



A CFO's Guide to Analytics – Arm yourself for the next wave in finance

Insights from BPM Partners, the Chubb Group of Insurance Companies, and SAS

We've all seen the headlines. There's an economic shakeup in the works that eclipses the collapse of the dot-com deck of cards. High-flying corporations with decades of market dominance are losing ground. Powerhouse companies with market-leading products are posting staggering losses and laying off tens of thousands of workers. Companies that hold the top market positions in their industries are watching their stock values plummet to a fraction of their former worth.

What gives? If success breeds success, why are some of the world's most "successful" companies struggling with slimmer margins and more unpredictable performance results than ever before? If business performance management (BPM) has evolved into its second generation, what is missing?

Business Finance and SAS raised this issue with three BPM experts in an April 2008 Webcast designed to help senior managers chart a BPM 2.0 strategy to solidify their organizations (and their careers). The opening premise was that although CFOs are no strangers to analytics, the finance function typically lags other groups (most notably marketing) in using analytics to drive performance. Early successes in marketing could energize the adoption of BPM 2.0 in other areas.

However, if the informal poll conducted during the session is any indication, BPM in practice is a long way from 2.0. Familiar and fundamental issues are still endemic. Data inconsistencies, information hoarding, metrics madness, cynicism ... these issues and more still plague enterprises and prevent BPM from delivering the results it should. And fully one-third of respondents in the online poll indicated that their organizations didn't really know how to get it better.

Our panelists discussed their experiences implementing BPM programs in their own organizations and for others. From their discussions, it became clear that senior managers need to ask some tough questions.

Are we on a shaky foundation?

"In many companies, there's a corporate set of data and then there's the spreadsheet that everyone keeps off to the side for the data that matters to them," said Craig Schiff, President and CEO of BPM Partners in New York, a leading independent authority on implementing BPM solutions. "Until that goes away ... until they can trust in a consistent set of common corporate data – that one version of the truth that everyone seeks – it's very difficult to do any real analysis."

The benefits are reciprocal; good data begets good will. "Once you have that quality data, people will start to pay attention to what that information is telling them," said Jeff Hoffman, Senior Vice President of Customer and Marketing Intelligence for Chubb Group of Insurance Companies. "They'll start to act on it. They'll make better decisions. If you don't take enough time and focus on that data quality piece, you will fail, because you'll have all kinds of skeptics coming in and trying to pick at the data and telling you why this is wrong – and that just undermines the entire effort."

Are we using analytics – really?

“Analytics is one of those terms that mean different things to different people,” said Jonathan Hornby, director of global performance management product marketing at SAS. “A lot of people think of analytics as being Excel, with the ability to drill down into reports and query a database. That’s interesting, but that’s about the past. When you start asking questions such as, ‘Why is something happening, what happens if trends continue, and what’s going to happen in the future?’ now you need more advanced analytics that focus on forecasting, predictive modeling and optimization.”

Spreadsheet renegades will not become instant converts. “People like what they know, so you can’t just turn it off overnight,” Hornby noted. “You have to wean people off, but you have to prove the value first. You can’t just throw them the new technology and say ‘use it,’ because there’s no trust. Piece by piece, you have to help them understand how it can impact their day-to-day jobs.”

Do our people even want a data democracy?

Many organizations have an “everyone for themselves” information culture – an us-vs.-them mentality where information mavericks have authority over what and how information is used, and the power to massage information to their personal benefit.

“We go to many companies where the CFO says, ‘This is great; we want to do this,’ but then there are certain people in finance who say, ‘We’re going to be sharing that data with *who*?’” Schiff said. “They’re concerned about confidentiality, the competitive aspects of this information getting in people’s hands, and then all of a sudden they’re not so free with sharing the data. There are also people in the company who don’t necessarily want that analytical light shining in their area. They may have their pet projects that they’re happily working on for years, and they don’t really want a bright in-depth analysis of that.”

Are we measuring the right things?

“Quite often, organizations just take key measures that have been in hard copy reports for years and throw them on the dashboard,” Schiff noted. “These are not necessarily the key measures they should be looking at or the ones that drive the business. A metric is a measure of anything; a KPI is a metric that *matters* – the 12 to 25 measures that are really key to an aspect of the business.”

Hornby agreed that irrelevant metrics bog down BPM efforts. “We have customers say, ‘We’ve got hundreds or thousands of these metrics and we don’t really know which ones actually move the dials on the dashboard.’ Unless they put a strategy behind it, regularly question the strategy, and determine that the metrics drive results, they could be wasting time trying to track all those things. Analytics can identify which metrics do statistically move the dial, so they can focus in on metrics that matter.”

When KPIs talk, who is supposed to act?

When asked to describe the metrics culture in their organizations, 55 percent of respondents in our Webcast poll said, “We talk a good game, but we don’t actually use metrics well.” Part of the problem is that the metrics might be irrelevant to begin with. But assuming you’re measuring the right things, what is supposed to happen when the metrics indicate a problem?

“You could have this great dashboard, and you could all be sitting in a boardroom looking at all the gauges in the red zone, and no one thinks it’s their problem,” said Schiff. “When you develop that dashboard and put those key metrics in place, you also need to define ownership and action plans. Who’s responsible if this is not where it should be? ... Because when you’re in a crisis, no one’s going to stand up and take ownership, and then it’s kind of late to start thinking about how to remedy the situation.”

Are we doing naïve forecasting?

Naïve forecasting is often characterized by a rolling forecast where you simply add or subtract a percentage from the previous period and roll it forward into a future period – regardless of trends, events and other cause-and-effect forces that could change the picture. Companies that take this passive approach are basically saying, “This is what could happen if we do nothing to change the way we act.”

Naïve forecasting also encourages gaming, Hornby noted. “If people realize they’re going to have a budget actual carried forward into the future, they’re going to spend that money whether they need to or not. You don’t want that to happen in your organization. You also end up spending far too much time trying to justify the figures that come in, particularly if people ask for more, and you won’t consider taking funds from other areas. It distracts from the strategic angle of, ‘How do we improve the business and differentiate ourselves in the marketplace?’

“An analytic forecast says, “Let’s have a look at the data at a much more granular level and identify some trends that actually cause things to happen. ... Then we can actually increase profitability across the board, rather than just check all the numbers and make sure everything is adding up.”

If we are doing “naïve forecasting,” how do we get out of it?

Organizations should blend multiple forecasting approaches and run “champion challenger tests” to prove which methods deliver the best results, Hornby said. “The first approach is time-series forecasting; the second is econometric or causal forecasting; and the third is judgmental. Judgmental is interesting because it’s taking people and saying; ‘Have a look at the figures and tell me what you think it should be, up or down, because you’ve got knowledge about what’s happening in your particular area.’ The key for the first two is to recognize that as markets and the economy change, so too will your choice of methods.

“You need to mix all three approaches to get the best return. A typical naïve forecast could have a 50 percent error rate. Apply time-series or econometric forecasting into the mix, and you can get it down to about 20 percent. If you then bring in the judgmental aspect and feed that back into causal forecasting approach, you can get the error rate down as low as 2 percent.”

Do we really have a handle on costs?

Schiff’s firm surveyed more than 700 business leaders for its annual *BPM Pulse* survey. When asked what they hoped to gain from BPM, respondents overwhelmingly pointed to profitability analysis. “That’s something we hear again and again, not just in our surveys, but in our daily work with customers,” Schiff said. “They truly want to understand how to improve the profitability and invest their money wisely.”

But at the same time, activity-based costing ranked way down on respondents’ wish lists, near the bottom. This disconnect may help explain why so many organizations are dissatisfied with their BPM initiatives. How can they truly gauge (and improve) profitability if they don’t track the true cost of doing business and understand what causes cost to vary?

“It bewilders me when organizations undervalue activity-based costing,” Hornby said. “You need to understand what drives profit.” Standard accounting makes broad-brush allocations of overhead and shared services and masks a lot of waste. In contrast, activity-based costing allocates costs to discrete transactions or processes, clarifying costs in a way that mirrors the real, day-to-day activities of people and equipment.

Schiff talked about a customer that used activity-based costing to determine that some intuitively sound decisions actually would have been mistakes. Outsourcing a manufacturing project was a bad idea. So was offering preferential pricing to its biggest customers, who proved to be more costly to serve. These discoveries were revealed in modeling, before the company invested time or money down the wrong paths.

Are we watching the dials or moving them?

To many organizations, performance management still is a rear-view activity. Sure, it should start with having a handle on past and present performance, but BPM 2.0 offers the methodologies and technologies to be far more proactive. Economic conditions require it.

Hornby referred to a five-stage process that goes by the happy acronym SMILE. “**S**ee what’s happening. **M**anage it. **I**mprove it. You’re going to make some mistakes or some discoveries, so you have to **L**earn, and then you want to **E**volve. Eventually you want to get to the point where you are differentiating yourself in the marketplace. If you just improve the same thing over and over again, it’s not going to help because everybody else will have caught up. When that happens, you find yourself competing on cost, which ultimately erodes margins. You have to constantly evolve. Analytics deliver fact-based insights that remove emotions and help you evolve faster with improved accuracy and less risk.”

Are we strategizing from the top or justifying from the bottom?

“You’re supposed to start with the strategy first,” Schiff said, while conceding that it doesn’t always work this way. “What is the company trying to accomplish? What is the long-term strategy? Out of that will come specific goals and objectives for this year, next year and so on. From that begin to fall out the right key performance indicators that are tied to executing on that strategy. But you’ve got to start with the strategy first.”

Is that how it works? “In a textbook, absolutely,” Hornby quipped. “In reality, it’s the other way around.” The challenge is getting buy-in. “If you try to go from the top down, there are just too many people to convince – people who may come off the fence and attack it for competing with their own pet project. If you don’t show progress fast, it gets kicked out in favor of the next issue for investment.”

Hornby recommended starting a BPM 2.0 initiative as a project within a business unit. “Once you can prove success, spread the word and encourage others to follow. The results might not be perfect, but at least you gain traction and have an opportunity to evolve.”

Are we locking analytics in an ivory tower?

Whether the organization uses action to set strategy, or strategy to set action, it should exploit analytics at both levels.

Hoffman emphasized the value Chubb has seen from bringing analytics to the people – in the right way. “Just putting out another brand new analytic tool can create more silos within an organization. So we’ve really tried to focus on embedding analytics into existing applications that the staff uses on a regular basis.” For instance, the company has developed analytics that are added as a process within existing underwriting and marketing applications.

For Chubb, this strategy has shown rapid results, dramatically reducing costs by identifying higher-quality leads to deliver to agents. “We’re not chasing a hundred different leads; we’re going after a very targeted group, and our success rate on those is much higher.” Early successes on the marketing side made it easier to promote analytics for other areas of performance management, Hoffman said.

Closing thoughts

Business performance management 2.0 requires synergy and energy among a lot of elements – human and technological. No one claims it's easy.

First, there's the delicate business of gaining buy-in from the executive suite to the employees, including a lot of independent types who will balk at the idea of anyone quantifying their contributions. Then there's the measurement element – defining fair metrics that represent results that actually drive success. And there's the enabling technology – the means to capture, cleanse and analyze mountains of data and then get it to decision makers quickly in a form they can use.

No, nobody claimed BPM 2.0 was either one-dimensional or point-and-click easy. But it's worth it.

According to moderator Michael Vaughan, a global chemical company reported saving \$200,000 every time they reduced forecast error by 1 percent. A major manufacturer of surgical, pharmaceutical and consumer products saved \$7 million by improving its forecasts. A major hotel chain increased profit by \$86 million in a single year by using analytics for optimization. A European energy company trimmed costs by 50 percent simply by increasing the accuracy of their forecasts. Results like this might be worth the angst of a little change management.

“It's an evolution,” Hornby said. “It's not something that comes with a silver bullet, or a turn of the switch and it works. It's something you grow into.”

Key takeaways for senior management

- Take the time and attention to create a solid data foundation.
- Look beyond the spreadsheet to predictive analytics and forecasting.
- Identify and address cultural barriers to information sharing.
- Use analytics to identify a limited set of metrics that really drive the business.
- Implement processes and accountability to act on performance metrics.
- Look beyond naïve forecasting to analytically derived forecasts.
- Blend multiple forecasting methods to maximize predictive accuracy.
- Adopt activity-based costing for a more accurate picture of profitability.
- Don't be satisfied with hindsight; use analytics to improve, learn and evolve.
- Develop strategy from the top, but expect to validate it soon from the bottom.



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