“Poor Growth Prospects”

Turning poor growth prospects to competitive advantage

A FSN & Oracle White Paper
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Introduction

At last the world seems to be emerging slowly from the global recession and attention is once again being trained on the ‘green shoots’ of recovery. The recovery in equities which commenced in the closing stage of 2011 has continued into 2012.

Markets appear to have drawn strength from the reaction of central banks. In the US, UK, Japan, Switzerland and the euro area central banks have been busy pushing money into the system. Outside the euro area this has taken the form of Quantitative Easing, or increasing money supply. The European Central Bank has opted to provide cheap liquidity to banks, an approach which some see as a covert form of Quantitative Easing.

Markets have also been encouraged by growing signs of a rebound in the US economy. America’s labor market has started to show signs of life with the unemployment rate dropping sharply. Consumer confidence has made up the big losses seen over the summer of 2011 and is at a 12 month high. Rail freight traffic and durable goods orders, two leading indicators of future activity, point to further growth to come. In recent months economists have revised upwards their forecasts for US GDP growth. There is also good news on inflation. Economists expect rates of inflation to decline across the industrial world in 2012. Lower inflation should increase the real value of consumers’ incomes and bolster household spending.

But despite the signs of green shoots recovery is far from certain. Much of the euro area will see little if any growth this year. Europe’s debt crisis has subsided but the primary causes – uncompetitive economies and indebted governments - remain. High levels of government and consumer debt are likely to act as a drag on global growth. Worries about America’s mountain of public debt could quickly build, just as they did last summer. Credit remains in short supply in much of the industrialized world. And the soaring price of oil testifies to the geopolitical risks the recovery faces.

Yet there are pockets of opportunity. Brazil overtook the UK to become the world’s sixth largest economy and Africa is widely touted as offering exciting growth prospects. India’s economy is expected to grow by upward of 6 percent annually in the next few years, among the highest rates of any big emerging economy. In several product and market categories—mobile handsets, for example—India could account for more than 20 percent of global revenue growth in the next decade.

So how does a company plan for a low growth economy and how does it position itself to identify the best opportunities amongst all of the economic ‘noise’ and contrary indicators without taking on indeterminate risk?
Finding ‘nuggets’ of opportunity

Finding ‘above average’ prospects in a bland economy can be extremely challenging but newer techniques and technologies are playing an increasingly important role in identifying the gold nuggets that reside within every organization.

Competitor benchmarking

Competitor benchmarking has always been a valuable tool used to highlight notable differences between close competitors and companies in the same business segment. The advent of International Financial Reporting Standards (IFRS) has facilitated deeper comparisons both internationally and domestically through standardization of accounting policy and measurement. XBRL (Extensible Business Reporting Language) has the potential to take this a stage further by automating the collection of comparative data and merging it with contemporaneous information. The results can yield valuable insights about organizational structure and effectiveness, financing, markets and products. But broad comparisons of publicly available historic data are by definition backward looking and, although helpfully identifying broad areas of uncompetitive activity are unlikely to yield timely insights into compelling new opportunities.

CRM (Customer Relationship Management)

On the other hand, information captured in a CRM system has the potential to identify new and exciting opportunities from existing relationships with customers and prospects. Patterns of buying, products selected and expressions of interest can yield information about future intentions and potential new markets. Furthermore, by leveraging loyal customer relationships when releasing new products or entering new markets organizations can substantially reduce the costs and risks of new initiatives.

Social Media

Social media analytics in combination with traditional analytical techniques have the potential to shed light on market trends and future prospects in a uniquely illuminating way. The ability to trawl unstructured data [mainly commentary] residing in blogs, discussion forums, tweets, Facebook and other web sites and turn it into quantifiable information [sentiment scores, volume of commentary, market segmentation], about the market’s affinity for a particular product can provide valuable forward looking data. Added to other insights from CRM and business intelligence tools, a rich picture of market opportunities can be developed, though the techniques are still at an embryonic stage.

Business Intelligence (BI) Technology

The creative use of Business Intelligence tools and applications can sometimes reveal exceptional performance or opportunities unintentionally masked by the weight of ‘normal’ performance, i.e. that which is within the expected range. It is therefore critical that BI allows positive variances and trends which may not be financially material to be rendered and brought to management’s attention at an early stage. Although on a small scale, these variances may provide an early indication of a rich seam of new opportunity so far undiscovered.

Strategy development

Not all opportunities can be deduced programmatically. Market experience and understanding driven by people in the organization can provide valuable insights into trading conditions and opportunities that cannot be readily identified and quantified from a system. Scenario planning via workshops with relevant management teams, supported by suitable strategy methodology and systems can be a valuable technique for thinking ‘out of the box’ and teasing out new market possibilities.
Best practice design
But strategic planning and modeling is a relatively idiosyncratic process – often directed at a particular initiative, for example a proposed merger or a capital intensive project, such as the creation of a new production facility or a move into new products and territories. It is not like the regular annual budgeting process or even the quarterly re-forecast which follows a well trodden, repeatable path or process. Therefore planning at the strategic level requires a unique blend of flexibility and durability which ensures that assumptions can be changed on demand and new scenarios added without compromising the integrity of the business model.

This desire for both robustness and flexibility needs to be balanced carefully to produce the ideal planning framework, and this requires a creative design approach, stripping out all barriers to flexibility within business models, allowing them to be rebuilt frequently as the business reacts to market conditions. Difficult decisions may need to be taken around the scope of the model but more specifically the granularity necessary to support informed decisions. For example, the planning horizon (time dimension) for an oil exploration company may be 25 years but only a couple of years for an on-line retailer. Similarly, the high cost of salaries in a multinational law firm may need to be planned down to the individual employee but the cost of payroll in a car factory employing 1,000 semi-skilled workers may be encapsulated in a single row of a model. It is about striking a balance between detail, accuracy and speed of computation.

Multi-dimensionality, a vital part of any planning process allows strategic planners to model several variables simultaneously, rather than the one-at-a-time approach forced on the planner by the flat two-dimensional world of traditional spreadsheets. This in combination with the difficulty of maintaining complex formulae and macros coupled with very limited data storage and reporting capabilities effectively rules out the use of spreadsheets in scenario planning.

Sometimes it is wise to employ specialist models (crucially integrated to the main business model) to leverage specific functionality. Capital Expenditure models and Workforce Planning models are two examples of specialized sub-sets that avoid the need to re-invent the wheel.

The role of risk and probability in forecasting
Most businesses are familiar with the relationship between risk and reward but in assessing potential opportunities rarely acknowledge risks and probability in a formal way. That is not to say that there is not a role for intuition and experience, it is just that the record shows that businesses that perform scenario planning and sensitivity analysis tend to produce more accurate forecasts of performance.

Even then, sensitivity analysis tends to be a limited exercise concentrating merely on three common scenarios, “best case”, “worse case” and something “in between”. So is there a better way?

Monte Carlo simulation
There is a growing appreciation of the value of mathematical techniques taken for granted in other forecasting environments but rarely applied in everyday business strategy settings. Engineers and scientists regularly make use of Monte Carlo simulation to refine their forecasts and set realistic expectations about the range of possible outcomes.

It works by modeling a number of business assumptions in parallel which each have an assigned range of input values and probabilities. For example, a house builder may decide to model “House Sales” based on assumptions about interest rates, inflation, and unemployment, setting for each of these variables as well as the range of likely values and their probability. Monte Carlo simulation then uses random number generators in combination with various mathematical probability density functions to generate thousands of scenarios. By summing the scenarios, the simulation provides a forecast of the results expected from integrating the interactions of all of selected variables (interest rates, inflation, and unemployment in this case – but it could be more), presenting the probability of achieving each of the builder’s desired levels of “House Sales”. Furthermore, models of this type can identify the most influential (sensitive) factors to take into account. For example, bad news on unemployment may in the majority of cases outweigh any other considerations and management can focus on this as the key determinant in deciding whether or not to turn its land bank into new builds. The same technique can be applied to investment appraisal, cash flow forecasting, and portfolio optimisation.
Balancing financial and non-financial KPIs

For most companies, the focus of financial measurement is deeply rooted in traditional accounting techniques, but strict financial measures merely provide information about past performance (lagging indicators) and do not necessarily provide a sound basis for extrapolating performance into the future.

In the search for more reliable harbingers of performance, business managers are turning to so-called non-financial indicators or KPIs (Key Performance Indicators) that are often tightly correlated with future financial performance. For example, measures of customer satisfaction extracted from a CRM system are often linked with a propensity to buy goods and services, or renew contracts in the future. Similarly, measures around innovation, such as the percentage of sales derived from new products and ‘sentiment indices’ extracted from social analytics could inform a company’s medium to longer term prospects for success.

Managing risk is one particular area that relies heavily on the skill of the people involved in assessing new market opportunities. It would be misguided to believe that weighing out opportunities to invest can rest solely on a comparison of net present value calculations in a forecast model. But how does an organization incorporate risk when forecasting?

The acquisition of new business is always accompanied by risk, but an organization’s acceptance of risk is often swept up informally in the decision to proceed. Few organizations formally assess risk and even fewer businesses seek to manage risk systematically after the event. But organizations are now faced with risk on an unprecedented scale. This is not only derived from the growth in trading volumes but also the diversity of risk that organizations face on a daily basis. Seemingly attractive financial propositions can be turned into ‘no-go’ areas when seen through the lens of risk management. However, a positive attitude to risk, which seeks to identify, quantify and actively manage it, can ensure that risk is contained to acceptable levels.

The risk landscape is as diverse as organizations themselves. Strategic risk such as reputational risk or geo-political risk can flare up with just a moment’s notice. Trading in far-flung places with unfamiliar cultures, volatile politics and a different work ethic can create profound difficulties for unwary organizations. But operational risks can be just as damaging. The unwitting transgression of local legislation, the impact of a rogue vendor in the supply chain, or a systematic fraud can all have a devastating financial and reputational impact. In a low growth economy the temptation is to take on anything that offers exceptional returns but this could prove foolhardy if not accompanied by a sensible approach to risk.

So how does an organization manage risk in the context of new growth opportunities? The challenge of tackling risk on an enterprise-wide scale is formidable yet it is possible to stack the odds in favour of the organization by adopting best practice methodologies, tools and techniques and by leveraging an appropriate blend of organizational structure, process and technology. Underlying the whole response is the need for a methodology which concentrates the organization’s efforts according to the “likelihood” of an incident and its “significance”. This can be documented and quantified according to the preferred methodology.

Once the nature of the risk is understood and quantified, it can then drive the type of response. Risk mitigation measures can be developed and Key Risk Indicators (KRIs) developed for monitoring and reporting on risk containment. In extreme cases, the appropriate response may be to withdraw from a particular line of business or geography altogether, for example, because of the high probability of violating, say, the Financial Corrupt Practices Act (FCPA).

Crucially, KRIs should be incorporated into forecasts and reported alongside the financial results to which they relate. For example, a KRI such as the “number of transactions over $100,000”, designed to give early warning of an FCPA infringement, could be reported in a risk-based scorecard or console alongside forecast and actual revenue for a new operation.
The acquisition of a business or the creation of a new business venture in, for example, an emerging economy can quickly present serious management challenges. In a volatile economy with limited growth prospects it is vital that management are rapidly equipped with complete and timely visibility of business performance.

**Standardized ERP**
For most multinationals, the advantages of a globally consistent approach are compelling, for example, standardizing business processes, eliminating unnecessary accounting complexity, maximizing user productivity, enabling tight performance management, encouraging operational excellence and promoting organizational responsiveness. Handled correctly, a newly established or acquired operation in a distant land can be brought onboard quickly without compromising specific local requirements. Even operationally diverse (heterogeneous) multi-nationals can benefit from a cohesive and unified approach to business processes, technology and human capital. It is about striking an appropriate balance between local and corporate or group needs, taking care to accommodate local custom, culture and business practice.

However, there is no single answer to the deployment of an ERP system and much depends on an organization’s existing IT and communications infrastructure. The decision about the optimum way to deploy (centralized, fully decentralized or regional) depends on a number of factors, such as, where servers are situated, where IT and application support is based and whether local language versions of the software are needed.

Fortunately, modern ERP systems are relatively undemanding in terms of hardware, and powerful servers are easily affordable. Usually, there are substantial benefits (economies of scale) in centralizing hardware on a global or at least regional basis. In this way hardware support can be centralized, security becomes much easier and IT skills do not have to be provided in locations where they would be difficult to cost justify.

Similarly, it frequently makes economic sense to centralize application development and help desk capability. In general terms multinational groups benefit from a standardized approach based on core functionality which can be rolled out rapidly to new ventures. Most modern ERP solutions support this concept together with localized functionality around the core.

**Shared Services Centers**
One deployment model that has rapidly gained favor is the shared service centre or SSC. This approach combines the underlying processes, technology and operatives in a single location and helps to drive down transaction costs for group companies through sharing a common platform and repeatable processes. It is another method by which new business operations can be brought rapidly on stream. A further advantage of the SSC approach is that the entire function can, if desired, be located off-shore in an even lower cost environment.

**Cloud-based services**
Cloud based provisioning is looking increasingly attractive. Once again there are a number of deployment options, such as private, public and hybrid clouds which reflect different degrees of infrastructure management. For a new venture, Cloud offers the possibility of a more rapid implementation with fewer resources being required. The approach is particularly appealing for smaller operations or early stage businesses that may not have proved themselves and may not be suited to the group-wide standard. However, the advantages of the Cloud such as devolving responsibility for maintenance of software and infrastructure to a third party have to be weighed against the need to integrate the solution into other group applications.

**Financial Reporting**
Web-based financial reporting solutions based around a centralized model are readily scalable and can usually be superimposed on whatever ERP systems are deployed to a new venture. This means that once transaction systems are embedded in the business it is a relatively straightforward process to add a new entity to a group structure and collect monthly actuals for consolidation and reporting.
Similarly once the group structure has been revised, results can be reported quickly according to an established group standard. Centralized Business Intelligence tools and scorecards should enable visibility of performance after a short period following implementation.

**Human Capital Management**

Standardized HR practices can be just as important as transaction systems in supporting a new venture which is rapidly gearing itself up with new personnel. The ability to plan recruitment and training while remaining compliant with local employment law is often an early requirement of a new venture. Group-wide HR systems can play a vital role in ensuring that a new part of an organization meets its growth objectives and that management has visibility of local staff.

**Summary**

Despite a relatively bleak global trading environment there are both economies and pockets of market activity that offer the potential for superior returns. The trick is of course sifting the ‘wheat from the chaff’, spotting the opportunities in amongst the mass of information.

Traditional methods of benchmarking can be helpful but CRM systems and Social Analytics coupled with advanced BI capability are likely to offer the best pickings. But it would be misguided to rely entirely on automated processes. There is no real substitute for decades of management experience to help sniff out and validate investment opportunities.

Strategic business modeling forms a central part of the investment appraisal process but a careful balance needs to be struck between the urge for detail and the need to make timely decisions. Flexibility is key to being able to model different scenarios and alter assumptions as different opportunities arise.

But having identified some possible courses of action it is vital to evaluate risk formally as part of the investment appraisal process. The risk landscape is becoming more challenging by the day and this trend is exacerbated by a low growth economy which tends to throw up fewer, but higher risk opportunities. Incorporating Key Risk Indicators into planning, financial reporting and forecasting is becoming an essential tool for managing risk.

Once a course of action has been decided upon speed of execution is critical. Management needs to gain quick visibility into the performance of new ventures and this in turn relies on the agility of its people, processes and technology. Business agility should be at the forefront of systems architecture design. Both local and group transaction and information systems must be able to accommodate new ventures and acquisitions with the minimum of fuss. In this context, Cloud-based computing offers interesting possibilities.

In a poor trading environment the organization that can seek out opportunities before anyone else, confidently manage the risks and has the systems and processes in place to execute on its decisions without delay will steal competitive advantage over others.
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