A BPM Partners White Paper

The Holy Grail of Business Performance Management:

Strategy Meshed with Operations and Finance

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Executive Summary

The "holy grail" of business performance management (BPM) – the alignment, co-measurement and adjustment of strategic, financial and operational plans and activities – is coming into view. It depends on an emerging class of strategy-focused enterprise software solutions – or on new capabilities being added to existing BPM solutions – that join together operational drivers of outcomes with their impact on strategic results. For the purposes of convenience and clarity, in this white paper we will refer to such software as strategic business performance management (strategic BPM).

> Over the next several years, strategic BPM will be accepted as a way to define a single version of the strategic, operational and financial truth for the entire organization.

There is no universal standard on how to conduct strategic planning. Many companies have worked out their own practices for strategic modeling, based on the vision of their individual executives. They have been limited, however, by the lack of tools that effectively link strategy with ongoing performance measurement.

BPM has already changed many aspects of how companies are run. More will change when it becomes clear that, with strategic BPM, they can go well beyond mere strategy planning. New software systems enable them to accurately measure how the organization is progressing day by day to meet its strategic objectives. This means that as a C-level executive, strategic planner or factory manager, you can frequently adjust in mid-course to fulfill strategic objectives.

Continuous strategic planning, modeling, measurement and adjustment are feasible now. One critical aspect is determining software solutions that enable managers to define the driver linkages between operations and strategic plans. These nuts and bolts are essential.

The software should jumpstart and streamline the process of establishing these driver linkages with links that are detailed, tangible and verifiable over time for accuracy, in order for strategic alignment with operations and finance to be real, dependable and useful. Adoption of such software will entail challenges, including a new level of collaboration. Finance, operations and strategy managers will spend more time together in front of a workstation, working in committee to define links and examine business processes.

Strategic BPM software should be full-cycle, not piecemeal. Its starting point: Help companies to identify strategic models and plans that will yield the profit or growth needed, and pinpoint the operational goals that have to be met. Well-conceived software will help boil down the analysis to the most significant key drivers and key business processes, and then specify their cost and their value.

Once evaluation of the strategic options is done and strategy is set, strategic BPM systems will enable tracking against plan with metrics, alerts and iterative modeling going forward. Strategic BPM software should project the consequences of uncorrected deviations and highlight likely sources of any exception so that corrective action can be more accurate and speedy.

There will be challenges and significant rewards in the adoption phase, as key drivers and linkages are hammered out. The result, for those companies that see it through, will be a CEO and COO more closely connected to the pulse of the factory floor. Their strategic plans will be chosen from more accurate, robust scenarios that are based on quantified, bottom-up operational facts. Because these facts (drivers) are quantified, it is easy to track them and detect when the strategic objective is in jeopardy.

A widespread motivation for adopting BPM has been to arrive at "a single version of the financial truth" for a company. We anticipate that over the next several years, strategic BPM will be accepted as a way to:

- Define a single version of the strategic, operational and financial truth for the entire organization.
- Gain commitment and alignment of the enterprise with this authoritative, cross-disciplinary representation of the business.
- Carry out strategic plans and, to a large degree, run the business based on this combined truth.

Introduction

Business performance management (BPM) began with tools focused on specific areas and evolved naturally to combine closely related areas within unified applications. An example is found in unified budgeting, planning and forecasting.

The holy grail of BPM – the elusive but potent prize at the end of the quest – is to combine strategic planning, measurement and adjustment with operations and financial performance management. It is the capstone on the enterprise software pyramid. We can anticipate that some more concise term will come into use to describe this juncture of strategic planning and BPM. However, in this document, because it links these three areas, we call it strategic BPM. If the wrong tools are deployed, this holy grail of BPM remains out of reach. In addition to the right software, new linkage between people across the organization is needed. Without a more intense level of collaboration between operations, finance and strategy executives, the correct linkages and alignment between strategy and operations are unlikely.

> Strategic planning goes hand-in-hand with measuring progress toward strategic objectives and taking corrective action to get there, when

The 2010 BPM Partners Pulse Survey found that managers ranked strategic planning as their top BPM priority, along with profitability optimization and scenario modeling. Performance management practitioners look forward to the benefits of combined planning, monitoring and adjustment of these three functions. The immediate goal of strategic BPM is to improve organizational alignment, with all three of the major guidance systems working in step. The grander purpose is to rank strategic alternatives realistically and accurately, and to ensure that strategic objectives are met.

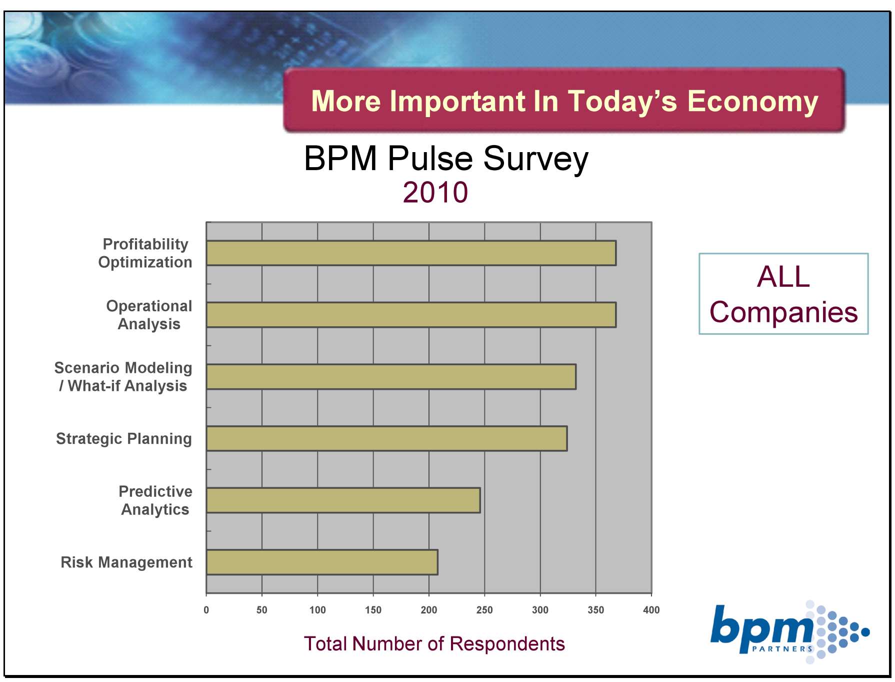

Figure 1 - 2010 BPM Pulse Survey - What Is More Important in Today's Economy?

Strategic BPM, like strategic models, does not need to examine every budget line item. To be effective, to be strategic requires looking at less: a small number of key drivers and components. Although operational processes will have costs defined, users of strategic BPM may do their modeling work almost entirely at a summary level without any budget line items coming into play. Once a strategic plan is under way, it should be possible to isolate line items that will be affected when exceptions are noted.

Strategic planning goes hand-in-hand with measuring progress toward strategic objectives and taking corrective action to get there, when necessary. Executives are under pressure to ensure that the planning of strategy, measurement of progress and correction are tightly linked to operational realities. Someday there may be a Sarbanes-Oxley of strategic planning and tracking; for now, it's a growing marketplace pressure.

Strategic BPM: The Struggle to Get There

It's difficult to drive a one-wheeled vehicle. Three wheels make it much more stable. In business, a trio of guidance systems – strategic planning, operational key performance indicators (KPIs) and financial performance management – enable leadership of most organizations. These three areas measure activity differently in many cases, and therefore do not combine easily, unless the right tools are available to mesh them together.

Strategy planners and company leaders have struggled to meet the demand for frequent, iterative strategic modeling. Small wonder: It has been difficult to mesh the other two wheels, operations and finance, with strategy.

> The software chosen will provide an environment where the collaborators give each key driver a name, a cost and a value, and estimate its impact upon results. The same is true for key business processes and for strategic models; they have to be named, defined, assigned values and stored, to be analyzed

Senior management is aware that leaving strategic planning to the company's most brilliant strategic thinkers is a recipe for poor outcomes. There needs to be a way to tie good strategic thinking to the concrete, granular realities of the business. Strategic models should relate to the key drivers that play a role in – for example – selling on the floor in retail stores or boosting productivity on an assembly line.

Today, few companies have the tools in place. Information overload tends to obscure the small number of key drivers that should be used to make decisions of the largest scope. Many companies are working to zero in on the key operational events and processes that determine success or failure. Some have already embarked by capturing KPIs in management dashboards.

It is useful to get buy-in on the vision for strategic BPM in your organization. Will it be conducted in a silo, using spreadsheet models that lack a means to track progress as a strategic model is carried out? Or will it be an enterprise commitment that bridges the company to align operations and strategy? In addition, committing fully to the three-way collaboration is a requisite. The software chosen will provide an environment where the collaborators give each key driver a name, a cost and a value, and estimate its impact upon results. The same is true for key business processes and for strategic models; they have to be named, defined, assigned values and stored in the strategic BPM system.

Strategy in Today's Economy

Given today's harsh economy, one might expect managers to prefer to apply BPM to nuts-and-bolts processes with fast, financially quantified return on investment (ROI), but they have maintained a bigger-picture view. As mentioned earlier, this was a key finding in the 2010 BPM Partners Pulse Survey. Profitability optimization and strategic planning were the clear winners.

Performance management becomes more valuable as conditions become more unforgiving. We have been shown by Lehman Brothers, AIG and other businesses that experienced extreme stress in the last economic downturn that there is little room for choosing the road less optimal in running companies. A large corporation that does not rationalize its strategic planning, with alerts that signal when actual results are veering toward the worst-case scenario, might well expect to fail sooner rather than later.

> Dashboards and KPIs gave organizations a start in the right direction, describing and monitoring their operations in a strategic manner.

Hindsight is easy, but consider how easily Lehman Brothers could have avoided its fate had it established just one KPI with alerts to upper management: delinquencies on the mortgages it guaranteed. In a well-conceived strategic BPM system, with interdisciplinary teams preparing strategic models, it's almost inevitable that someone from the operations side would have spoken up and proposed such a KPI when a high-risk strategy like 33-to-1 leverage was being tested.

Up to now, business motivations for BPM initiatives have usually been finance-oriented. These were essential applications that addressed immediate problems for the enterprise. As a result, BPM is now strongly entrenched in finance processes from budgeting to consolidation and reporting. BPM had relatively low impact on operations, but now it is time to bridge that gap.

Except for a few industries, finance is how we describe the results and control the money needed to pay bills, buy goods and issue dividends. Operations is generally the central activity: what a company was formed to do. Dashboards and KPIs gave organizations a start in the right direction, describing and monitoring their operations in a strategic manner.

There are two major gaps between operations and finance/strategy in most organizations. First, the linkages of key operations and market drivers to financial results are not established. Second, there is little collaboration between operations executives and their counterparts who set strategic and financial plans. Without some guidance and pressure to establish the drivers together, that collaboration is unlikely. With the right tool before them, ready for scenario modeling once the driver linkages are hammered out, operations-finance-strategy collaboration will be almost inevitable. Build the framework, and they will come.

What Management Needs from Strategic Planning

How do C-level executives know if they are evaluating the metrics in their business that matter the most? If they have gone through a KPI and dashboard process already, they're on the right path.

It is helpful to see a demonstration of strategic BPM software so as to judge how effectively it guides the prep work for joining strategy to operations via BPM. That preparation – quantifying drivers and their impact – makes it relatively easy to see which metrics really matter and which ones don't.

Strategic planning can deliver considerably more than modeling capability, but a discussion of its scope can start with that feature. Before shopping for solutions, it is important to consider the following types of modeling:

- Scenarios for increased profitability
- Scenarios that seek company growth
- Modeling that tests reconfiguration of the enterprise
- Modeling of mergers and acquisitions

We recommend looking for BPM solutions that deliver on all four of these capabilities.

Information Overload

Strategic BPM should address the dilemma of the senior executive: how to track the inner workings of the entire business (which a dashboard can do) and their effect on strategy (which a dashboard doesn't do). It needs to do this without drowning managers in detail.

Strategic BPM software needs to support simplification by implementing the following cycle:

- Boil it down.
- Find what matters.
- Use that to build strategic models.
- Calculate internal rate of return (IRR).
- Choose the optimal key performance indicators.
- Track actual performance and compare to plan.
- Choose effective course corrections.
- Keep looking for better options.

Coexistence with Existing Systems

Strategic BPM is, by necessity, built to coexist with current systems including business intelligence (BI), corporate/business performance management (CPM/BPM), enterprise resource planning (ERP), customer relationship management (CRM), general ledgers (GLs) and other financial tracking systems. All those can be data sources for strategic BPM to use in tracking progress toward meeting strategic objectives. Strategic BPM is perhaps best thought of as a capstone that leverages the pyramid of other enterprise applications in a company. It helps fill a connection gap between certain pieces of the pyramid. It queries only the actual results that are relevant for the strategic models in use, and only with the frequency needed; it does not impose an analytical processing load on the underlying systems. It's the executive boardroom of enterprise software.

Forward Looking

Strategic BPM, as implemented by most companies, is strictly forward looking. Other systems report on what happened and analyze which sales team and product contributed the most to positive or negative surprises. The purpose of strategic BPM is to help align and plan upcoming activities, alert the right people to deviations, and enable them to correct course with more precision.

Strategic BPM will guide companies through the delicate task of aligning operations, finance and strategy. Thinkers from all three disciplines will work together to discover which strategic scenarios are most rational and profitable. Forecasts will reflect the contributions of all three areas.

The New Collaboration

Interdisciplinary collaboration must entail joint work to define drivers, processes and plan models, or strategic BPM will stall before it starts. A well-conceived system can streamline this startup phase with industry models, predefined templates and standardized business processes already defined and ready to be tweaked to fit. For most companies, once the operations, finance and strategy managers are together in a conference room with workstations using the strategic BPM system, the collaboration should come naturally – as long as the software is designed to provide the framework for that cooperation.

We recommend giving some thought to who participates on this important team. They don't have to be technical people, although a database administrator will be involved in the latter stages to establish the needed feeds from data sources. The operations managers should be strategic enough in their thinking to step back from each process and consider it objectively. The finance team will probably need to include controllers or assistant controllers, as well as budget managers who understand costs in detail and can communicate them to the others.

The strategic analysts, for their part, will be in learning mode during the initial stages. They must be ready to be educated about specific business processes, such as how many steps are involved in placing orders for raw materials. If they are ready to embrace the knowledge of their counterparts, the process should go fairly quickly and with more agreement than dissent. Motivation should come easily; it will be clear that "air pockets," or gaps in underlying facts, are being cleared out of the strategic models.

Strategic BPM will not be carried out by analyzing the maximum amount of information possible. The reverse is closer to being true. The company that can laser in on its key drivers, that subset of metrics that truly drives performance, will probably be more successful with strategic BPM and running its business.

Beyond Strategic Modeling

When a round of strategic modeling is finished and strategic directions are decided upon, managers can shift into a mode of tracking progress and catching deviations from the strategic path – with the ability to model new scenarios at any point. Executives want these capabilities; many are under pressure today to manage as if they already have it.

After the strategic modeling and decisions are made and strategic objectives are set, a strategic BPM solution needs to help planners determine a realistic performance trajectory, measure progress, alert management to deviations, and help choose effective course-correction responses.

The final part of the strategic BPM "loop" is to reforecast, to gauge whether the strategic objectives can still be met, and to see precisely how that will happen. Iterative, ongoing strategic modeling is also included in the strategic planning and management cycle.

Once the driver linkages between operations and strategy are defined, they need to be updated from time to time. If "cost of overtime" is a high-impact driver and it changes, strategic models might need to be recast. With the operations-strategy-cost linkages defined, that will not require much intervention.

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To project forward 20 years, it will probably seem archaic to managers in 2030 that, as recently as 2010, companies ran on strategies without systems to alert them when they were veering drastically off course. Lehman Brothers did not arrive at 33-to-1 leverage overnight; that takes time. Almost certainly it was adding leverage long after its most critical KPIs had veered into the red zone. The appropriate strategic BPM solution would have uncovered this important area of voluntary managerial blindness and projected the consequences of continuing on the same disastrous course.

Strategic business performance management will help instill cross-departmental agreement on what's critical and what drives or stops the business. That will bring discipline, consistency and useful checks and balances. It could also enable companies to safely take on strategies that otherwise appear too risky, and certainly it will support management's ability to change direction quickly.

How Does Strategic BPM Work?

Executives across the three disciplines (finance, operations and strategy) can think of strategic performance management as incomplete unless all three pillars are meshed together.

Who will provide the tools to do this? We expect newer vendors to fill this role initially; those with applications already established in the marketplace may be held back by loyalty to their own and their accepted approach to extension of transactional systems. They are probably less likely to establish vendor-agnostic links to all relevant data sources, such as multi-vendor ERP infrastructures and multiple GLs. Over time, though, larger software vendors will acquire or develop capabilities for strategic BPM.

Strategic BPM is delivered, in software form, as an application that combines strategic modeling with the capability to define and specify linkages and business processes. Other key components include the ability to draw data on actual performance from multiple sources as needed, alerting the right people to deviations and surprises, and finally helping to choose the best responses.

Strategic BPM systems from independent vendors will have a smaller, self-contained data repository. It will tend to be significantly different from transactional and even BPM databases. It will be more selective, containing key drivers and processes, but not every line item or activity. It will retain all the saved strategic models and business configurations that have been analyzed.

The holy grail for enterprise management software will need capabilities along these lines:

- Scenario A versus B versus C for the existing enterprise
- The existing enterprise versus reconfiguration #1 versus reconfiguration #2 versus selling a division

These are simple summaries of potential analysis capabilities. Note that every business is different and the solution deployed must align with an organization's unique modeling and tracking requirements.

Time

A strategic solution needs to address the issue of time with a high degree of accuracy, and to present it in a way that is easy to grasp. For each strategic model, there has to be clarity on the timing of costs and of both production- and finance-wise results. Only then can the IRR of a change be calculated.

What does this actually mean, as implemented in strategic BPM software? At a minimum, users need to see when outcomes occur, both numerically and graphically. For example, if shortening a delay-ridden process will enable faster production time but cost money up front, will the increased profitability begin in one month or 10 years?

It will also be helpful if users can goal-seek by telling the system when results need to happen. If there is an edict that the strategic plan achieve a milestone within 12 months, the user needs to work the model to see that the target is met by the deadline. Goal-seeking is the easiest method.

To identify that latent profitability, strategy teams need the ability to drill into key business processes seeking profitability optimization. This is relatively simple with strategic BPM software, assuming that finance and operations can attach accurate costs and output value to each step of a business process

Drilling into Business Processes

As mentioned, some strategic plans focus mainly on growth; others on how to wring more profit from existing operations. Significant profit, as many operations people know, is often waiting inside inefficient business processes.

To identify that latent profitability, strategy teams need the ability to drill into key business processes seeking profitability optimization. This is relatively simple with strategic BPM software, assuming that finance and operations can attach accurate costs and output value to each step of a business process. Operations will assign a time to each step and be the sanity check on what improvements are possible.

If a 10-step process can be cut to eight steps, with 20% cost reduction and zero damage to productivity or value produced, that is important to model. Strategic BPM software should then "ripple out" the impact of this reengineering through the production metrics, showing financial impact and the new IRR of the strategic option – actually, of each scenario that depends on that particular process.

Key drivers

Companies probably will not need to define more than a half-dozen key drivers, in most cases. Production line capacity is an obvious example. Operations can explain what adding a new printing press will do for output capacity in the real world – with caveats such as training new operators and working out startup bugs. Finance can detail the costs. Strategic planners may be weighing the advantages of expanding capacity in the current plant versus buying a competitor located in a new market area.

In this scenario, operations and finance define the key driver in the existing business and might guide strategy for defining the capacity drivers in the competitor's plant.

Conclusions and Next Steps

A class of new software applications, principally from emerging vendors, is opening the way for strategic modeling, planning, measurement and management meshed with operations and finance.

Strategic BPM will be a means to define and generate commitment to a single version of the strategic, operational and financial truth for the entire organization.

Today, for companies to take this route toward what has been called the holy grail of BPM, they need to document their internal business requirements and ascertain which software system will fit with their internal metrics and business processes. It should also integrate smoothly with their legacy systems, as these will be data sources feeding into the strategic BPM system.

A key step will be selecting an interdisciplinary team to collaborate closely on specifying the key drivers and business processes and working through the initial modeling process. This team must dedicate sufficient time to the process of defining those drivers, process steps and values. An administrator will need to specify which data sources are queried for actual results and when – and then which managers will receive alerts for particular events. It is probably advisable that this entire team take part in constructing and comparing the first set of strategic models.

These steps should enable management to carry out full-cycle, closed-loop strategic performance management with timely deployment and attractive ROI. As pointed out earlier, one widespread motivation for adopting BPM has been to arrive at “a single version of the financial truth” for a company. In the next several years, strategic BPM will be a means to define and generate commitment to a single version of the strategic, operational and financial truth for the entire organization.