Trusted Advisor or Compliance Enforcer?

> *"Can anybody remember when the times were not hard and money not scarce?"*
> Ralph Waldo Emerson

Of all the various roles Finance can play in a retail operation, the two most necessary to balance are complying with legal, tax and accounting regulatory requirements and dispensing sound advice on the efficient allocation of resources. In the first, Finance must focus on checks and controls. In the second, it leverages its extensive expertise in understanding what resources are required to generate which revenues. It is uniquely positioned to play this second role because, while most business departments push as far as they can in a single direction, Finance must evaluate the entire business's contrasting realities.

How Finance strikes this balance (and many others) to a large measure determines the success or failure of the business. *Is your budget a tool to control costs, or to sponsor investment?* Depending on targeted customers, channels, unique value proposition and economic circumstances, one choice is better than the other.

Finance is the mind of the business, using a structured approach to evaluate the soundness of the many commercial propositions and opportunities you face every day. Information feeds this process, and Finance has more information than most departments. As it fills its role of balancing—aligning processes and controls while advising the business on future directions—Finance faces a number of barriers when it comes to information and how to use it.

Barrier 1: ***Lack of information needed to regulate what has happened and shape what will happen***

Finance requires new levels of information about past and present processes and events to meet its regulatory compliance responsibilities. *Did the right employee or department sign off a particular expense item? Are the right approval processes in place?* For some retailers, the information demands of compliance and control have forged better relationships between Finance and IT. They have led to improving data integrity, information gathering and collaboration methods, raising the accuracy of information for business use.

But while Finance works to manage these issues, it must also ensure the information investment helps drive its other key responsibility: helping guide decisions that make a difference to the future bottom line.

The executive team and commercial functions both look to Finance to help the business assess risk and plan its future with confidence, not simply manage compliance and controls. Finance must pay attention to the drivers that make profit, using value-added analysis to extrapolate the financial impact of decisions—and anticipate them when necessary.

Valuing, monitoring and making decisions about intangible assets exemplifies the interconnection and sophistication of the information Finance requires. Regarding human capital, for example, Human Resources and Finance must work together to identify the value-creating roles of individuals, reflect their worth and manage their growth, rewards and expenses.

Without information sweet spots that show both the status of control and compliance and the impact of drivers on future business opportunities, Finance can't strike the necessary balance.

Barrier 2: ***The relevance, visibility and credibility of what you measure and analyze is designed for accounting rather than business management***

Finance collects, monitors and reports information with distinct legal, tax and organizational requirements to fulfill its fiduciary role. But Finance also needs an integrated view of these and other information silos to fill its role of advisor. This role requires not simply reporting the numbers, but adding value to those numbers.

For example, in times of economic uncertainty or downturns, understanding the impact of changes in customer buying patterns on sales and margins is critical. Understanding basket trends will indicate if customers are making fewer trips, reducing purchases or "trading-down" to less expensive goods, which will allow managers to revaluate assortment, pricing and promotional strategies. Another related example: Marketing must understand spending and return on advertising and promotional programs. And Finance must allocate these marketing expenses across a wide range of detailed and hierarchically complex general ledger accounts. Without this comprehensive view, the same expense may be classified in different accounts by different individuals, and the return on promotional programs will not be visible to management.

Barrier 3: ***Finance must balance short term and long term, detailed focus and the big picture***

Finance balances different and contradictory requirements. It must deliver on shareholder expectations every 90 days; it must also determine a winning vision and a strategy to achieve that vision over quarters and years. Companies can cut costs and investments to meet short-term profit objectives, but at what point does this affect long-term financial health? A well informed executive team is able to understand the drivers, opportunities and threats when balancing short- and long-term financial performance.

Executives and financial analysts define performance in terms of shareholder value creation. This makes metrics such as earnings per share (EPS) growth or economic value added (EVA) important. However, these distilled financial measures tell only one piece of the story. You need to augment them with more detailed measures that capture sales, market share gains and revenue growth targets to understand the real health of the multi-channel operations and strike a good balance between long- and short-term growth.

Barrier 4: ***Finance must find the path between top-down vision and bottom-up circumstances***

To what extent should goals be set top-down versus bottom-up? *If the executive team mandates double-digit profit growth, does this translate into sensible targets at the lower levels of the organization? Does it require a double-digit target at the lowest profit center?* Top-down financial goals must be adjusted to bottom-up realities. Finance must accommodate top-management vision while crafting targets that specific division, store, channel and product categories can achieve. And the importance of reconciling the top-down and bottom-up plans across the organization ensure everyone is managing to a single set of financial goals and business objectives.

This barrier in particular illustrates the importance of engaging frontline managers in financial reporting, planning and budgeting. The need for fast and relevant information requires an interactive model. Frontline managers must assume some budgetary responsibility and feed back changes from various profit or cost centers as market conditions change. This decentralized model engages the business as a whole rather than relying on a centralized function to generate information, especially important in retail where hundreds or thousands of stores are the frontline operations.

Besides freeing up Finance for value-added decision support, bottom-up participation generates an expense and revenue plan that overcomes hurdles of accountability, relevance, visibility and credibility. Individuals who engage in the process take responsibility for delivering on expectations. This helps expose drivers of success and failure that are otherwise lost in a larger cost calculation or financial “bucket”—for both the frontline manager and Finance.

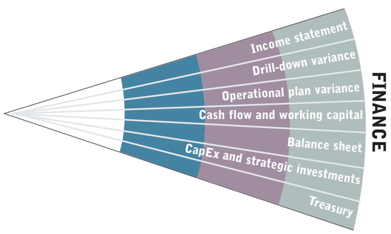
Balancing Short Term and Long Term, Past and Future, Compliance and Advisor

The information Finance uses to report what has happened and shape what will happen is critical to the rest of the organization. Dynamic tools that allow Finance to balance compliance and performance, accounting and business structures, short term and long term, top-down vision and bottom-up reality, are more important than ever. Information sweet spots can support Finance's responsibilities and decision areas.

A Balanced Financial Experience

Finance decision areas:

- **Income statement ➔** How did the business team score; where was performance strong or weak?
- **Drill-down variance ➔** What causes changes in financial performance?
- **Operational plan variance ➔** How do we best support, coordinate, and manage the delivery of meaningful plans?
- **Cash flow and working capital ➔** How do we manage working capital, collect accounts receivables and monitor cash use effectively?
- **Balance sheet ➔** How do we balance and structure the financial funding options, resources and risks of the business?
- **Capital Expenditure (CapEx) and strategic investments ➔** What are the investment priorities and why?
- **Treasury ➔** How can we efficiently manage cash and liquidity requirements?



Income Statement

This decision area represents the bottom line. It is the cumulative score achieved by everyone in the enterprise for a set period. Everyone needs to understand his or her individual contribution and performance measured against expectations. You must understand where variances against budget occur so you can correct the course. If costs are increasing too quickly, you risk damaging future profits unless you control them, adjust selling prices or develop new markets. Unexpected revenue spikes can mean additional resources are required to continue future growth. Adjustments such as these take time: the sooner you take action, the sooner you improve margins and realize the full potential of a growth opportunity. The ability of Finance to quickly identify, analyze and communicate important variances has competitive implications for your operation. How quickly the retail business recognizes a new trend and capitalizes on it is determined by how quickly it discovers budget variances.

GOALS	METRICS	DIMENSIONS	
Actual vs. Plan Variance ($/%) Net Trade Sales ($) Operating Profit/EBIT ($/%)	Net Profit ($/%) Gross Profit ($/%) COGS $/% Operating Costs $/% Labor Costs $/% SG&A ($/%) Fixed Costs ($/%) Interest ($/%) Tax ($/%) Overhead Costs $/% Marketing Costs ($/%)	Fiscal Month Year Quarter Month Week Organization Division Channel Store Department Org. Code	Region Region Territory Locality Product Hierachy Product Category Product Group Product Line Plan/Actual Scenario Scenario

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance	Executives	•		
	Professionals	•		
Audit	Executives			•
	Professionals	•		
Store/Channel	Executives		•	
Marketing	Executives		•	
Human Resources	Executives		•	
IT / Systems	Executives		•	
Supply Chain	Executives		•	

Drill-Down Variance

Once you identify a difference between actual and plan, you need to drill down into the details to understand what caused it. *If sales increase by five percent between two time periods, was the cause greater volume, higher price or a change in the product mix? Did your competitors have the same increase in sales? If profits increased, was it due to decreases in the cost of goods, a change in product mix to lower margin products or a reduction in discretionary spending? Did your competitors experience the same increase?*

Finance needs to understand the *why* behind changes. Knowing what drove changes in revenue and profit provides a more complete picture to help guide the company.

GOALS	METRICS	DIMENSIONS	
Profit Change ($/%)	Net Sales ($)	Fiscal Month	Region
Sales Change ($/%)	Net Price ($)	Year	Region
Volume/Price/Mix Variance ($/%)	Markdown (%)	Quarter	Territory
	Shrinkage ($)	Month	Locality
	Rebates ($)	Week	Product Hierachy
	Units Sold (#)	GL Lines	Product
	Unit Cost ($)	Organization	Category
	Net Change ($/%)	Division	Product Group
	GL Expense Detail ($/%)	Channel	Product Line
		Store	
		Department	
		Org. Code	

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Professionals	•		
Audit				
	Executives			•
	Professionals	•		
Store/Channel	Executives		•	
Marketing	Executives		•	
Human Resources	Executives		•	
IT / Systems	Executives		•	
Supply Chain	Executives		•	

Operational Plan Variance

Once Finance understands what caused performance variances, it can lead discussions about future operating plans. The ability to advise and push back on management plans is important. Knowing the *why* behind variances from plan helps managers reevaluate and improve the next plan. Without this information, plans lose their purpose and become academic exercises to please senior management. Ideally, Finance offers input and feedback that other business areas can use for guidance. At the same time, these other areas provide frontline information to Finance that helps improve the plan. Such cross-functional and coordinated effort lets you test the roadworthiness of existing business plans.

Operating Cost Variance ($/%) Overhead Cost Variance ($/%) COGS/Sales Ratio (%)	Actual vs. Plan (%) Net Sales ($) Unit cost ($/% Labor Costs ($/%) Distribution Cost ($/%) Overhead Costs ($) Operating Profit ($/%) Employees (#) Sales per Employee ($) Sales per Store ($) Operating profit per Employee ($) Operating profit per Store ($) Marketing Costs ($/%) Net Sales	Fiscal Month Year Quarter Month GL Lines Organization Division Channel Store Department Org. Code	Region Region Territory Locality Product Hierachy Product Category Product Group Product Line

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance	Executives	•		
	Professionals	•		
Audit	Executives			•
	Professionals	•		
Store/Channel	Executives		•	
Marketing	Executives		•	
Human Resources	Executives		•	
IT / Systems	Executives		•	
Supply Chain	Executives		•	

Cash Flow and Working Capital

Effective collection of accounts receivable fuels better performance. The cost of delay is high; managing the profiles of aging accounts receivable or the days of sales outstanding (DSO) is a key priority for any operation. The flip side of the coin is that delaying your own accounts payable is good for cash flow. In both cases, Finance must have insight into customer and supplier preferences to ensure the bottom line does not damage valuable relationships.

Investment analysts scrutinize working capital requirements as one factor in determining financial performance. *Is the business managing its valuable cash resources? How does the ratio of debtors (accounts receivable) to sales or the DSO compare to the industry average? Are stock days increasing, meaning more cash is being diverted to holding stock? Are the accounts payable days increasing?*

Working capital requirements have a direct impact on the market valuation of a business. They are a critical area for Finance to monitor.

A/R Days (#)
Net Cash Flow ($/%)
Working Capital Ratio (%)
	A/P ($)
	A/P to Sales (%)
	A/R ($)
	A/R to Sales (%)
	Current Assets ($)
	Current Liabilities ($)
	Inventory ($)
	Inventory Days (#)
	Inventory to COGS (%)
	Net Change ($/%)
	Quick Ratio (%)
	Sales / working capital (#)
	Supplier credit ($/days)
	Customer credit ($/days)
	GMROI % (gross margin return on inventory investment)
		C/F Lines
		  Class
		  Sub-class
		  Account
		Fiscal Month
		  Year
		  Quarter
		  Month
		Organization
		  Division
		  Channel
		  Store
		Department
		  Org. Code
		Supplier/Vendor
		  Vendor/Merchant
		  Supplier/Manufacturer

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Professionals	•		
Audit				
	Executives			•
	Professionals	•		
Store/Channel				
	Executives		•	

Balance Sheet

This decision area balances the financial structure and resources of the business. How much debt, long- and short-term, can the business safely take on? For shareholders, a higher debt-to-equity ratio means higher rewards and greater risk. A highly leveraged business will generate attractive financial rewards, but if operating profits fall, this may jeopardize the company's ability to deliver on interest and debt repayments. The operation's financial structure is a balancing act that must be based on business fundamentals. *Are future market conditions likely to be favorable? Are sales increasing or decreasing? Is more cash investment needed to expand or upgrade the chains locations and other assets?* Depending on the strategy and future direction, Finance has to accommodate such demands while maximizing returns.

GOALS	METRICS	DIMENSIONS
Capital Employed ($)	Assets ($)	Bal. Sheet Lines
Debt-to-Equity Ratio (%)	Debt ($)	Class
ROCE (%)	Equity ($)	Sub-class
	Fixed Assets ($)	Fiscal Month
	Fixed Assets/Assets (%)	Year
	Liabilities ($)	Quarter
	Liabilities-to-Equity (%)	Month
	Market Value ($)	Organization
	Sales/Capital Employed (%)	Division
	Sales/Operating Assets (%)	Channel
	Sales / fixed assets (%)	Store
		Department

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Professionals	•		
Audit				
	Executives			•
	Professionals	•		
Store/Channel				
	Executives		•	

Capital employed—working capital plus fixed assets—and return on capital employed (ROCE) are critical factors that influence how lenders and shareholders value a business. Investors perceive a high-capital-employed operation as more risky. If such capital employed is largely financed through debt, the business will be more difficult to manage in an economic downturn. ROCE reflects how well the company can convert investment into profit. Selling the financial attractiveness of the business to new investors is an important Finance function. ROCE is a benchmark that reflects positively or negatively on senior management and Finance. It highlights the importance of managing future investments and having a clear understanding and sense of priority about which investment projects generate better returns. This understanding leads to the next decision area.

CapEx and Strategic Investments

Since capital expenditure (CapEx) has an impact on ROCE performance, businesses must evaluate and monitor investment decisions carefully. Asset investments can range from minor to strategically significant: from new point-of-sale or merchandising systems to additional distribution centers or store upgrade programs. Finance must ensure that CapEx and investment requests don't simply become wish lists. Finance must establish the basis for prioritizing and justifying capital expenditure. This means coordinating with different function areas. For example, Finance must understand the impact of both "yes" and "no" before agreeing to new property investments. *Will the location lose sales and market share if you don't refurbish your stores? Will this action improve traffic and conversions, and increase average basket size? Will labor, overhead or other costs increase or decrease?*

The real estate portfolio and its management is a major area for any retailer. It represents a strategic investment decision and a long-term development concern for Executive Management and Finance. *Can the management team pursue an aggressive growth strategy and build its property portfolio bank? Or should a more cautious strategy prevail, perhaps even leading to property and store divestments?* These are all Finance concerns, although the specialist capabilities of real estate management often lead to a separate function within the retail operation.

GOALS	METRICS	DIMENSIONS
Investment ($) NPV ($) ROI (%)	Market Value ($) Assets ($) Capital Employed Change ($/%) Fixed Assets ($) Breakeven Months (#) Payback Months (#) IRR (%) Incremental Profit Growth (%) Incremental Sales Growth (%)	Bal. Sheet Lines Class Sub-class Fiscal Month Year Quarter Month Organization Division Channel Store Department Project Project/Program Type Project Plan/Actual Scenario Scenario

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance	Executives	•		
	Professionals	•		
Audit	Executives			•
	Professionals	•		
Store/Channel	Executives		•	
Marketing	Executives			•
Customer Service	Executives			•
Merchandising	Executives			•
Human Resources	Executives			•
IT / Systems	Executives			•
Supply Chain	Executives			•

Mergers and acquisitions represent another strategic dimension of investments. *What are the potential cost savings from combining two chains or divisions? If the operations merge and lose their particular brand identity and differentiation, will there be significant customer attrition?*

Understanding upside and downside impacts from potential investments is part of the evaluation process. Finance arbitrates such decisions, and requires detailed financial scenarios that forecast investment ROI and payback.

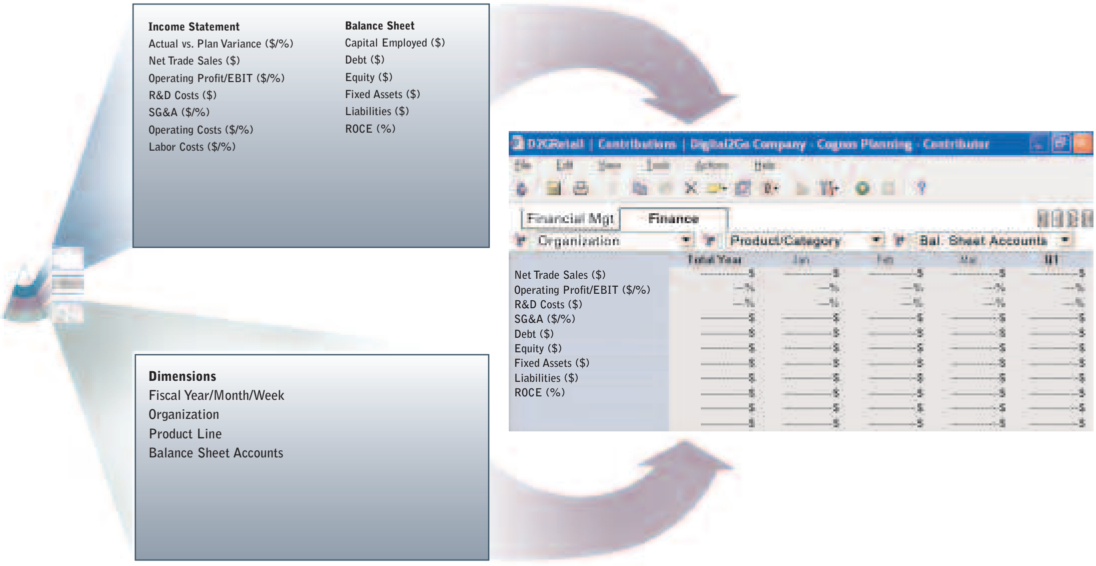
Treasury

Moving beyond the strategic finance structure of the balance sheet, there are regular day-to-day liquidity management concerns that require constant attention. Treasury is concerned with the effective management of cash and liquidity, financing, bank relationships and financial risks. *What are the options for short-term borrowing and cash requirements? Should any surplus cash be placed in the money markets or into a bank account—and, if so, at what rate of return and for how long?*

Effectively managing these liquidity options and dealing with bank relationships requires constantly updated information. Having access to current market information and aligning it with future business requirements are the key to effectiveness.

GOALS	METRICS	DIMENSIONS
Borrowing Cost (%)	Shares Issued (#)	Bal. Sheet Lines
Investment Yield (%)	Shares Outstanding (#)	Class
Net Liquidity ($)	Accrued Interest ($)	Sub-class
	Dividend Payments ($/%)	Fiscal Month
	Interest ($/%)	Year
	Investment Risk (#)	Quarter
	Investments ($)	Month
	Loan Balance ($)	Organization
	Net Cash Flow ($)	Division
	Options Outstanding (#)	Channel
	Options Paid-Up ($)	Store
	Price Earnings Ratio (#)	Department
	Repaid ($) – Interest	
	Repaid ($) – Principal	
	U/W Loan Amount ($)	

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Finance				
	Executives	•		
	Professionals	•		
Audit				
	Executives			•
	Professionals	•		



The Income Statement and Balance Sheet decision areas illustrate how the Finance function can monitor its performance, allocate resources and set plans for future financial and operational targets.