

Male Speaker: Welcome back everyone. It's now my pleasure to introduce to you Mary Driscoll, a Senior Research Fellow at APQC. Mary is an author, editor, and lecturer with expertise in corporate finance and business management. She serves as Senior Research Fellow at APQC, where she leads the new financial management best practices research initiative. For over 30 years, APQC has been on the leading edge of improving performance and fostering innovation around the world. APQC is a member based, nonprofit, currently serving more than 500 organizations in all sectors of business, education, and government. Now, previously Mary was President of CFO Research, the research services arm of CFO Magazine. She spent seven years as a senior editor at CFO, developing features on topics ranging from finance transformation and capital markets to financial management information systems and leadership development. CFO Magazine is a division of the Economist group, which is based in London. Mary has also written several business books including the professional reference guide *Cash Management: Corporate Strategies for Profit*. Mary is joining us today to talk about how CFO's are using new performance management practices and analytical tools to cope in 2009. Mary, over to you.

Mary Driscoll: Thank you *Mark[Phonetic]* for that very kind introduction and thank you everyone for your attention today. I am Mary Driscoll and I am a senior research fellow with APQC as Mark mentioned and I am going to be sharing an awful lot of what I think are very interesting benchmarking and survey data with you that will help us all take a look at this very poignant question and that is how are CFOs coping in turbulent times. Before we jump into that I just want to take a quick moment and explain what APQC is because I am sure that not everyone knows. APQC stands for the American Productivity and Quality Center based in Houston. We are a nonprofit research organization. We are not a consulting firm. We have been around for over 31 years and recognized around the world for helping organizations accelerate performance improvement. How? Largely through benchmarking and our databases focus on metrics that are global and that are current and really what we are trying to do is help people see how they stack up against peer groups and different types of industry segments with a view toward process improvement. With that said, let's jump right into it. Certainly, no one would argue with the fact that we are in turbulent times. North America and certainly European economies are in a painful decline. Unemployment rate is headed over 10% in the US alone before there is any retrenchment. We see governments bailing out industries left and right. Emerging markets are not immune. I mean it was once thought that China, India, Vietnam, and Singapore, those very you know fast growth Asian tigers, that perhaps they would not be affected by what was going on in the western economies, but that is not true at all. Even India has had a slow down in growth and countries like that have a great deal of fear about political unrest. Russia in particular is currently watching the events in the Ukraine very, very carefully. So, these are very, very unprecedented and scary times. Let me submit to you that 2009 will be remembered as the year of the business refinancing crisis. I mean certainly the major banks in US and Europe were in distress. The government here in the US has been working very closely with the very largest banks and people worry about really what is the core health of some of those organizations, but think of it this way. Seven hundred billion dollars in commercial loans in the US are going to have to be addressed in the coming 12 months. Those loans will

need to be either cut, reduced or rolled over, which is a neat trick when we have like credit markets and capital markets in particular remaining frozen and shut off to all, but the strongest buyers. The weaker credits are paying 500, 700 basis points more than they were even six months ago. Bank lines of credit can evaporate even if the company is current on all its loan payments and doesn't have a problem with the fault. If a banker comes in and wants to see your cash flow levels and sees a quarter over quarter decline in liquidity, that bank could *get into your*[Phonetic] your credit line. We have already seen that in the commercial real estate sector. What sector is next? I think what CFOs are really asking themselves or should be is can our business model support the loss of liquidity and that is what I am going to focus an awful lot today is working capital management, really the notion that cash is oxygen, and that you have to link you know your forecasting of the P&L with forecasting over on the balance sheet drivers and we will talk a bit more about that in a moment, but I would like to submit that we are going to talk about five steps to make finance much, much more relevant in these very difficult times. The first one is understand what drives the speed of cash conversion and steer around those obstacles that slow you down. Secondly, we are going to talk a great deal about how to liberate cash trapped in working capital by addressing the drags on performance that exist in financial processes, for instance, billing errors. Think of it this way. With more and more exposure to customer defaults with less easy access or less affordable access to bank credit or even capital market funding, there may not be an awful lot a CFO can do about those kind of external factors, okay? But the things he can, he or she can do involves addressing internal operations and where processes are really putting the breaks on cash conversion. So, we are going to talk a lot about that today. We are going to talk about redirecting finance talent to relevant areas, we are going to talk about performance planning and forecasting in management and finally how to deliver financial intelligence to the real business decision makers, helping them understand how their activities impact liquidity, capital efficiency, revenues, *costs, and* [Phonetic] margin. It's so easy in good times to just focus on quarter over quarter or period over period earnings growth. In times like these, people have to be redirected to focus on the metrics and the operating drivers that really do count. Here is our CFO coming down a rapids; what you have to think about is what drives the cash conversion cycle and anticipate that you are going to run into the obstacles and figure out ahead of time how you are going to steer around those obstacles. Certainly, turbulent rivers pose greater risks. Think about it. You need to understand or inspect, look for the risks in your revenue streams that aren't there in times of bubbling economic growth. You want to really understand your customers' exposure to their customers' inability to pay or their customers' slow pay. You want to look for or anticipate unexpected declines in demand. We will talk a bit more as we go on about demand because that scenario where CFOs are telling me really loudly and clearly that they want to address, demand forecasting has *broken it*[Phonetic]. I would gather you know the vast majority of companies could use some improvement in that area. Companies also looking at risks in the cost structure; what if suppliers disappear? Not only might your prices skyrocket, but are you exposed to perhaps a very dangerous glitch in your own ability to operate because a key supplier component or piece of your process isn't there? So, what you want to do is also assess the viability of your very key suppliers as well. So, risk of the cash conversion cycle, you know, you could have suppliers tightening terms, you can't move inventory or you can't

remove obsolete stock fast enough, but more than anything else you are going to see exposures to customers who are slow paying or not paying. A quick case study here talking about how to liberate cash trapped in operations, now this comes from Jack Alexander's book called Performance Dashboards and Analysis for Value Creation, a really great book, John Wiley & Sons, 2007, when he joined this company, this is a case study from a company he joined as CFO, over billion dollars in sales, a manufacturer of electronic systems, he felt that DSO was too high and he felt that inventory turns were too slow. Well, to cut to the chase, they were able to address those things and found they could liberate 90 million dollars in additional cash and that was a good... a nice piece of change that was used to pay down debt, which in turn had an impact on asset turnover, net income, and return on invested capital. The point of this case is not only the significance of the amount of cash that can be liberated when you address certain things, but also the fact that working capital management, a lot of it is real meat and potato type of stuff. It's not rocket science. In this case, Jack explained he had gone in and taken a closer look at the process and found that an awful lot of these... the late paying customers were coping with errors in invoices and bill payments. Well, further inspection shed light on the fact that there was just a real mismatch of the way data was being entered and master file setup, but... so it was very common sense stuff. He also found that finance people were re-keying an awful lot of invoicing data that didn't need to be and as a result you know errors were slipping in, errors worth you know some portion of 90 million dollars. So, the point being that you can find these things if you look and the payoff for doing so is quite good. More than anything we are focusing on what questions CFOs should ask in business reviews. It doesn't make sense. It doesn't now to talk about you know what's the reforecast, *these are [Phonetic]* the targets that was set six months ago in these uncertain times, some major companies recently have said, "We are not going to give quarterly earnings guidance anymore because we can only see out eight weeks. What sense does it make to say we think our earnings in three months are going to be x when our visibility into what our sales pipeline or demand pipeline looks like and what our availability is, we don't know." So, stop asking irrelevant questions and start asking, well, why is demand fluctuating, what can we do about it? Engage your sales and marketing and front line business people in conversations about how you can be really more adaptive and agile. It's all about adapting to these troubled times. Secondly, let's talk and here is the meat of the presentation, let's talk about boosting the speed and accuracy in financial management processes that hold cash hostage. You could take any of the *[Inaudible]* processes. I chose revenue management here because the point I want to leave you with is that you really need to identify how to leverage improvement opportunities. Now, we talked a minute ago about order taking and order placement and how accuracy in that process is so very important, certainly cycle speed in any one of these subprocesses is critical as well. I will show you some data in a second on the cycle speed of credit approvals and what the impact of being slow is. Down in invoicing I am going to focus in particular on some benchmark data having to do with cycle time to deliver accurate invoices. All in all you see that what you want to come up with are the relevant metrics to manage trends in cash collections and cash conversions. Okay? So, you don't want to help customers slow pay or no pay. Okay? When your exposure to customer debt is at an unprecedented level, it really makes sense to focus in this way. Here is some data right out of APQC's recent refresh of what it calls its OSBC database.

The point here is we are looking at cycle time in days for credit approval. Now, on the right we see that the very best performing companies, the top quartile, can approve a credit for sale in less than two days; the median, three days, but the poor performers, those at the bottom of the ladder, take over a week and I will look at this and I say, "If I am the CFO of this company, there is at least five days difference between the top and the poor performers, five days where a customer is waiting for approval and may that sale could easily evaporate." So, that's negligent practically in this day and age I would say. Let's take another look at cycle time in days to generate complete and correct billing data. Well, here we see the top performers and the median performers are kind of neck and neck. The poor performers take over three days, now keep in mind they do averages, three days on average for the poor performers, so what that means is some do it, it could take more than five days, right? So, the difference between one day and three day in my mind is an unnecessary two day addition to your day sales outstanding metrics. Okay? And finance people can easily do the math and figure out two days of DSO, unnecessary DSO in my mind is worth what? Do the math, it can be awful lot of money. Let's look here now. The percentage of line items billed or invoiced, the percentage of invoices paid on time, now, this is interesting. The best performers report that close to 90%, okay? That's not too bad. Even the median, well, that could be better, the median performers say that 70% of their invoices are paid on time, but look at the poor performers, 46%, 47% of invoices are paid on time, okay? What's wrong with this picture? All right. That says to me again that there must be process areas that are really the weak links in the chain and if I were a CFO at a company that had that kind of performance, I would come in and say like, hopefully, I would be the new CFO looking at this, "Why is that? What is causing that drag?" So, all in all, you want to look at the root causes, obstacles to DSO reduction. Again, I have a lot of charts here that I would like you to use as checklists. These are discussion points you can have with your staff. You know, you could go in and say, well, all right, time needed to prepare and send accurate invoices. Do we know what our performance is? You know, given the annual volume of invoices, are we too slow? How do we know if we are too slow? Is the process sufficiently automated? How long after past due date and reminder notices are sent? Well, funny thing here, I think you know this is probably more of an organizational issue. Many, many finance organizations contain people who are constantly multitasking. What this means is it's probably likely at many firms that when it comes time to do the monthly close or the quarterly close, everything else stops and the focus is on the close. Well, you have got to ask yourself are the eyes taken off cash collection for a week, 10 days, five days? Can you afford that? Can you afford to let your attention drift from the obstacles in the cash flow stream and I would argue in this day and age you can't. Any time delay has a mathematical value to it and time value of money with a time value of cash not collected, do the math. So, again, look at the percent of payments received on or after only one reminder notice. I saw a statistic recently that said that 50% of companies that don't pay on time actually are just sitting there waiting for a reminder notice. Now, that's bad manners, but be that as it may, if you are a collecting company, you know you want to go in and ask are we really strictly enforcing the terms, are we offering any faster pay incentives, are there technology solutions that could speed this up or make it more frictionless for our customers? Redirecting finance talents - here is where we start to talk about not just process cycle or process accuracy, but the

intelligence that can be pulled out of operations, that can help finance make some good recommendations to operating managers about how they can intervene and influence cash flow conversion. Unfortunately, when we look at how the typical finance analyst spends his or her time, it's a gloomy picture. This picture ladies and gentlemen hasn't changed I submit to you in roughly 12 years, okay? If we had done this data, done this kind of survey 12 years ago, it would just about stack up the same. Now, this is a survey that APQC just completed in early January, right? December, January. What we see here is that basically 77% of an analyst time is spent either administering the process or collecting and validating data. Only 23% of the typical finance analyst time is spent doing value added analysis. Now, that just doesn't make any sense. It's just a waste of talent and should send up a big, big red flag to many CFOs who find themselves in the situation. Here is an interesting finding having to do with forecast visibility. Again, we have collected this data just at the beginning of the year and look here, we see about the number of people doing rolling forecasts. Well, we see that 24%... about 25% forecast on a rolling basis for a consistent period of four quarters, okay? And almost 8% on a rolling basis for consistent period of five to eight quarters and a bit more, 5% nine or more quarters. What really jumps out at me with this finding is that the vast majority of companies do what we call forecasting to the wall. They are merely forecasting the end of the period, each quarter forecast to the end of the year, okay? In this case, the question you are asking is fundamentally different than a true rolling forecast. What they need to do and you can see is be able to look around corners. You need to give yourself that visibility on what's emerging so that you can react. So, again, the wrong questions asked when you forecast *[Inaudible]*. The question is radically different and it should be a performance management question about what was our strategy, what has changed, what's different, how can we adapt as opposed to are you going to hit a target that was set six, nine months ago? You can also see that there are a number of things that companies can do to really simplify and eliminate redundancy. Now, achieving simplicity requires you know really obviously we talked a lot about stopping unnecessary activities, but you also need to ensure access to real time data and real time updates. So, you know, you can't get around the fact that you need a robust infrastructure to allow constant instantaneous review of measures and other vital information. Now, we have some statistics here that show that organizations using commercial applications or internally developed systems are significantly more likely than spreadsheet users to be able to keep themselves to less budget iterations. Now, we did find in our survey there are some companies doing six annual budget iterations. You know that just sound insane. What a waste of talent and time and energy. Okay? So, certainly technology can help cut down iterations. It can also increase accuracy, right? Companies that are using commercial applications or internally developed applications you know find that they can hit their planned targets within 5% and that is a significant increase in accuracy. Here is a quick list at other advanced practices in financial forecasting and planning that we drew out of our December survey; 41% are using driver based planning and forecasting. This is really, really the emerging trend. Now, the tricky bit here is that to make it really, really worthwhile, you have to do what you can to capture the actuals. On top of that, finance will want to build a number of dashboards or graphic representations of what it means. This is a place where finance really needs to become the educator, you know to reach out to nonfinancial people and help them make the connection between well the activity over



here has an impact on finance metrics over here. The other thing we see here is 37% indicating that they are moving toward or using already growing forecasts. The other techniques in this list are pretty much status quo, but it is the top two that we are seeing some good movement. The other point I want to leave you with today is talking about what finance can do to really make performance planning, forecasting, and management relevant. The point here is that finance must ensure that business managers really have clear visibility into the key performance indicators on a timely basis. It's not enough just to have dashboards. It must be well designed performance dashboards with relevant metrics. You don't want to be like the penguins who find themselves suddenly on the melting iceberg. You want to be able to give your managers key process measures as well as leading edge measures of leading indicators of cash and capital performance. This picture here strikes me as very germane to where many CFOs find themselves today. This is actually a graphic from Hurricane Gustav. This is an actual picture from the hurricane tracking center and you can see how when the hurricane was still over Cuba, the hurricane control center was able to predict or provide various extrapolations about the path of that hurricane and so if you were a mayor of a major city such as Tampa or New Orleans or Houston or Corpus Christi, you were very much watching that shifting picture, that shifting radar of where the hurricane might land. So, I want to suggest that CFOs really want to think like the mayor of a city about to be hit a major storm and that brings me back to our relentless theme on being in adapted mode. Certainly, we are in an emergency. Our capital markets have never been in the shape that they are in now. Think of it this way. Two thirds of all US industrial companies are rated junk bonds, okay? *[Inaudible]* predicts that in 2009 we will see a default rate on those bonds of close to 14%-15%, *when normally in a recession we just see [Phonetic]* junk bond default rate kind of eke up from 4% to 5% to maybe to 7%. We are facing a massive exposure to debt defaults on top of everything else. What is a CFO going to do to prepare for that emergency storm? Well, don't you want to put your folks through their paces before the storm hits and ask, do a stress test of your ability to withstand various levels of payment defaults by customers? Stress test your ability to withstand a variety of possible scenarios such as the loss of the key supplier, so that if you have to you can activate contingency plans and minimize the risk of damage. In this way, finance can be transformed into a damage control center and that's really what finance needs to do today to be relevant. So, again, stop doing useless things, start doing relative things and certainly continue doing things that are all aligned with the goal of helping to navigate through this very difficult time. A couple of ideas, again from Jack Alexander, who is a Babson professor and author of the book on performance analysis and management, he makes a few suggestions when it comes to focusing on cash collections. He will say, "You know, okay, why don't you start under the heading of find high leverage opportunities to reduce DSO?" Okay. Well, why not drill into patterns of past due collections? Perform a root cause analysis of any invoice exceeding a certain dollar level and past due for a certain period of time. Now, it is best if you can do this with an automated general ledger analysis system or other type of systematic approach, but again, this is what I mean as a perfect example of how finance can control and anticipate and measure, okay? Measure the potential risk and damage if the storm hits at a certain angle. Another thing you can do is track the level of receivables past due by you know say 10 days and do this on a monthly, weekly or daily basis and what you want to do here

is obtain timely identification and faster resolution of emerging problems and use this analysis as a leading indicator of accounts receivable performance. Extract information from those patterns and sit down with your sales and marketing people so that they understand when they provide payment terms to key customers or spark certain promotions that involve discounts, what the impact is not only on the underlying credit risk in your customer portfolio, but your customers' ability to pay. So, a big thing here is modeling the impact of declining revenues or rising cost on margins and cash flow. So, you know what you can withstand and what you can't. Motivating sales force - well, this is where the rubber meets the road for a lot of CFOs is as we said earlier, revenue forecasting. Now, sales people by nature hate to fill out reports and CFOs tell us that by and large, not all certainly, but by and large an awful lot of the sales forecast data is *dodgy[Phonetic]*. In this environment, a company can't tolerate that kind of *dodgy[Phonetic]* data. So, this is just an opportunity where and it can be done successfully either with a carrot and/or a stick. Finance has to find a way to motivate the sales people to work differently, so that their sales forecasts are more reliable and useful to the finance department in planning cash and cash flow allocations. So, again, this is another one of these checklists that you can use to sit down your staff and some of these things may or may not apply to your organization, but you can just go through and you will find yourself doing some soul searching and that's what we want to leave you with today. To wrap it up, you want to find ways to release cash during tough times. Now, you can benchmark your performance, you can track the underlying processes in finance that might be unnecessarily putting a drag on cash collections. I mean your DSO is going to go up anyway in a recession of this kind, but look at ways that you can keep it creeping up even further by fixing things that you now do poorly. Another thing we could spend a lot of time on talking about segmenting customers based on their value and risk. All right. So, here is a question. Are you treating all customers equally? Well, all customers aren't equal. There is good customers and bad customers when you look at their payment pattern, okay? So, certainly those who are behaving badly and not paying and really abusing credit terms need to be addressed. Finally, you want to use predictive analysis and tools where we tend to monitor cash flow drivers. Assess where you can negotiate better terms with suppliers, monitor the financial health of key suppliers, you want to really look at how you can use financial analytics and tools to monitor and anticipate future demand trends and learn how perhaps you can better align your inventory levels in accordance. Now, the academics will tell you that 50% of working capital is allocated to inventory investment. We haven't talked an awful lot about inventory optimization today, that's perhaps a completely different conversation, right, but the linkage between good inventory management and cash flow management has to be tighter at many, many companies and certainly what you want to do is keep a balance between being too lean and therefore exposed to you know supply price risk so you want to have a balance between being too lean and being too fat obviously, but that's a very tricky thing to do and that's a hard thing to address overnight. That's not an easy fix, but companies who have invested in those linkages between inventory management and financial forecasting are finding themselves in relatively better shape right now. Finally, as I said before, finance needs to do the math for all players. Okay? Nonfinance people don't automatically compute that an activity that doesn't look to be a financial activity actually has a financial impact. It's up to finance to spell it out, do the math, reeducate, educate,

raise the financial intelligence of everybody. That's the way you are going to get cooperation and goes without saying to the extent that you can compensate people to influence working capital management in a positive way, well, more and more companies are including working capital metrics in their incentive compensation mix of targets. So, you may want to look at that. Again, you want to tie incentive pay to the achievement of working capital management improvement goals. I mean easier said than done because think about it, to really, really succeed, what is required is courteous and attentive cooperation by a variety of functions that are often on each other's throats - sales, logistics, manufacturing, service delivery, marketing, finance, customer service, all these different groups are often battling each other out for scarce resources or protecting their own turf, the real way to get improvement in working capital management is to find ways to get cross functional cooperation. Before I leave off, just want to show you two quick slides to show you types of benchmarks we do at APQC, in case anyone is interested, they can let us know. You can find out for instance where you stand. These will be your peer group in terms of frequency of forecasting updates; that will help you do kind of a quick check on how good is your or how relevant is your some aspects of performance management relative to your peers. How long does it take to complete forecasts? Are you too slow? Are you keeping up? Are you fast enough? These are the types of things that you can do with process benchmarking. There you have it. If anyone does want to reach me, here is some contact details. Love to hear any feedback or any questions that anyone has from listening to this presentation and finally, I just want to say thanks for your attention. Have a great day.