Integrating Operations and Finance: A Two-Way Street

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Introduction

One of the hot buttons in enterprise performance management (EPM) is operational and financial integration. In many organizations, operational plans and financial results are not aligned very well, and in most cases, both have their own set of performance indicators. From a top-down perspective, the reasons for better alignment of operational plans and financial results are clear.

- Alignment provides senior management with increased insight and control
- Alignment gives financial managers higher predictability of financial results
- Increased insight, control, and predictability allow the organization to be transparent and to comply with regulations with confidence

However, the *opposite* business case—sharing financial information with operational managers—is less often explored because too often financial data is held "close to the vest." This is unfortunate because financial information holds interesting operational insights that can be crucial for operational managers.

Operational and finance integration should not be a one-way street for financial and general managers that's used only for external reporting and executive decision making. Integration should be a two-way street allowing financial information to go both ways.

Why Should Operational Managers Get Financial Feedback?

- **Capital should be deployed in operations where the return is highest**
- **Financial results are the bottom line for every business function**
- **Financial results make departments and regions comparable and "benchmark-able"**
- **Business functions have indirect financial contributions including what they achieve for other business functions**
- **Bonus plans are directly connected to financial results**

Why Is Financial Information Crucial for Operational Managers?

Managers need the ability to see the financial consequences of their operational plans and optimizations. Methodologies such as Economic Value Added (EVA) and performance indicators such as Return on Capital Employed (ROCE) are designed to help managers understand that financial resources are limited and that capital should be deployed where the return is highest. Also, since financial results are the bottom line for every single business function and domain, managers can use them as benchmarks to compare results from various parts of the organization.

Financial information about business performance should not be limited to consolidating the individual results of departments or regions. Success can also be measured in the indirect contributions to other business functions. For example, because procurement is highly connected to manufacturing, it may be more effective to work with suppliers to create an integrated value chain that leads to much higher cost savings, than to spend large amounts of time trying to squeeze the last penny out of the cost. Other examples include manufacturing planning departments that have a huge impact on logistical optimization and marketing budgets that should be aligned with sales opportunities. Ultimately, finance is the language of business and these cross-domain optimizations can be expressed in terms of lower cost and additional revenue.

Last, but not least, managers should have financial feedback because their bonuses are often directly connected to the organization's financial results.

Because financial reporting generally focuses on executive and financial management, financial reporting is too often a one-way street. Financial data is collected, aggregated, consumed by top management, and then externally reported on the consolidated level. At this level, it's almost impossible for operational managers to recognize their contributions.

Even though most organizations do share financial data with their operational managers, it often consists only of their slice of the cost or profit center. Also, the account structure is usually optimized more for financial data processing (for example, in journals) and technical financial reporting than for operational insight.

The bottom line is that financial reporting for operational managers needs urgent attention.

What Financial Information Do Operational Managers Need?

Fact: Oracle's Hyperion Financial Management is a single solution that provides financial reporting for all managers across the organization, as well as for all relevant external stakeholders.

Most operational managers have an intuitive understanding of a profit and loss statement, but balance sheets and cashflow statements can be a different story. Standard financial reports—usually limited to providing insight to the financial experts—have only partial usefulness for operational managers. Organizations that want to create operational and financial integration can use these guidelines to construct useful reports that will provide helpful financial information to their operational managers. Most organizations have already done the following:

- **Standardize financial reports.** Financial reports—particularly profit and loss (P&L) statements—need to be standardized so that everyone is looking at the data in the same format, with the same reference point. This can also help operational managers feel more ownership for the results of the overall company.
- **Provide the variance.** Providing the variance between the actual numbers and the budgeted numbers (or the actuals and the forecast), helps managers focus purely on what operational buttons to push. It also helps to split the variance in a price variance and in an efficiency variance to take out the effects of different currencies—particularly in a global business.

- **Provide the right level of detail.** For example, provide revenue numbers broken out by operationally relevant dimensions such as products, markets, customers, sales channels, and so on.

Examples of financial information for operational use include

- **Contribution margin**
- **Working capital**
- **Indirect contributions**
- **Non-financial information**

These are some basic ways to provide useful information to operational managers. However, with more creativity you can truly empower your operational managers with insight into how their plans and actions can affect the organization's financial results. Take a look at these examples of specific operational uses of financial information.

Contribution Margin

Fact: Oracle's Hyperion Profitability and Cost Management determines true customer and product profitability to plan for the most profitable segments and also defines actions to improve or abandon unprofitable ones. It helps operational managers gain insight into cost structures and drivers that can help them create plans for increasing efficiencies and improving profit margins.

In many organizations there is a disconnect between the way the business is run and how the sales force is compensated. For example, the sales force may be measured in terms of revenue, but the CFO manages the company based on profit and margin. This often leads to the end-of-quarter discussion on how margins are under pressure because the sales people are giving much higher discounts. If the company is being *managed* on margin, then sales operations should also be *measured* on margin.

The easiest way to align sales operations with corporate objectives is to create a straightforward model that calculates the contribution margin as "revenue less the costs of goods sold (COGS)." If sales people are compensated based on contribution margin, they will start to make different decisions on how to position products to customers and how to conduct negotiations.

Contribution margin is also relevant for other parts of the business. For example, this measurement can motivate workers in the manufacturing department to monitor the contribution of each shift to the company bottom line—especially if contribution margin is connected to an incentive program. Contribution margin drives operational team managers to investigate how to reach the target production for each shift using the minimal number of resources.

A note of caution: When you use cost allocations to calculate contribution margin, use direct costs—rather than indirect costs—for your estimates as much as possible. If the contribution margin includes too many indirect costs that the operational manager cannot influence, the manager may be tempted to abandon the indirect cost-pressured activities because they are perceived as loss-making activities. This, then, leads to even more pressure from indirect costs on other activities.

Operating Cash Cycle and Working Capital

Both the finance and operations side of an organization contribute to the organization's operating cash cycle (OCC)—the time an organization's money is tied up in inventory and other current assets before the company is paid for the goods and services it produces. A reduced OCC improves an organization's working capital and financial results. Operational managers can reduce the OCC by optimizing business turnovers—making procurement strategies more efficient, reducing inventory holding periods, and aggressively managing other supply chain activities.

Traditional working capital information is not very intuitive for operational managers, but it is *extremely* important. A low amount of working capital is bad because it means the organization is not able to pay their suppliers. On the other hand, if a low working capital is supported with an effective receivables collection effort and favorable (long) payment terms with the organization's suppliers, then the low working capital can be a sign of efficiency.

By themselves, working capital amounts do not reveal much. It's the movement of working capital over time and the contributions of the individual components that give you relevant information. However, operations throughout the organization can also have a positive (or negative) effect on the overall result.

Working capital is driven by both accounts payable and the collection of receivables. The average number of days sales outstanding (DSO) is used to measure accounts receivable. Operation managers should review DSO reports regularly. For example, back-office departments in charge of order entry, billing, or other administrative tasks should be able to see DSO reports to understand the positive impact of a speedy and error-free administrative process.

DSO reports containing a breakdown of DSO by customer segment and by geography are fairly common. However, for procurement departments (for example), it makes more sense to have a report that breaks down DSO by product. In many cases, products sold never see the organization from the inside; they are produced by contract manufacturers and shipped directly to the customers.

Increasing numbers in a DSO report are an early warning signal that the extended supply chain is not working optimally or—even worse—can indicate product quality issues.

Indirect Contributions

Insight into your own operations just to optimize financial results is no longer enough. Business departments affect the results of other business departments in an indirect way. If the impacts are not managed effectively, financial results will be a consolidation of local (sub)optimizations instead of an optimized result for the entire organization.

For example, the procurement department should take into account that negotiating a mutual investment in value chain integration between the supplier and the organization could lead to cost savings in the manufacturing department far beyond squeezing the last bit of discount out of a contract. Manufacturing, in turn, should take warehousing costs into consideration when putting together an optimized production plan, because large batches of product could lead to higher storage costs. If these increased warehousing costs are higher than achieved cost efficiencies of the production plan, this local optimization should be avoided.

After considering indirect cost savings, credits should also be shared. For example, think about telecom company providers who sell "triple play" subscriptions consisting of internet access, telephony, and television. Although senior management usually frowns on double-counting revenue (because it can lead to an increase in commissions), each division should get full credit because their contribution is an inextricable part of the value proposition.

Indirect contributions can also come from the "softer" areas of finance, such as brand value calculations. It would be interesting to see what a hiring campaign implemented by the Human Resources (HR) department contributed in additional brand value or what an award-winning systems implementation by the information technology (IT) group has delivered in terms of brand value.

Nonfinancial Information

Fact: Oracle's Hyperion Financial Management is often used for nonfinancial reporting, such as sustainability reporting, combining economic, social, and environmental performance.

Increasingly, the financial consolidation system is also used for nonfinancial reporting. Traditionally, this reporting is created to provide executive and financial management with operational insight so they can better predict financial results. Relevant, nonfinancial information would include units sold, pricing information, workforce counts, and sales pipeline updates.

Another area of reporting that is gaining popularity is sustainability reporting. The financial consolidation system easily holds information on an organization's carbon footprint and their use of natural resources, energy consumption, workforce diversity, and health and safety reporting. The system facilitates the complex calculations, the hierarchies of metrics, and the audit trail needed for external reporting. However, sustainability reporting is only effective if it is backed up with solid business practices. This means that operational managers must have the right processes in place to meet sustainability demands and must—as with any other business topic—require the appropriate feedback.

What Should Financial Information for Operational Managers Look Like?

A reporting system should include

- **Interfaces to various sources, and various end-user tools**
- **Predefined and intuitive formats**
- **Graphical interfaces**
- **Guided analysis**

Financial specialists, the producers of management information, often choose to analyze large financial overviews in a spreadsheet format and are familiar with the standard layouts of P&L reports, balance sheets, and cash flow overviews. As consumers of information, operational managers are certainly no strangers to spreadsheets, but they often prefer a more graphical presentation.

Financial information, then, should be distributed in a predefined, intuitive manner that makes use of informative graphical representations. It should provide guided analysis and should enable users to share insights and discuss results.

These requirements are not unique and can very well be captured with an out-of-the-box dashboard that has the appropriate templates along with a built-in understanding of typical financial information.

Open to multiple sources and uses

In order to collaborate, managers – both financial and operational – need to work off the same set of information from a variety of sources. 'Being open' is an important characteristic of a reporting system sharing financial information with operational managers. First, it needs to be open to include multiple sources. Not all data may be in the financial consolidation system, it may for instance come from transactional systems or from external data sources such as credit rating agencies for benchmarking purposes. Also, to create a complete view, financial information may come from partners upstream and downstream in the value chain, and they may use different systems or different implementations from the same system. It must be easy to read data from a wide variety of sources. The financial reporting process also needs to be open for various end-user reporting tools. In some organizations it is best to integrate the financial information with other types of information, making use of a standard business intelligence system, such as Oracle Business Intelligence. In other organizations it makes more sense to see the financial information for operational managers as a specific extension to their financial consolidation system.

Oracle supports both styles of being open, through its own offerings as well as via partners.

Oracle's Common Enterprise Information Model is a single repository, containing all metadata for Oracle's BI technologies, BI applications and Performance Management Applications.

Oracle BI Applications are complete, pre-built BI solutions that help people at all levels of an organization better understand how their business is performing. The Oracle BI Applications product portfolio, based on a Common Enterprise Information Model, offers the following analytics products and many industry specific solutions:

- Oracle Financial Analytics
- Oracle Supply Chain and Order Management Analytics
- Oracle Procurement and Spend Analytics
- Oracle Human Resources Analytics
- Oracle Sales Analytics
- Oracle Service Analytics
- Oracle Contact Center Analytics
- Oracle Marketing Analytics

Oracle Financial Analytics provides hundreds of financial metrics, alerts, reports, and dashboards for financial professionals and line of business managers, and includes prebuilt adapters for packaged applications such as E-Business Suite, PeopleSoft Enterprise, Oracle's Siebel CRM Applications as well as a universal adapter for third party systems like SAP.

Oracle is also open to partner-specific solutions. Take for instance CXO Cockpit. The CXO-Cockpit Community is a network of CFO's and finance professionals from large organizations, sharing their best practices for presentation of financial data. This network of professionals created a platform and developed a product (the CXO-Cockpit) that brings these presentations into practice. The CXO-Cockpit is an out-of-the-box executive dashboard that presents data from consolidated Oracle|Hyperion systems.

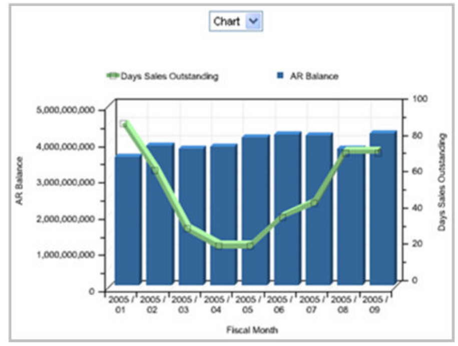
Predefined and Intuitive

For reasons of compliance and control, everyone should be seeing exactly the same financial information—multiple versions of the truth are not allowed. Supply and consumption of financial management information is, by necessity, a highly controlled process. Users cannot simply decide on how they would like specific ratios or line items to be calculated for their personal use. For everyone to have the same understanding of the information, you need pre-established formats.

The following is an example of a pre-built DSO report that comes with out of the box Financials Analytics functionality.

DSO Monthly Trend

- **Purpose:**
  - Displays the days sales outstanding and AR balance by month for the trailing 12 fiscal months
- **User Focus:**
  - CFOs, VPs, Director of A/R, Managers
- **Location:**
  - Dashboard – Receivables
  - Page – AR Balance
- **Source:**
  - Financials – AR Overview Subject Area



Oracle BI Applications, Financial Analytics

Operational managers could get the same information from a traditional financial report, but the added value of an information system is shown when operational managers are able to drill down into the relevant details (for example, the operating company, the product, or the customer) instead of having to browse through a printed booklet or an Excel spreadsheet with hundreds of predefined pages (one page for every operating company, product, or customer). A dashboard with the right information fits the overall trend in information management that provides users with flexible, self-service tools instead of static reports.

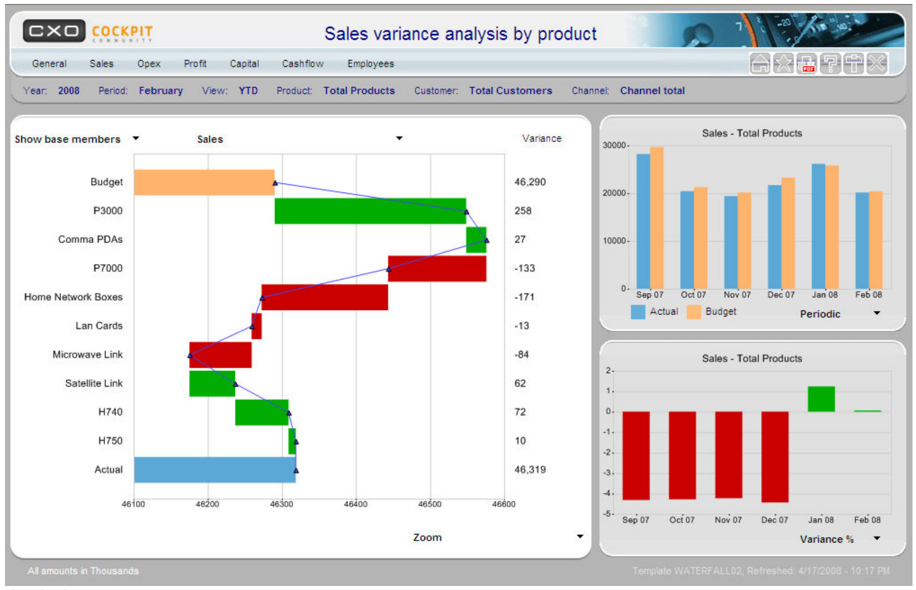
Graphical

To help operational managers understand the numbers, it's important to present them with an appropriate graph for the selected data. Strangely enough, business professionals pay very little attention to this subject. As a result, management information systems often contain fancy reports full of colorful graphs that are ineffective in giving mangers the information they need.

A few, simple guidelines can help you create presentations and dashboards that are effective and informative.

- Stick to lines, bars, and straightforward pie charts wherever possible. Avoid visualizations that are too flashy.
- Distinguish between base data and variances. Use signal colors (red, green, and yellow—often referred to as traffic lighting) for variances and use softer colors for base data.
- Be sure that you use colors that can be distinguished by people who are color blind.
- Always use graphs at the top of the screen and tables at the bottom to make screens more readable for people with reading glasses.
- Keep screens as clutter-free as possible.

A popular and clean-looking graph is the waterfall graph shown here being used to analyze the difference between the budget and actual sales numbers by product for this manufacturer of consumer electronics and personal computers.

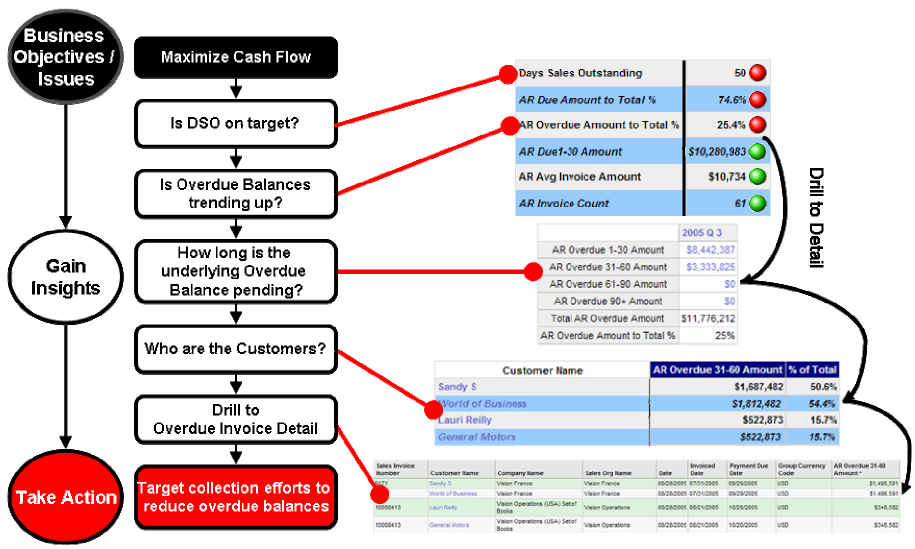


CXO Cockpit example

This waterfall graph provides fast insight into which products are over-performing and which products are "bleeders." The green bars show a positive variance between budget and actual numbers, and the red bars show a negative variance. The graph makes dramatically clear that, although actual numbers are higher than the budgeted numbers, the company's sales are not healthy because there is a huge difference in how the various products have contributed to the overall result. A table, showing separate columns for the budgeted numbers and the actual numbers, with a drill-down list of the products underneath, would have shown the same data, but would not have provided the same clear insight.

Guided Analysis

Guided Analysis enables the content and layout of an interactive dashboard to change dynamically based on changes of the information that is being analyzed. Specifically, sections in dashboard can be set up and appear only when there is “interesting” information in the data. Let’s consider cash flow again. A dashboard for a financial manager might contain a section that only appears when cash flow has fallen behind pre-set objectives for the quarter. Clicking on the link would bring up an analysis (or a whole dashboard of analyses) focusing on the cash flow management process and the relevant dashboards and reports that could provide insight into the problem area.. Through Guided Analytics, organizations can capture best practices and guide other users through the system in the same way.

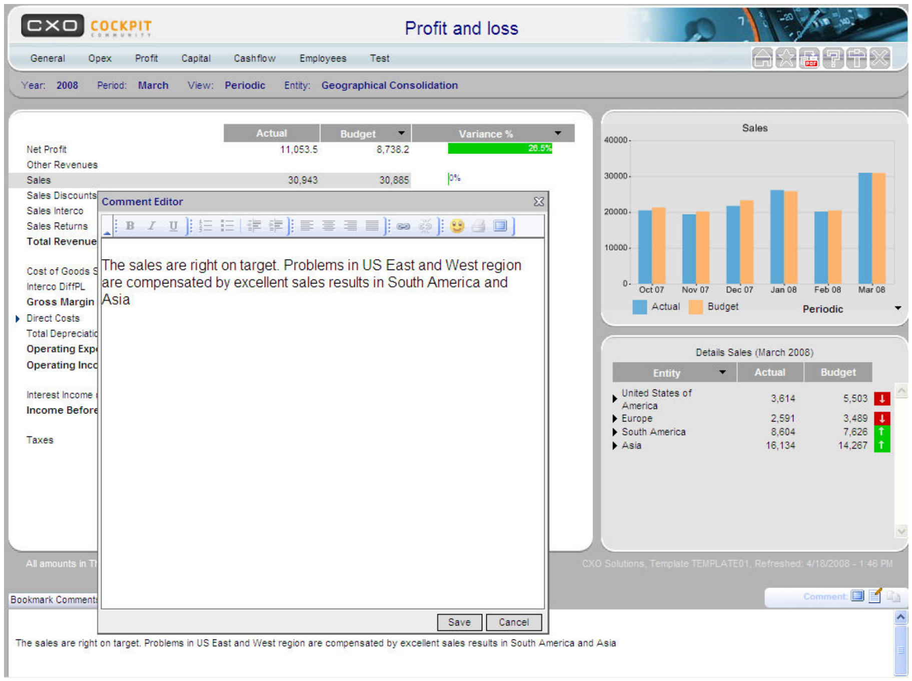


Oracle Guided Analysis

Share and Discuss

Information is more than just numbers. Context sensitive narratives form an essential part of overall management information, and today’s Web technologies offer huge benefits in helping the operational manager take advantage of this information. Office and e-mail integration also helps managers share information with their colleagues in a structured and intuitive way.

The possibility of adding comments and discussing results further strengthens operational and financial integration. Also, different users may come up with different and innovative ways to analyze and present information.



CXO Cockpit example

Not only should numbers be shared across an organization, but best practices should be shared as well. And, the most important thing to share across the enterprise is the insight gained from these numbers and best practices.

The Bottom Line

Financial information is important for all managers, whether they are financial, general, or operational managers. Looking at operational and financial integration from a traditional point of view—as a one-way street for external reporting and executive decision-making—is too limited.

Thinking of the integration between finance and operations as a two-way communication can lead to new and powerful insights throughout the organization.

Integration between finance and operations should be a two-way process. Finance managers need operational information to increase the accuracy and predictability of financial results; operational managers need financial information to understand the effect of their operational decisions and to optimize their overall results for the benefit of the entire company—not just for their own department.

When creating financial feedback for operational managers, organizations may need to rethink the best way to define and structure their financial performance indicators. After all, financial information can only be actionable if it is relevant to the daily work of the organization. Thinking of the integration between finance and operations as a two-way communication can lead to new and powerful insights throughout the organization.

About Oracle's Enterprise Performance Management System

Oracle is the leader in Enterprise Performance Management (EPM), unifying performance management and business intelligence (BI) and supporting a broad range of strategic, financial, and operational management processes. Oracle provides a complete and integrated system for managing and optimizing enterprise-wide performance, letting organizations achieve a state of management excellence that provides competitive advantage and leverages their operational investments.

Oracle's Hyperion Financial Management (Financial Management) is part of the market-leading suite of Web-based, performance management software applications that deliver global collection reporting and analysis in a single, highly scalable solution. Financial Management uses today's most advanced technology, yet is built to be owned and maintained by the organization's finance team. You can use Financial Management to

- **Accelerate reporting cycles.** Reduce closing cycles by days, and deliver more timely results to internal and external stakeholders
- **Improve confidence and compliance.** Help reduce the cost of compliance (as stipulated by the Sarbanes-Oxley Act, BASEL II, and other regulatory requirements) and build a sustainable compliance framework
- **Perform strategic analysis.** Spend less time on processing and more time on value-added analysis
- **Deliver a single truth.** Provide a single version of the truth to support financial management and statutory reporting
- **Easily integrate.** Integrate not only with Oracle products, but also with your existing infrastructure

Oracle Business Intelligence Applications

Oracle Business Intelligence (BI) Applications are complete, prebuilt BI solutions that deliver intuitive, role-based intelligence for everyone in an organization—from front line employees to senior management—that enable better decisions, actions, and business processes. Based on best practices, these solutions enable organizations to gain greater insight and value from a range of data sources and applications including Oracle E-Business Suite, PeopleSoft, Siebel, and third party systems such as SAP.

Oracle BI Applications are built on the Oracle BI Suite Enterprise Edition, a comprehensive, innovative, and leading BI platform. This enables organizations to realize the value of a packaged BI Application, such as rapid deployment, lower TCO, and built-in best practices, while also being able to easily extend those solutions to meet their specific needs, or build completely custom BI applications—all on one common BI foundation.

About CXO-Cockpit Community

The CXO-Cockpit Community is a network of CFO's and finance professionals from large organizations, sharing their best practices for presentation of financial data. This network of professionals created a platform (www.cxo-cockpit.com) and developed a product (the CXO-Cockpit) that brings these presentations into practice. The CXO-Cockpit is an out-of-the-box executive dashboard that presents data from consolidated Oracle/Hyperion systems. For information about CXO Solutions, visit www.cxo-cockpit.com.

About Oracle Corporation

Oracle is the leader in Enterprise Performance Management (EPM), unifying Performance Management and Business Intelligence (BI), supporting a broad range of strategic, financial and operational management processes. Oracle provides a complete and integrated system for managing and optimizing enterprise-wide performance. This allows organizations to achieve a state of management excellence – being smart, agile and aligned - which provides competitive advantage and leverages their operational investments.

S**mart** – Leverage market-leading products and technologies that address enterprise-wide requirements and drive new insights into your business

Agile – Enable advanced integration that improves agility and lowers costs of ownership

Aligned – Drive pervasive intelligence across the enterprise by linking strategic, financial and operational management processes

For more information go to http://www.oracle.com/epm.

Contact us with any comments or questions at epmgbu_ww@oracle.com.

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