THE FP&A SQUAD:

Financial Agents for Change

By Kasthuri V. Henry, CTP

Snooze and you lose.

It's an old saying (well, perhaps not that old), but it captures the essence of what every company in the current global economy needs to do to be successful: Be mindful of its strategic mission while building the trust of employees, customers, suppliers, investors, and even regulators. It's a daunting task, to be sure, but businesses that aren't agile enough to react when the windows of opportunity open will fall flat, and those that keep their eye on the ball will rise to the top. A corporation's success is predicated on competing effectively for scarce economic resources in a tight economy by remaining congruent to the organizational mission while focusing on the intended strategic vision. Doing so builds on the firm's reputation to garner employee commitment, customer loyalty, investor confidence, and regulator trust by upholding good governance, effective enterprise risk management, and responsible regulatory compliance.

It sounds simple enough, but advocating and adhering to these standards of diligent stewardship is no easy feat when times are good, and the challenges are magnified when times turn rough. Navigating these interdependent challenges requires an organizational culture rooted in learning from itself to effectively groom change agents capable of shaping and controlling the business process with a deep understanding of the root causes. These financial "superstars" should be part of a learning organization's Financial Planning and Analysis (FP&A) team, capable of looking multiple layers beneath the financial statements, establishing the various dependencies of the operational processes, and predicting, with forethought, the ramifications of their advice.

The Evolving Role of FP&A

Traditionally, the FP&A team focuses on providing support to upper management to help them make effective and timely decisions. Members of the FP&A team include financial accountants, as well as management accountants who have earned the CMA® (Certified Management Accountant) designation, who drive the processes of long-range planning, annual budgeting, ongoing driver-based forecasting, financial analysis, and decision support. In keeping with the *IMA® Statement of Ethical Professional Practice*, the FP&A team is responsible for functioning with integrity and in an unbiased manner to provide consistent, reliable, relevant, and meaningful information. Needless to say, these internal guidance providers must emulate the utmost level of principled leadership so they won't compromise the fundamental inputs driving all aspects of business decision making. They ought to embody good governance by exhibiting transparency and full disclosure, understand the need for effective risk management, and present unbiased information to allow the decision makers to weigh all the pros and cons for sound decisions as well as plan for contingencies. If anyone on the team is biased and filters out important facts and information, this will have a domino effect on management's ability to weigh all of the risks and ramifications that could potentially be harmful.

Globalization places an added burden on the FP&A team. These professionals must now perform their function not only in the context of the underlying business, as in the past, but they also have to become strategic business partners to the organization by evaluating, synthesizing, and integrating global socio-economic and competitive issues into their deliverables. Here are just a few of the top-view questions the FP&A team is tasked with answering:

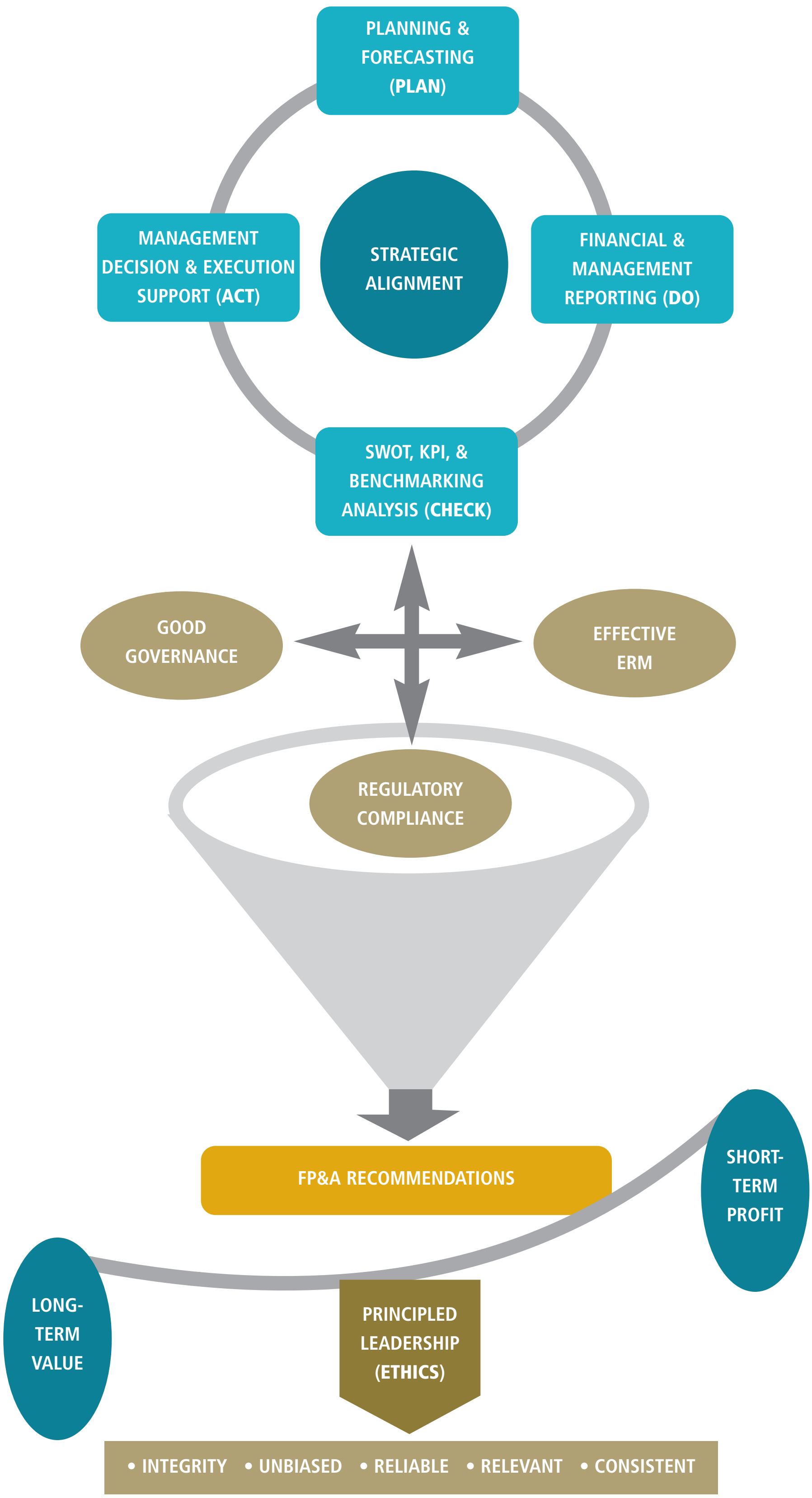
- How will the shifting geopolitics impact regulatory issues that affect the supply chain?
- How will consumers' shrinking wealth shift demand for the firm's goods and services?
- How will the increasing rate of business failures affect the organization's strategic partner network and thus its competitive advantage?
- What technological innovations are taking place in adjacent industries that could bring new competitive threats while potentially rendering the company's current processes obsolete?

The evolving role of the FP&A team is illustrated in Figure 1, which integrates the financial process model that was published in 2009 in the *Journal of American Academy of Business*, *Cambridge* (see "Is the Relationship between Capitalism and Society Parasitic or Symbiotic? The Role of Finance Leadership as Strategic Partners for Sustained Prosperity" by Kas Henry, Robert DeYoung, and Jean Gordon). As value-centric stewards, FP&A professionals have an unwavering fiduciary responsibility to the company's stakeholders that they should take seriously to ensure that success isn't rendered optional when choosing between short-term profits and the creation of long-term value. Short-term profits are necessary, but they must not take the place of the economic purpose of the business, which is to create value over the long haul by attracting capital from investors. The consequences of going astray can be disastrous. Just look at the automotive and financial services industries in recent years.

The top portion of Figure 1 reveals the quality-conscious FP&A process rooted in W. Edwards Deming's Plan-Do-Check-Act (PDCA) cycle tempered by good governance, effective enterprise risk management, and regulatory compliance to generate sound business recommendations. The principled leadership of the individual professionals on the FP&A team, abiding by the *IMA Statement*, allows them to pragmatically weigh short-term profits against long-term value creation to drive a sustained competitive advantage. Moreover, the professionals on the FP&A team are expected to build a culture reflecting purpose, courage of conviction, whole-person approach, empowerment, succession planning, and emotional intelligence, as captured in the Comprehensive Ethical Leadership Model™ that appeared in my article "Leading with Your Soul" in the February 2009 issue of *Strategic Finance*.

The Deming cycle provides the underpinnings for the

Figure 1: FP&A Change Agents Are Essential



continuous improvement of business processes and operations, thus establishing the base toolkit for management accountants in the FP&A value chain. If companies in the financial services sector had followed the Deming cycle, they would have analyzed their financials at a deeper level instead of merely getting energized by soaring revenues and profits. Take the mortgage business, for instance. If lenders had scrutinized the numbers as they should have, by doing a root-cause analysis, their management accountants would have discovered the toxic implications of a rash of subprime lending and learned that not all revenue is good revenue and not all profits are good profits. If an organization is capable of discerning such insights via its FP&A value chain, then the management team has the opportunity to discuss, determine, strategize, plan, and execute the necessary course correction.

Generally speaking, financial accountants don't have the tools or the overall business knowledge to look beyond the financial statements because all growth looks good from their vantage point. Management accountants, on the other hand, add value by participating in the FP&A process because it takes a long-term view and can prevent the company from betting on a mirage.

Good Growth vs. Bad Growth

There are distinct differences between good growth and bad growth. Good growth will never be contrary to the mission of the organization. Every company claims allegiance to a lofty mission that aims at making life better for its stakeholders without destroying the environment that hosts it. Likewise, every financial services organization engaged in

Figure 2: Characteristics of Good Growth vs. Bad Growth

GOOD GROWTH

- Respects stakeholders and acts congruently with the company's mission
- Strengthens the business through employee loyalty to drive customer loyalty
- Creates value for customers and is socially responsible
- Examples: Amazon, Southwest Airlines, Costco

BAD GROWTH

- Misleads stakeholders and acts inconsistently with the company's mission
- Gradually erodes the business from the inside out by destroying employee morale and customer loyalty
- Extracts value from customers and is socially irresponsible
- Examples: financial sector, telecom, and travel industry

mortgage lending had a mission similar to Bank of America's mission to bring "the power of our human and financial capital to transform communities into vibrant, desirable places for people to live, work, and raise families." That certainly sounds commendable. But if the entire business model was predicated on such a mutually beneficial goal, then why was no one analyzing the root cause of the sudden and unusual growth spurt or evaluating how it might affect the company months or years into the future? A situation such as the one that occurred in the banking sector is a priceless opportunity for FP&A professionals to become change agents by asking the following questions:

- Is this trend good?
- Does it reflect the purpose of this organization?
- Is it congruent to the mission and vision of the organization?
- Is it capable of driving a sustained competitive advantage and creating long-term value?
- What are the potential risks arising out of such a trend, and what risk mitigation plans need to be in place for responsible stewardship?

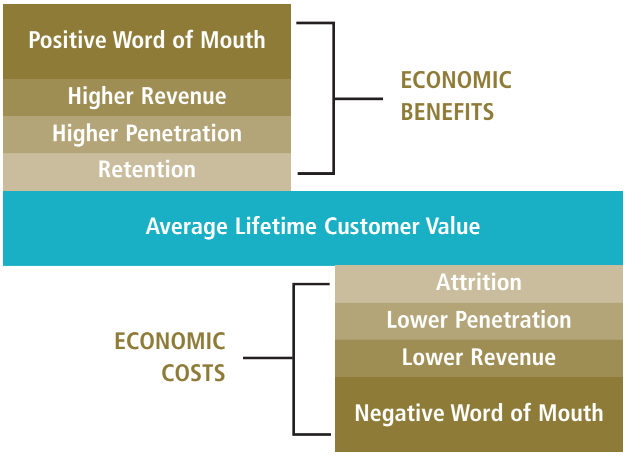
Using continuous improvement as the basis for good growth, Figure 2 summarizes and encapsulates the choices available to organizations.

Self-preservation alone should propel an organization to embrace good growth. Amazon, Costco, and Southwest Airlines are three great examples. By staying true to their mission, they garner loyalty from both employees and customers. They understand the basic truth that being an employer of choice establishes the rite of passage for becoming the *provider* of choice because empowered, happy, energized employees will take care of the customers, and the business will then be able to take care of itself. A positive organizational culture lays the groundwork for all those who come in contact with the company, including employees, suppliers, creditors, and customers, who, in turn, become promoters of the business purely through word of mouth. These promoters expand the company's market reach while simultaneously reducing its reliance on paid advertising and other customer acquisition costs, keeping margins high.

Eroding Value, One Customer at a Time

An organization that doesn't embody the culture to promote customer loyalty by becoming the employer of choice will lose value over time through negative word of mouth. It's a well-known fact that unhappy employees and customers will voice their dissatisfaction often and loudly. For example, telecommunications businesses have learned this all too well. This industry appears to embrace a churn-and-burn culture in dealing with customers and to disregard the average lifetime value of a customer. Discounts and promotional offers are targeted at landing new clients, and existing customers often receive poor service. Many customers have decided that the only way they can derive value from telecom services is to switch providers every one to three years. So, while they switch their video, voice, and data providers often to take advantage of lower-

Figure 3: Economic Costs and Benefits of Growth Choices



cost bundled services, the industry is mainly competing for new customers and disregarding their existing base. In short, nobody is winning, as various customer satisfaction polls have showed.

This cycle of *ignore what you have and try to get what the other guy has* systematically increased the delivery cost of all services as well as accelerated the cost of acquiring new customers. As these costs increase, the breakeven point and profit margin take a big hit. This is a negative cycle, for sure, but it wouldn't have been missed by a strong FP&A team focusing on average lifetime value of a customer and asking the right questions based on sound root-cause analysis.

Figure 3 explains this phenomenon by drawing attention to the economic costs of a churn-and-burn business culture and the benefits of retention, based on Fred Reichheld's net promoter concept as outlined in his book, *The Ultimate Question: Driving Good Profits and True Growth*. FP&A professionals are well-positioned to ascertain such economic cost trends and function as an early-warning system to the organization by being trained and empowered to connect the dots between the various functional areas of the business and evaluate the interdependencies. This requires more than mere technical financial skills; it calls into play business acumen, communication skills, emotional intelligence, integrity, and understanding of enterprise-wide risk. An FP&A professional who embodies this diverse portfolio of skills and is respected as a trusted business partner rises up to become a true change agent.

The Six Roles of an FP&A Pro

Any change requires the duality of shaping and controlling. In their book *Managing Organizational Change*, Ian Palmer, Richard Dunford, and Gib Akin present six images of change, which are classified as controlling and shaping images. The roles of Director, Navigator, and Caretaker reflect the images of *controlling* change, and Coach, Interpreter, and Nurturer reflect the images of *shaping* change. As a change agent, an FP&A professional ought to embody the ability to help shape change by *coaching* for the intended change, *interpreting* the partially intended change, and *nurturing* to deal with the unintended change. At the same time, he or she should take on the other three roles in controlling change by providing the information necessary to direct the intended change, navigate the partially intended change, and being the caretaker of the unintended change.

Change is never easy, of course, nor is influencing or directing it. In their book *Switch: How to Change Things When Change Is Hard*, Chip and Dan Heath outline the blueprint for change with a deep understanding of human psychology. Their concept, summarized in Figure 4, is a valuable reminder to FP&A professionals that numbers and explanations alone won't suffice for those who want to become a change agent; emotional intelligence is equally vital. The Heaths discuss the rational and emotional mind of individuals and the challenges of driving change by appealing to both of these aspects.

What does this mean to an FP&A professional? Just as the rider of an elephant has to coax the animal to go down a particular path, knowing that the elephant has a will of its own and could easily crush him, FP&A professionals should lead change with their rational mind while understanding the emotional mind and appealing to the rational mind of the organization. Change agents are the riders, and the organization is the elephant that could crush them at any time. Riding an elephant is nowhere near as easy as riding a horse, and the speed of movement could be rather painful, but reaching the intended destination would be a worthy pursuit.

The Drive Toward Continuous Improvement

An FP&A team functioning under Deming's PDCA process forms the underpinning for continuous improvement. The initial phase consists of formulating the overall business strategy, deciding what needs to be done to operationalize it, setting up checks and balances to monitor progress, and agreeing on what actions to take in the event of unanticipated issues. This planning stage is followed by a budgeting cycle to manage the day-to-day running of the business, determine key performance indicators (KPIs), and establish the baseline for the forecast process cycle. The forecast process then becomes the third iterative cycle, integrating variance analysis and the refinement of strategy as well as the plan. This iterative cycle, with root-cause analysis across every stage, is the foundation for driver-based planning as well as continuous improvement (see Figure 5).

KPIs and root-cause analysis in tandem allow the organization to understand the relationship between the internal and external environments to drive true growth with good revenue. It also highlights the key business drivers influencing the operation. When business drivers are well-identified, planning, budgeting, and forecasting become more well-oiled processes. Line-item-based planning and forecasting with guesstimates and material variance would no longer be the norm. The FP&A value chain will intrinsically become a normal part of doing business instead of remaining an additional layer. People, processes, and technology will be utilized more effectively to drive quality-based good growth and true profits, as illustrated in Figure 5.

When driver-based planning—focused on good growth and true profits—is set in motion, annual planning ceases to be a monumental task. The FP&A team produces ongoing driver-based forecasts for a 12-to-18-month horizon with the ability to take a rolling 12-month snapshot to establish the budget. This planning process with root-cause analysis establishes a lower-cost, high-impact,

Figure 4: Shaping the Path for Change

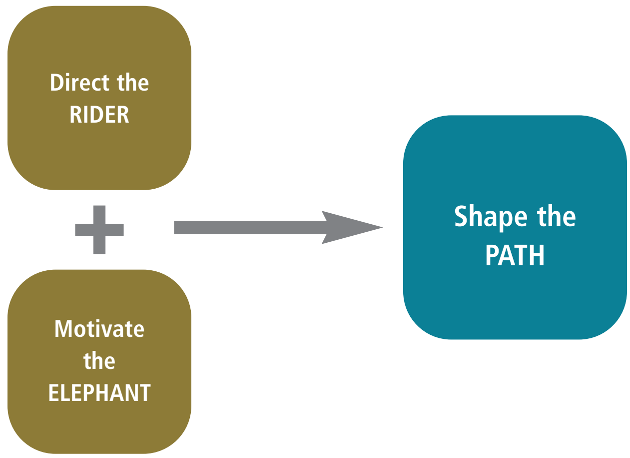


Figure 5: FP&A Team Leads Continuous Improvement

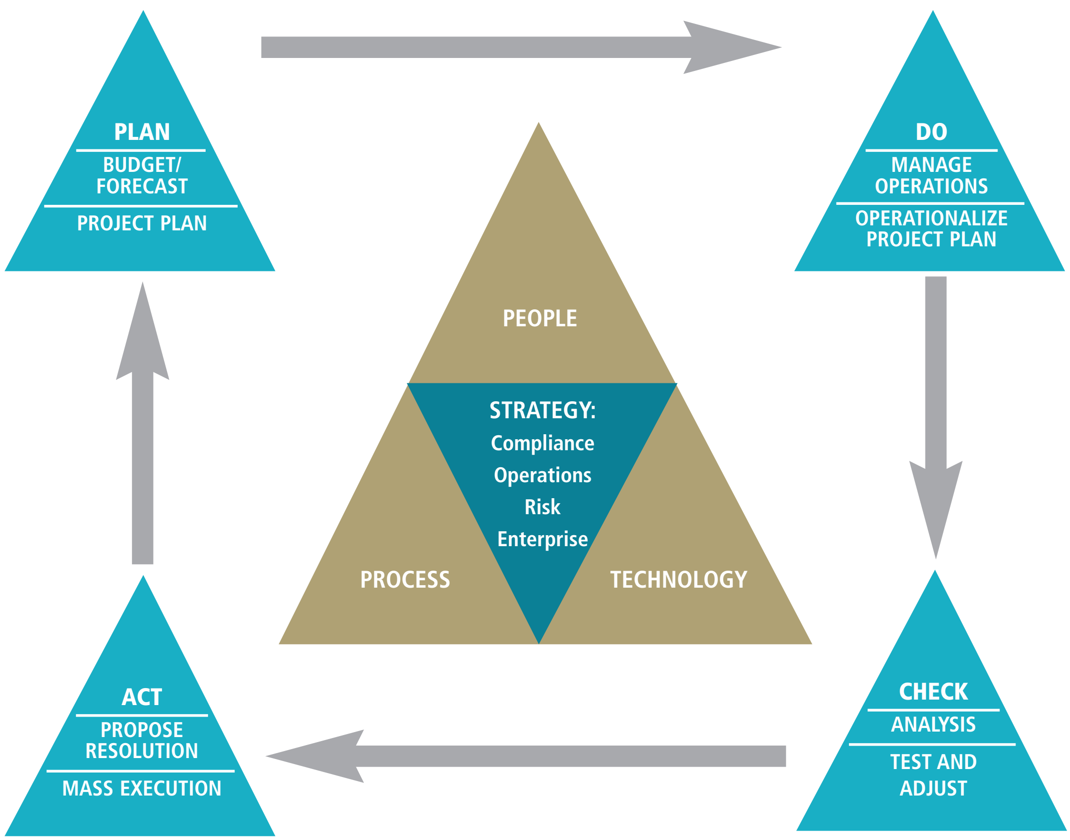
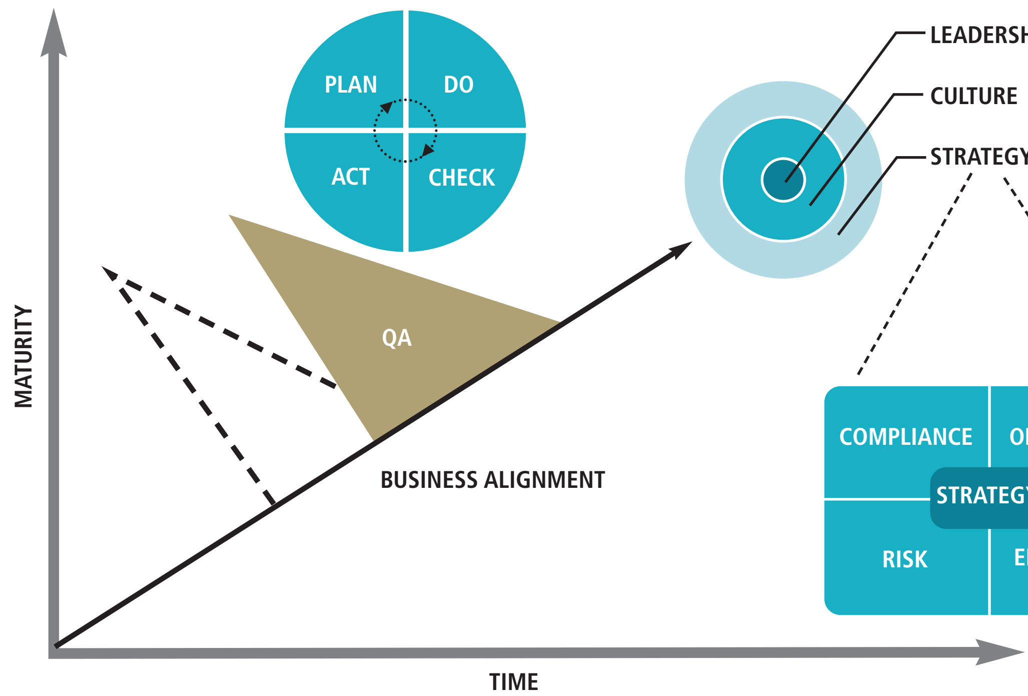


Figure 6: Integrated Approach to Strategy-Focused Change Management



and effective planning process for the organization. An organization involved in such a planning process based on continuous improvement would have a built-in quality assurance (QA) fail-safe, allowing the firm to evolve into a learning organization that's capable of improving on itself with the purpose of aligning its mission with its goals for growth (Figure 6).

A Sustained Competitive Advantage

A learning organization centers itself on principled leadership, with leadership traits prevalent across the whole organization as opposed to only at the top. As I explained a few years ago in "Leading with Your Soul," the culture of a learning organization will be conducive to cultivating an environment that allows for the courage of conviction, whole-person approach, empowerment, succession planning, and the emotional intelligence necessary to drive brand loyalty and a sustained competitive advantage to achieve the corporate goal of sustainable value creation and reputation.

A principled, leadership-centric organization formulates strategies with an understanding of good governance, the need for mitigating enterprise risk, and the importance of adhering to regulatory compliance. Collectively, this process—spearheaded, of course, by FP&A change agents—will succeed in building and sustaining a business with a strong CORE: **C**ompliance, **O**perations, **R**isk, and **E**nterprise. I won't get into CORE programs here, but I refer you instead to "Strengthen Your CORE" by James Bierstaker, Kenneth K. Marshall, and Jonathan Greenwald in the December 2010 issue of *Strategic Finance*.

Management expert Jay Barney's definition of sustained competitive advantage theory says that an organization that's perceived to have products and services that are valuable, rare, difficult to replicate, and organizationally based will command a sustained competitive advantage. Only when an organizational culture capable of synergy brings people, processes, and technology together in its own unique way to embody value, rarity, and replication will the economic benefits be long lived enough to afford a long-term competitive advantage. Therefore, a learning organization dedicated to quality—with FP&A professionals acting as partners and stewards of the business—can create the winning organizational culture that's conducive to generating and sustaining a competitive advantage with the goal always being good growth and true profits. **SF**

Kasthuri V. Henry, CTP, Ph.D., is a Six Sigma Black Belt and the president of Kas Henry Inc., a consulting and training firm serving the corporate finance space. She also is a visiting assistant professor at Southern Illinois University and North Park University and is a member of IMA's Northwest Suburban Chicago Chapter. You can reach Kas at (224) 595-7418 or kas@kashenry.com.