimise investments. In one year the company was able to invest 20 percent more funding over their base plan, which led to an 8 percent rise in new cards.

Six step guideline for assessing business value creation

1. Create as many value centres as possible (each with its own profit and loss account). These offer senior executives a more transparent view of where value is created and destroyed.
2. Act as a venture capital company rather than a central banker. Derive projects from strategy reviews and align resources according to the highest priority initiatives.
3. Reorganise accounting and information systems so that value centre teams have fast access to full profit and loss information as well as key operational indicators. Design insightful value centre reports based economic profit realised.
4. Use a standard investment approvals process and criteria to identify innovative value creation projects. Support this with balanced and “weighted” strategic impact, risk assessment, NPV, cost, timeframe and sustainability impact. The table below is used by an investment bank.
5. Implement EPM to enable the executive team to continuously examine risk and reward both at the individual project and portfolio levels whilst actively managing the portfolio.
6. Reward teams based on value creation relative to peers. Implement an evaluation and rewards scorecard that include criteria weighted towards value creation.

<i>Investment Approval Criteria</i>	<i>Definition</i>	<i>Weighting</i>
Strategic Importance	Supports objectives on Balanced Scorecard	40%
Cost	Total cost of implementation and ownership	15%
Implementation Timetable	From concept to realisation	15%
Net Present Value	Three year cost and benefits analysis	10%
Interdependencies	Assumptions concerning external factors	10%
Risk and Complexity	Operational and Technological dependencies	10%

Improving project investment criteria

A further requirement is a common process for project approval and tracking. When capital is scarce, use criteria strictly aligned to strategic objectives such as: attract and retain high potential value customers; increase revenue per customer; or reduce cost per customer. Strategic initiatives should build competitive advantage such as sustainable differentiation. Initial screening addresses issues such: the impact on resources within other functional units; absolute cost (e.g. is it over half a million); and will it take more than three months to implement? A bank undertook a retrospective analysis of over one hundred initiatives against the criteria set out on the front page of this document. Only eleven survived the screening. All the others were referred back to the owners to either resubmit or stop.

Investment optimization includes all “capital” or “revenue” based initiatives. Use data on financial returns, risk and strategic importance as an ongoing process. Key performance questions include: “How do we use available resources to improve future performance?” The process of allocating resources amongst various projects from functional groups is a way to increase enterprise flexibility by showing which items to fund.

Above all, enable your executives to focus on value creation rather than budget variances – move resource decisions to front line teams and leave the board in control of the strategic portfolio.

Europartnership delivers high quality support designed to improve organisational performance through consulting, facilitation and training in strategy development, performance management and Balanced Scorecards. Our approach is to work in partnership with clients to establish continuous improvement programmes – adding value by knowledge and skills transfer.

Our mission is “to equip organisations to improve performance”

For more information contact john.shuttleworth@europartnership.com