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Succeeding in a volatile world

How the best managers and organizations are adapting to the new economic realities

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When historians look back on the first decade of the 21st century I suspect they will mark it down as a period of transformational change in the world of commerce. The last few years have seen a unique combination of systemic change driven by globalization, technology and increased environmental awareness combined with a number of seismic shocks to the global economic system such as 9/11, SARS, Hurricanes Katrina and Rita, the Asian Tsunami, Sarbanes Oxley and the global credit crunch. The combined effects of these two forces will forever change the way managers manage. Add in the emergence of the Internet as the primary means of information sharing and as a powerful force in the conduct of global commerce, and the emergence of China and India as economic powers and it is no surprise that there has been a tremendous increase in volatility, uncertainty and risk.

The world has been transformed from a series of loosely connected economies with reasonably predictable flows between them to a complex web of relationships where the global impact of local events is felt almost instantaneously. Managers must learn to succeed in a world where:

- Volatility will remain high due to the ever-increasing interdependence of customers, suppliers, regulators and markets.

- Events formerly viewed as extraordinary are now part of the normal course of business. All companies need to be able to understand how they will respond to unexpected material events, both positive and negative.

- Opportunities for competitive advantage and differentiation will increasingly depend upon an organization's ability to lead markets (e.g. Apple's purposeful obsolescence of its own products to maintain market leadership) or exploit opportunities (McDonalds' and Wal-Mart's ability to capitalize on consumer's renewed focus on low cost).

The implications for performance management are significant. The relatively static five-year strategies, annual budgets, quarterly forecasts and monthly reports upon which organizations have relied for decades will no longer get the job done. Such processes do not deliver the flexibility and visibility that managers need. They are being asked to manage real time businesses using batch processes. So how are managers responding to the challenge?

As part of the research for this paper, I interviewed current and former executives from a number of companies including Empower RF Systems, IBM, Qualcomm, Sonax and Target Corporation. Their collective insights provide a clear roadmap for the management practices that will be required to navigate through an uncertain and volatile world. Five key points emerged:

1. Make confident decisions

2. Maintain (increase) flexibility

3. Collaborate more, not less

4. Focus great talent

5. Use the best technology

Lets look at each in a little more detail.

Make confident decisions

It is ironic that in uncertain times, when fast, confident decision-making is most important, traditional planning and forecasting techniques work least effectively. Instead of increasing confidence, they simply raise doubts in the minds of managers. The old adage about past performance being no indicator of the future has never been truer. History provided few pointers to the near collapse of the global banking industry, the dramatic decline in automotive sales and property values, or the incredible volatility in oil prices during 2007-08. Managers need better decision-support tools that allow for more confident decision-making.

Effective performance management processes can significantly reduce management uncertainty in a number of ways:

- Provide visibility in to key revenue and expense drivers.
- Model alternative scenarios based upon a range of market assumptions.
- Continuously monitor key business metrics and provide early alerts of the need to change course.
- Automatically communicate plan or forecast changes to all impacted parties.
- Establish confidence levels around key forecast metrics.
- Ensure broad collaboration to bring the best knowledge to bear on decisions.

For most organizations the basics are in place. Over the last few years we have seen the progressive application of technology to nearly all aspects of business as enterprise resource planning, customer relationship management, data warehousing, e-commerce, and web enablement have digitized much of the internal and external data available to an organization. Access to critical information about leading economic indicators, key business drivers, customer behavior, and supply chain performance has never been greater; however we have only just begun to harness the potential for managing performance. Effective integration of these rich data sets into our performance management processes can revolutionize the quality and timeliness of the insights available to managers by providing earlier identification of potential opportunities and threats; tracking customer and supplier behavior; and continuously monitoring key business indicators. Instead of relying on static budgets and out of date forecasts, managers can track the real time flow of business activity, which can only improve decision-making speed and confidence.

The best organizations are seeking out more relevant market and driver-based insights in order to better understand their future prospects and make more effective decisions. At Empower RF Systems, a $25 million amplifier design and manufacturing company, CFO Cordell Sweeney described how the company paid close attention to the winners and losers in the Federal Communications Commission auction of new wireless spectrum in early 2008 in order to identify new growth opportunities: "We asked ourselves how can we align our business with those organizations that won and position ourselves as a key partner?"

IBM tracks its pipeline on a continuous basis with both business units and the corporate office collaborating to get as complete a picture as possible. Like many companies, IBM experiences significant back-end loading of contracts in the final days of each quarter, so it has invested in companywide processes that allow for an accurate view of pipeline throughout the period. The result is a more complete and accurate view of likely future business that greatly aids timely decision-making.

Sonax, a German manufacturer of car care products, has been able to translate investments in new performance management systems from Cognos into a much more rapid planning process. In mid-November 2008, the executive board determined that the plan for 2009 no longer made sense given the dramatic changes in the economic outlook; they needed to start again using a new set of assumptions. At a typical company, it can take sixty to ninety days to develop a new annual plan: Sonax was able to complete the process in 14 days, providing the company with a sound plan well before the new business year started.

Combining the best tools with rich, real time source data allows managers to make decisions based upon the latest and greatest intelligence. They can also be confident that any material changes in future prospects that may require a change in direction will be quickly identified. The result: increasingly confident and rapid decision-making.

Maintain (increase) flexibility

In turbulent times, the best companies seek to maintain flexibility in all aspects of their business from strategy to operations.

Between 1995 and 2004 IBM successfully grew its revenues from $72 billion to more than $96 billion but saw its gross profit margins shrink by 5 percent as some of its businesses became more commoditized. Given its business portfolio at the time, the company was forced to seek ever-greater expense reductions in order to grow earnings. The solution was to reposition the company. Over the last few years IBM has shed lower margin businesses such as PCs and hard disk drives while adding higher margin service and software businesses such as PWC and Cognos. The results are clear. While revenues in 2007 were only marginally higher than in 2004; net income increased by more than 38 percent from $7.5 billion to $10.4 billion and gross profit margins increased from 36.9 percent to 42.2 percent. Despite the global economic crisis, 2008 proved to be even better: revenues grew to $103.6 billion; net income rose to $12.3 billion; and gross profit margins rose to 44.1 percent. Jesse Greene, VP of Financial Management at IBM commented, "We anticipated the major issues with our business and repositioned ourselves well in advance." Greene's advice to others is clear, "Don't wait until you are materially threatened to act."

Beyond having the courage and confidence to make key portfolio decisions, the best are also tuning their operations to operate in a more volatile world. The ability to adjust to either sharp increases or decreases in the level of business activity is crucial to survival. Throughout the second half of 2008 we saw companies adjusting capital expenditure plans, production schedules and inventory levels as they sought to adapt to rapidly falling demand in many segments.

At Qualcomm, flexibility manifests itself in a number of ways. First the company did not follow many others in investing large sums in implementing a single, companywide ERP system. The business did not need it. Instead the company invested in building a sound foundation of high quality data and then allowed individual businesses to deploy the best solutions for their specific needs. For IT, this translated into deploying small development teams operating with a reasonable degree of freedom and employing rapid development approaches to meet individual business needs. Such an approach also allows Qualcomm CIO, Norm Fjeldheim, to quickly re-prioritize projects based upon changing business needs or changes in the external environment.

Maintaining flexibility also extends to the Qualcomm's approach to outsourcing. Fjeldheim has maintained an approach of not outsourcing any core function completely. Outsourcing is used as the "flex" in resourcing enabling the company to rapidly adjust capacity, either up or down, in response to markets trends and business needs. By retaining core capabilities in house, the company can manage service levels while also being able to size capacity to current needs.

Organizations that build flexibility into their operating model will be best positioned to weather bad times as well as profit from good times.

Elements of dynamic performance management

- Continuous monitoring of the leading indicators of customer behavior such as order frequency and size, payment timing, and responsiveness to pricing and promotional activities.

- A deep understanding of internal cost structures and the drivers of elasticity.

- Routine modeling of the impact of increasing revenue volatility on margins, earnings and cash flow.

- Increased utilization of short-term (30 day, 90 day) scenario-based forecasts in order to develop increased ability to respond to changing market and economic conditions.

- More frequent evaluation of projects and initiatives to ensure that the original business rationale remains valid in increasingly turbulent times.

Collaborate more, not less

It is tempting in a downturn for people to "hunker down" and retreat inwards as they seek to navigate through challenging economic times. The best companies recognize that this is exactly the wrong behavior. Challenging times demand even closer collaboration, both internally and externally. Effective performance management processes and systems help enable communication and collaboration but leading companies do more.

Strategic partnerships with key customers and suppliers always make sense but in turbulent times the value of relationships where both parties are fully vested in each other's success is even more valuable.

Since the emergence of e-commerce, reverse auctions, and other competitive bidding techniques many long-standing relationships have been sacrificed for the sake of short term cost reductions. For many this has backfired. The absence of a strategic connection reduces the customer-supplier relationship to that of a transaction. At the very time that people are looking for understanding and mutual support there is no basis for loyalty. Steve Kowalke, former Vice President and Treasurer of Target Corporation, emphasized the crucial importance of developing and maintaining key relationships in good times: "Maintaining strong relationships with key funding sources will pay dividends in tough times." As banks have dramatically reigned in their lending, those organizations that have developed trusting and mutually binding relationships are in the best position to maintain liquidity.

Qualcomm has long invested in its relationships with key technology suppliers by being an active participant on customer advisory boards and collaborating on new product development. CIO, Norm Fjeldheim commented that, "It's important to get our technical people connected to our partners technical people rather than just interfacing with sales or client service teams." Partnership also means doing the basics well. Jesse Greene of IBM commented, "We value the relationships and pay on time." For small and mid-size companies this can be the most valuable attribute of a strategic relationship at a time when many other clients routinely extend payables cycles causing significant hardship for their suppliers.

Internally, effective collaboration and communication greatly enhances decision-making quality. Steve Kowalke described how the treasury function at Target was actively encouraged to work effectively across the organization, "We were given the license to look across the business and see where our skills could have an impact."

At Qualcomm, CIO Fjeldheim, is investing in social networking tools to complement the core business systems as a means to further encourage collaboration and communication. In addition to improving execution the company has also seen new innovative ideas surface that can help position Qualcomm to benefit when the economy improves. At IBM, collaboration means ensuring that the best global and local intelligence is built into sales forecasts by having both corporate and business unit functions work together.

Underpinning effective collaboration is confidence in the underlying quality of the data. At Sonax, scorecards for each decision-making unit can be immediately combined into a total company view supporting the company-wide performance management cycle. Sonax's CIO and Controller, Gerhard Jahn, comments that, "We have a transparent view of all the figures at all times and can provide all the relevant people with valuable information for decision-making." Fjeldheim at Qualcomm has invested heavily in "getting the data right" to ensure managers have confidence in the information they are using to make decisions.

Clear and honest communication based upon mutual trust and respect underpins all successful relationships. The price of failure was clearly exhibited in the financial services industry during 2008 as Bear Stearns, AIG and Lehman Brothers all suffered the consequences of a loss of confidence by key trading partners.

Focus great talent

It is easy during volatile times to view people as simply your largest expense. The litany of layoffs and rising unemployment rates around the world supports such a view. However, tough times also allow the best to shine. In the aftermath of 9/11, not a good time for airline industry, Southwest Airlines was able to further distance itself from its competitors by not only making money but also avoiding any layoffs. The company was actually able to upgrade its talent during a bleak time for its industry. This is what the best do; they see a downturn as an opportunity to get stronger.

Attracting and retaining talent is a core competence of all great organizations; equally important is allowing talented people to perform by providing the right leadership, focus and tools. The tendency is to limit freedom when times are tough. Effective leaders, who hire and develop the right talent, do the opposite; they encourage initiative and innovation confident that their management processes will avoid the big mistakes while not limiting creativity.

Staying focused requires discipline when times are tough. It's easy to get distracted and pursue strategies that don't make sense in the hope of reversing a downward trend. At Target, Steve Kowalke says the acid test for any decision is, "How does this decision reinforce the brand?" By applying such tests to new ideas the company retains its focus on offering a differentiated shopping experience.

At Empower RF, Sweeney has put in place a driver-based planning approach that focuses on key metrics including sale quote volume, order close rate (quotes that turn into orders), average price and cost, and book to bill cycle times by product category. His team can then focus their analysis and discussion with business managers on the real drivers of performance. It's working, as Sweeney commented, "I had an engineer come up to me after a team meeting and tell me that he knew he had generated $1 million in revenue after completing a new program because he now understood how what he did impacted the financial results of the company."

In tough times there's also pressure to stop investing for the long term. Often the easiest cuts are those where the payback is sometime in the future. Smart companies will reprioritize investments but they will take the time to ensure they continue to invest in those areas that best position themselves to benefit from an upturn. They expect to emerge from a downturn in a much stronger competitive position. Qualcomm's Fjeldheim emphasizes that it is important to, "continue to do the things that are important in the long term." For example, the company continues to hold its annual VentureFest where employees are able to submit business plans for new ventures and the winners receive funding from the company to fully develop their ideas. IBM's Greene comments that the company "maintains discipline in the way we operate and continues to invest in infrastructure, R&D and intellectual capital."

One of the biggest frustrations for many managers is the time their professional staffs spend collecting and maintaining data as opposed to performing insightful analysis. This causes strain as the demand for high quality analysis increases while staff levels and budgets are being cut. The key is to drive up productivity (see exhibit 1) allowing professionals to focus the bulk of their time on developing insightful analysis and spending time with key decision makers.

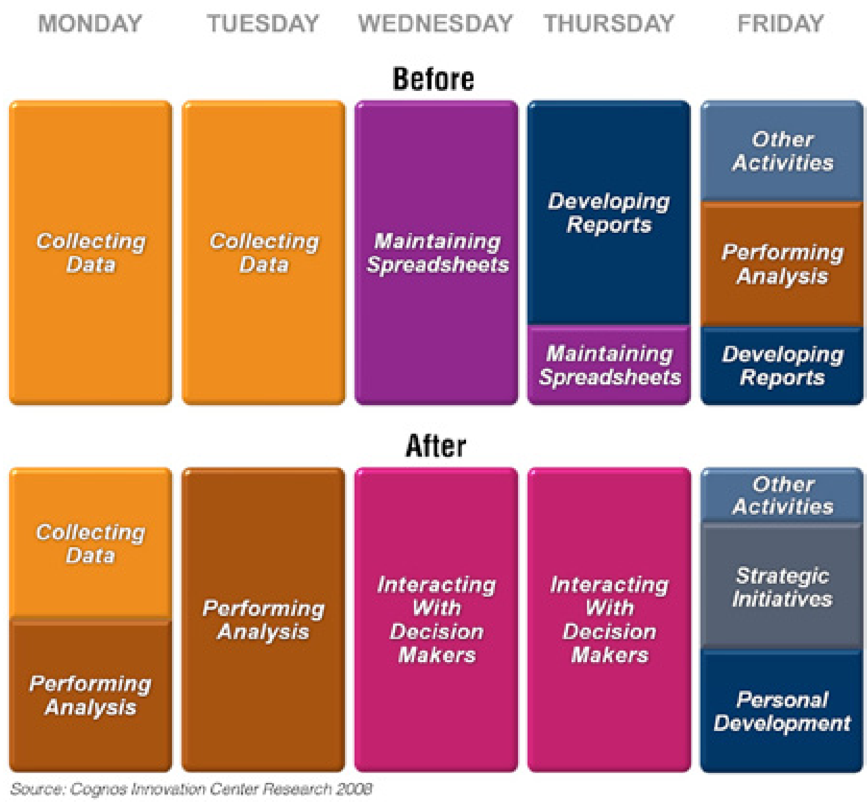

Exhibit 1: Staff productivity before and after best practice implementation

Implementing the right systems is a big part of the solution, but so is focus. For example, IBM has segmented its global markets into two categories. Major markets which represented 82 percent of the company's revenue in 2008 and are growing over the long term at around 5 percent per year, and growth markets where growth is in the 10 percent range. Such a segmentation allows the company to focus on the drivers of profitability in each area: productivity and cost discipline in major markets; and steady investment to capture both market growth and increased share in growth markets.

Such discipline is only possible if you have the right talent equipped with the right tools Instead of balanced scorecards or rolling forecasts simply being reporting mechanisms they can become the foundation for rich analysis of different scenarios and decisions thereby enhancing the overall management process.

Use the right technology

Since its first appearance in the finance department in the early-1980's, the spreadsheet has served as the "go to" tool for the finance professional and it's done a fine job – as a personal productivity and analysis tool. However, as an enterprise-wide tool for collaboration and customization to individual business or market needs it is sadly lacking. As organizations increasingly compete and source globally the complexity of planning, budgeting, forecasting and reporting have increased exponentially. Different products and markets have different drivers and measures. Budgets need to reflect the unique characteristics of different functions and reports need to be assembled, analyzed and disseminated rapidly. The spreadsheet can't cope; it needs to return to its rightful place as a rich and flexible personal productivity tool. Yet many organizations are trying to navigate through the most uncertain economic times in more than half a century using numerous poorly connected spreadsheets containing questionable data and suspect formulas. This is not just dangerous but naïve. Using the best technology for the job is no longer optional; it is essential.

In recent years, many companies have deferred their investment in performance management systems. They felt unable to justify the investment and continued to rely on the spreadsheet as the tool of choice to support the majority of their budgeting, forecasting and analytical tasks. Events of the last year have exposed the flaws in that strategy. Sonax's Jahn is clear about the value of using the right tools, "An important factor was the ability to analyze targeted strategic and operational management data and feed the results back to planning. This was crucial in creating a solid foundation for decision-making."

Failing to invest in the right tools and technology severely handicaps the management process. Specifically:

- Concerns over data integrity reduce confidence in decision-making
- Rapid visibility to changes is handicapped
- Collaboration is difficult
- Drilldown to underlying operational data is nearly impossible
- Professional staff time is consumed by data collection and consolidation tasks

The bottom line is that such approaches take too long and are too unreliable to work in today's volatile world.

IBM learned its lesson almost twenty years ago. In the late 1980s, the company faced a number of significant performance challenges some of which were caused by an overly complex organization supported by numerous different systems. For example, it was impossible to get a timely view of the company's global cash positions – essential for effective management in volatile times. IBM invested in new systems so that the company can monitor and tightly manage its global cash positions on a centralized basis.

At Qualcomm investing in the right tools has had some unexpected benefits. The company now provides direct access for customers to some of its internal management systems to speed the flow of quality information.

The best news is that there has never been a better time to make the case for investing in the right tools. Three of the most compelling reasons to invest now are:

1. Recent economic volatility has exposed the weaknesses in current processes and systems. Investors, regulators, board members and managers are all demanding improved transparency and confidence in management information.

2. Today's applications offer the richest set of best practice functionality ever. While I was researching my last book, *Best Practices in Planning and Performance Management*, I was able to confirm that today's applications are fully best practice compliant.

3. The price points for beginning the journey to world class have dropped dramatically. Even small and midsize organizations can take advantage of the rich functionality now available at reasonable cost.

Empower RF Systems is a good example of a relatively small company that is embracing best practices to upgrade its performance management processes. Cordell Sweeney arrived as the new Chief Financial Officer in early 2008 after holding a variety of senior finance positions at DirecTV. Cordell was brought in at the direction of the Board to help upgrade the management team of the company. In a little over a year Cordell and his team have been able to successfully implement a best practice demand management process. The new process provides company managers with visibility into the sales pipeline from quote through order and on through the management of the backlog of engineering work. This is delivering more accurate revenue forecasts and also allows managers to more efficiently schedule engineering and manufacturing work. Cordell and his team initially relied on spreadsheets but the team is now introducing more sophisticated tools including Cognos planning to provide a solid foundation of high quality data to further extend Empower's adoption of best practices.

Looking forward both Sweeney and Qualcomm's Fjeldhiem are looking to integrate mobile technology into their performance management processes: be it delivering key reports to the CEO's Blackberry; or enabling employees in the field to have real time access to key business information. No longer do managers need to be tied to their desktop computers in order to keep their fingers on the pulse of the business.

Conclusion

The stunning pace of the global economic meltdown during 2008 simply confirmed what many practitioners already believed; namely that our system of accounting-calendar based (think annual budgets, quarterly forecasts and monthly reports) management processes are poorly suited for today's volatile and uncertain world. The good news is we don't have to put up with it anymore; the technologies are now available to allow managers to monitor the real time flow of business activity using a series of sophisticated alerts, tolerances, and exceptions to identify material trends, both positive and negative, which require immediate attention. Reporting and forecasting can become real time, event-triggered activities that deliver focused, timely information the instant a meaningful trend reveals itself. Not only will finance have more time to complete rich analyses, but managers will also have more time to evaluate alternatives and make better, more confident decisions.

While talking with business executives around the world, I have seen a new urgency as organizations seek to capture the benefits of speed, focus, integrity and insight that effective use of performance management tools and best practices can deliver. These remain challenging times but I fully expect to see great advances in performance management over the next few years. Are you ready?

Many thanks to the following executives for their insights:
Norm Fjeldheim, CIO, Qualcomm
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Steve Kowalke, former Vice President and Treasurer, Target Corporation and an advisor to the IBM Cognos Innovation Center
Cordell Sweeney, CFO, Empower RF Systems

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