To enhance effectiveness, Financial Management has to be more offensive

The debate and conversation has raged for years: What is the role of finance? How can finance migrate from bean counter to being a "strategic business partners? What is the value of finance?

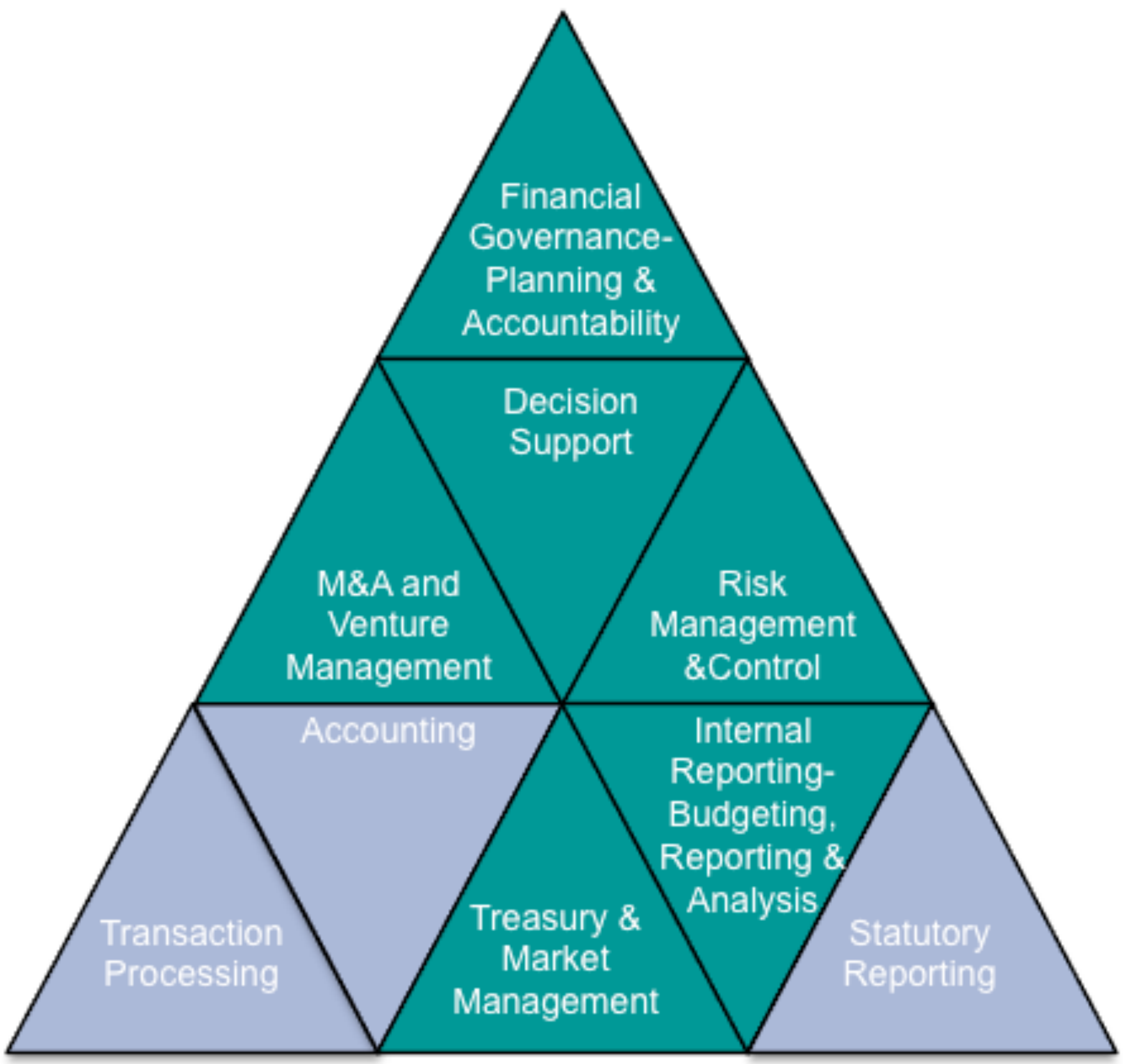
No matter the assigned topic, the role of finance differs by business with some businesses appreciating finance more or less than others do. In many companies it is the monster in the middle of the room- that few are willing to acknowledge. We have been following the conversation for years, and have worked with scores of companies in one-off situations to help deal with the issue.   We believe that the performance challenge is so significant, that it is important to reengage in the conversation because a highly performing finance organization can help drive the entire company's performance.

In a prior note we identified nine key domains of financial management. In our experience these seem like they cover most of the areas of finance that would benefit from an explicit conversation about the role, requirements and performance of finance in any given situation. The purpose of the nine dimensions is to create an organizing framework for an important discussion and set of decisions about finance. To be effective, the conversation needs to simultaneously focus on both the whole of finance as well as its key components. The chart below identifies the Nine Domains of Financial Management.

Perhaps it is Post March Madness depression but the metaphor of defensive and offensive financial management seems to make some sense- at least as an entrée to having a grainier conversation about the challenges of finance- and the huge benefits that effective finance can bring.

We have identified three defensive (grey) and six offensive (green) domains.

Defensive Financial Management ("DFM") domains are the basics of the accounting world- recognition of economic events, assessing the economic events to ensure proper accounting treatment is applied and transforming them and their relevant data into transactions that are codified to produce statutory reporting.



We have classified the following domains as DFM:

Domain	Key Considerations

Transaction Processing	• Economic events are recognized and their relevant data elements are captured in transaction systems that update operational and financial systems, in accordance with appropriate accounting conventions
Accounting	• This is a three-part process for high performing companies. ○ The first part for expected recurring events - in the anticipation of new business, new transaction forms, unusual economic events etc. is to assess them in light of the appropriate accounting conventions to capture appropriate data in appropriate systems to ensure that appropriate transactional information is reported and substantiated at the end of the accounting period. ○ The second part involves financial leaders participating in the business to identify new/unusual (generally one-off) economic events or transactions to ensure that they are appropriately captured and accounted for. ○ The third part includes the "manual" review of financial transactions, reports etc. as part of the close process to identify anomalies that may have "slipped through the cracks" of the first process
Statutory Reporting	• The periodic Statutory reporting process is the opportunity to take stock of all that has transpired in the period and to ensure that all appropriate economic events are reported to stakeholders in compliance with the appropriate accounting conventions. This practice enables comparisons over several periods and begs explanations of financial results in the context of similarly vetted results in prior periods. For public companies around the world, there is a presumption that auditors will be involved in the process, further increasing the prospects of the reliability of reporting for investor and other key decision maker evaluation and decision making processes.

In most organizations, there are several truisms that can be said about DFM:

- Historically, more staffing and costs have existed in these areas and as a result, they have been the subject of downsizing, reengineering, shared services, automation, outsourcing and significant management attention etc.....
- It is the job of DFM to
    - "Catch" non-compliant transactions and make them compliant;
    - Ensure transactions are authorized
    - Group transactions according to accounting regulations for reporting.
- Sarbanes Oxley focused a substantial amount of rule, regulation and control on the DFM arena and as such, there has been additional attention applied to this arena.
- For many organizations, the rapid implementation of Sarbanes caused them to be expedient and they adopted a largely detective oriented control environment- not because it was most effective- but because it was fast to stand up. Some are starting to revisit their mix of controls and processes to make them more preventive in their orientation.
- In the post Sarbanes implementation area, companies are turning to make DFM more efficient

Because the outcomes in these domains have been assigned explicit measurements their effectiveness can be "seen":

- Controls are either effective or not effective- and if not effective there are gradations of their "non-effectiveness"
- Accounting treatments are deemed to be either acceptable or non acceptable
- Reporting is deemed to be compliant or non-compliant with standing regulations

The outcomes, in terms of trends in restatement of financial reports, citing of control deficiencies speak volumes for the advances that have been made. Yet the amount of energy and cash that has been invested in these areas when you include the extraordinary "start up investments" in testing and remediation has been substantial. Whether or not you agree or disagree if their have been positive returns, on this "investment", most all agree that the unexpected outcome, has been that the investment that was poured into these areas precluded investment for many companies in the Offensive Financial Management ("OFM") domains. In fact, because of the penalty of non-compliance in the DFM areas, some of the resources in the OFM domains were reduced and redirected to DFM.

As a result, as the economy begins to show signs or recovery and change, many companies are finding themselves concerned or deficient about the capabilities in the OFM domains to provide effective financial management in the post recession era that will be hallmarked by hypercompetition, super sensitive lenders and investors, a paucity of debt etc.

The development of OFM capabilities will help companies

- Create, protect and sustain their options
- Avoid or prudently manage risk
- Proactively deal with a rapidly changing and tightening competitive environment.

Here are some key considerations regarding the OFM Domains:

Domain	Key Considerations
Financial Governance- Planning, and Accountability	• This is an end to end process that starts with the goals and strategies of the Business, creating high level business plans, understanding results and analyzing and presenting results in a manner to establish a culture and focus on accountability for results. • The need for better planning in an uncertain environment with limited or high cost capital resources being available is evident. The quality of the processes employed is variable. The need to hold business leaders accountable for achieving their plans is not a new concept- just one that is under applied in many instances- but given capital constraints, among other factors, the internal demand for capital will lend itself to an environment of explicitness and accountability for returns. • With investors and lenders digging out of holes, they will be working to re-establish their own credibility. As a result, they will be very attentive to later vintage investments- and their performance against agreed plans- Business leaders will have to clarify data, sharpen their assumptions and logic and be explicit about expected returns on ongoing business results and results of incremental investments in strategies and hard assets. • Solid Planning and Accountability processes are key to achieving this end state.
M&A and Venture	• Industry consolidation most always follows challenging

Domain	Key Considerations
Management	economic times. Strategic M&A is underway- in what is proving to be a not very deep market (we are not witnessing a lot of competitive or follow-on bids), and as credit loosens and lending rates move up from 2-2.5X EBITDA, we should see more financial players enter the market. The volume of refinancing that will take place over the next five years is about $800 Billion in the PE/LBO market alone. The ability to attract capital and wisely deploy it will depend on the perceive quality of M&A and venture management capabilities. • Absent M&A, "Ventures" will emerge as a form of strategic alliance. If history repeats, these will prove to be tricky to manage- as many of them fail, and it will take new and smart skills to successfully manage relationships in this environment • M&A process from diligence through assimilation needs to be made more effective and efficient. The demand for effectiveness is apparent from historical M&A results- and becomes ever more important in this financial environment as big gains in values will have to be wrung out of operational excellence. People performing M&A diligence will have to become really good at handicapping the range of possible operational improvements that can be garnered in the first 5 years of ownership as they perform diligence efforts
Decision Support	• The lack of leverage in the market- places a premium on solid risk adjusted business returns • The attentiveness of capital sources will require iron clad and timely cases for investment • The quality of the investments in the business will be the determinant of the perceived quality of management • As a result, companies will need to invest in sharpening their decision support processes, tools and capabilities, and these will have to be applied consistently and constantly throughout the business and the business year
Risk Management processes and Control	• Enterprise risk management has been shunted to the side in many businesses. The language surrounding it has been off putting for many- but the basic concept of identifying risk factors and working into your strategies and plans- how you will manage or exploit them, doesn't seem to be an idea that should be dismissed. In a hypercompetitive environment, new risks will emerge and existing risks- will become more

Domain	Key Considerations
	complicated and challenging. If a business believes it faces risk- it should get much better at identifying, managing and exploiting them.
Treasury and Market Management	• Capital markets are going to be attentive and full of expectations. With many investors digging out of holes, it is not unreasonable to think they will be especially attentive to late vintage investments as they try to regain their footing and demonstrate results for their investors. As a result it will be critical for companies to "do what they say " and say [very clearly, articulately and convincingly] what they did. • Because of current but hopefully increasing leverage availability, management of capital, will be key. • Access and relationships with capital markets will be key to ensure that options are opened and sustained and that trust bonds are built
Internal Reporting-Budgeting Reporting and Analysis	• The demand for results will place a burden on finance to ensure quality of earnings. • Analysis and internal reporting protocols will have to be relevant, reliable, readily available and compelling to management to draw early attention to problem areas and to provide laser- like insight into remedies • Leading businesses will be able to simultaneously understand their business performance across multiple dimensions- Geography, markets, channels. Products and services, by strategy element, lines of business etc. Moreover, businesses that are effective in their financial management will be able to both predict/forecast results and to provided suggestions for remedies when anticipated results do not meet existing expectations.

Bolstering and deploying capabilities in these areas will be key for business success. We are not suggesting that achieving high levels of performance in this regard is easy- or else a lot of company's would already be doing it well, and it would not be an avenue to help fundamentally or incrementally improve performance

Enhancing OFM capabilities is hard for several reasons:

- Scope and reach across the organization
- OFM can deal with a seemingly infinite number of opportunities, challenges and situations- making it hard to develop a "play book"

- The lack of play book implies the need for "smart and savvy people" working in consort with each other across theses dimensions- until the processes can be ironed out within the organization- and then deployed so that the organization can gain leverage on the knowledge and skills of a few smart and savvy people
- The imperative to introduce effective financial management concepts into the thinking and capabilities of most every business group by helping to spread and intensify people's knowledge of the "business of the business"- how it makes profits and creates value in each sector of the business
- Variety of the "starting" preparedness and capability of the stakeholders and players that need to be involved
- There are few objective measures of success- making it difficult to gauge progress or to modulate investment in these domains
- The best players in this domain start out as great athletes and develop a specialty, and then another, and another- whereas in DFM- the players specialize early and forever

There are few if any one-size-fits-all solutions for OFM. Despite the challenges, it seems that more effective financial management capabilities would be better than fewer. The work that needs to be done to help make Finance more effective depends on several factors:

- The current state of financial management capabilities
- The depth and breadth of skill and capability the organization decides it needs
- The resources to develop/acquire the skills and capabilities
- The pace at which your organization can endure the required changes.

A relevant story about this has been circulating. A CFO was discussing the investment required in people and processes to achieve the desired end state. Like many CFO's this one was cost conscious and was having a personal struggle about the amount and pace of investment. In relaying the dilemma to the CEO of the company, the CFO said: "what if the people leave after we have trained and developed them" then this will be wasted". The CEO quickly responded- "what if they stay and we don't develop them?"

We believe that most every organization can improve the Effectiveness of its Financial Management. We also believe that organizations that don't focus on it now will find themselves further behind in the very near future and will require more resources to achieve reasonable end state performance levels.

Software companies have invested heavily in the downturn to create and polish systems to aid in most every domain- from planning and budgeting through reporting and decision support. Enterprise Risk Management has also undergone transition that makes it more practical and less esoteric for companies to employ. In addition, new companies have delivered solid product to market and many are offering capability through SaS business models. These advances make the tools available to most every size company.

The challenge for every great offense is a sound plan

Start with understanding your current capabilities (real and perceived) and then decide on the end state of capability you need to be successful. Enter into dialog about the gap and decisions about closing the gap:

○ Define the gaps in terms of business practice, process and people
○ Identify the best way to approach each dimension of the issue
○ Decide to Make or buy the talent? Develop or hire?
○ Engage key people in the process
○ Make fundamental decisions
○ Launch and monitor the change process