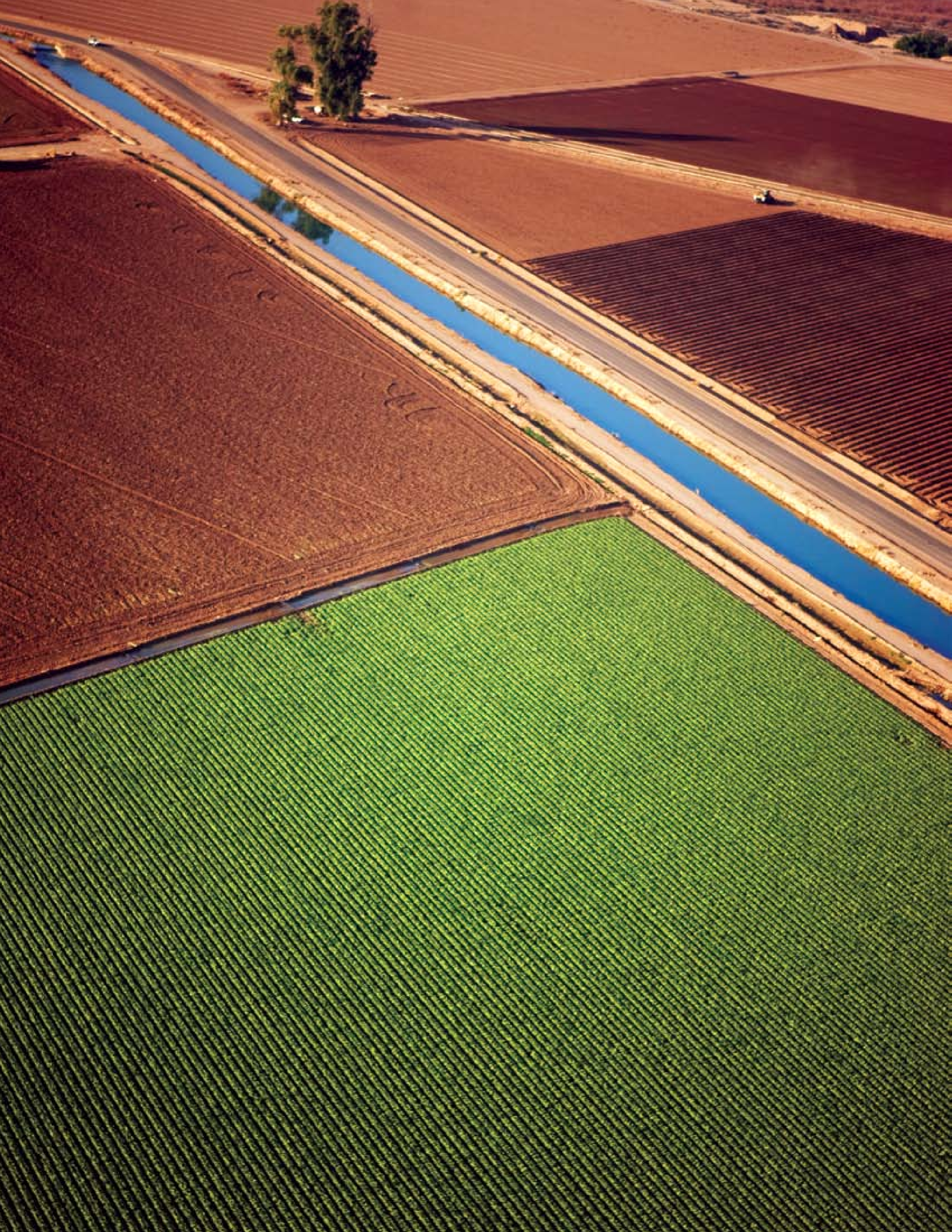
IBM GLOBAL BUSINESS SERVICES

Balancing Risk and Performance with an Integrated Finance Organization

Implications for Chemical and Petroleum Industry CFOs



Balancing Risk and Performance

with an Integrated Finance Organization

"The scale and pace (of the current wave of global economic integration) is unprecedented … the greater part of the earth's population is now engaged."
– Ben Bernanke, Chairman, U.S. Federal Reserve, quoted in The New York Times

In the globally interdependent marketplace, Chemical and Petroleum (C&P) organizations need to deliver consistently strong growth and big profits. They need to be adaptable to change and seize the opportunities, but they also need to be especially resilient to risk. Many companies let their business units and geographies conduct Finance activities according to specialized standards and provincial preferences. But, according to the IBM Global CFO Study 2008 (CFO Study) of more than 1,200 cross-industry CFOs and senior Finance professionals, including 51 C&P executives, this is often ineffective. What follows is an executive summary of the implications for C&P CFOs. To get a copy of the full CFO Study 2008, please visit, **ibm.com**/gbs/2008cfostudy.

Rethinking business models, operations and the impact of risk

Nothing is constant in C&P businesses today – nothing, that is, but change. Markets restructure as new players enter the field, companies merge, joint ventures are launched or commodity markets spring up. And the customer influence is stronger. Emerging nations increase demand for fuel and products. Customers want more for less. Feedstock prices and availability of reserves are volatile. Operational complexity is high – as companies move into increasingly remote, technologically and logistically complex locales. On top of the business complexities are the geopolitical dynamics from facility investments in new countries, nationalization of companies by governments, political instability and health, safety, and environmental influences. And most of these changes can be tied back to globalization – the fact that the world is truly a single global market.

Global business presence is key

The notion of being "global" is evolving beyond a multinational structure or mere presence in different countries and is moving toward the establishment of an interdependent network of worldwide assets with the ability to optimize resources horizontally and vertically. Enterprises are transforming their business models to take advantage of this new way of defining a global presence. The CFO Study found current enterprise management structures (for example, holding companies, decentralized operating companies and vertically integrated operating companies) show little differentiation in revenue and stock price growth in the global study sample across all industries.

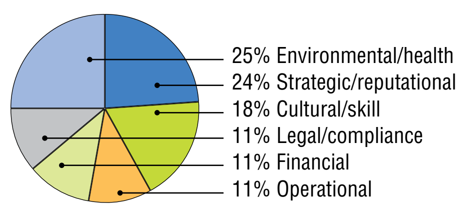
To make a strategic transformation, enterprises also recognize the need to transform their operations. The key question is do current financial management models have the necessary flexibility to enable this transformation and remain resilient to risk?

The world is undeniably risky

In 2005, a U.S. refinery experienced a catastrophic process accident. As one of the most serious U.S. workplace disasters in 20 years, it served as a turning point for the industry to better understand, monitor and prepare for risk events. Since the accident, C&P companies have worked to improve process safety performance and risk management through increased investment in environmental and safety programs. But is it enough? Our study indicates it probably isn't. Half of C&P companies surveyed in the CFO study have encountered risk events since 2005. Of these, only a third considered themselves well prepared. Despite the prevalent exposure to risk, only half of the C&P companies surveyed formally identify possible risks or routinely monitor risk factors.

There are many inherent risks beyond financial ones in industries dependent on natural resources. The complexities of locating resources, operating in hostile environments and changing environmental regulations are just a few. In fact, of the emerging risks C&P CFOs identified as requiring more visibility in the CFO Study, only 11 percent were financial (see Figure 1). Scarcity of reserves, mentioned by several petroleum executives, reflects the fact that only 6 percent of the world's crude reserves are fully available to international oil companies.[1]

Figure 1. Emerging risks identified by C&P CFOs.



Source: IBM Global Business Services, The Global CFO Study 2008.

The Integrated Financial Organization (IFO)

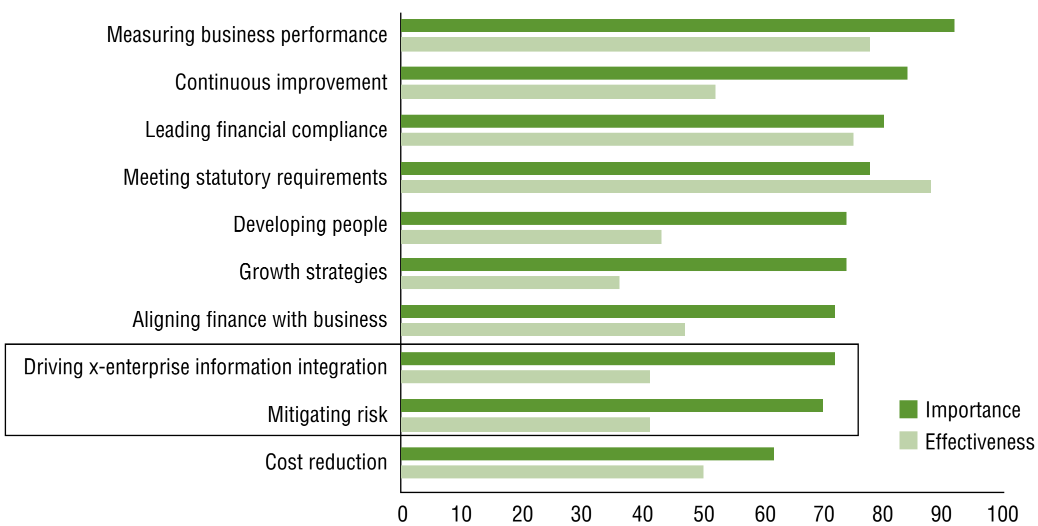
Globalization and the prevalence of risk place an additional burden on the already full agenda for the Finance organization. And, ultimately, all risks are financial. When asked what areas topped their agendas, C&P CFOs categorize almost every Finance activity as important or *very important*. The CFO Study also finds that two of three agenda items ranking lowest in importance by C&P companies, *supporting/managing/mitigating enterprise risk (70 percent)* and *driving integration of information across the enterprise* (72 percent), are key differentiators for outperformers in revenue and stock price growth. These two priorities also represent two of the larger gaps (29 points and 31 points respectively) between effectiveness and importance (see Figure 2).

So how do C&P companies bridge these performance gaps in enterprise integration and risk mitigation? The Global CFO Study, using an analysis of the global sample of all industries, identified the drivers of *information integration across the enterprise as* enterprisewide common data definitions, an enterprisewide standard Chart of Accounts, common enterprisewide standard processes and globally mandated enterprisewide standards. These are the components of good governance and what the study defines as the *Integrated Finance Organization.*

The survey indicates that C&P enterprises consider themselves more likely to be globally integrated (60 percent versus 44 percent for other industries). This may indicate that C&P CFOs believe themselves to be *vertically integrated.* But, with the myriad of mergers, acquisitions and joint ventures, it is unlikely that they are *horizontally integrated* – because less than one in seven (similar to other industries) govern and manage the integration of their Finance organization by the combination of the IFO criteria. *IFOs* have a clear performance advantage. In the global industry sample, they are more likely to have revenue growth rates nearly double that of their *non-IFO* industry peers (see Figure 3). *IFOs* also consider themselves more *prepared* for risk because they are more *aware* of risk.

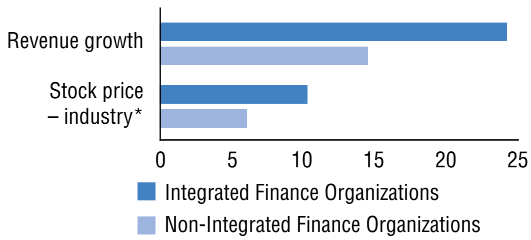
Figure 2. C&P CFO responsibility areas importance versus effectiveness.

(Percent)



Source: IBM Global Business Services, The Global CFO Study 2008.

Figure 3. Integrated Finance Organizations outperform with consistently stronger growth and profits (global industry sample).
(Percent)



Note: Executives asked: How would you describe your company's operating environment? This figure depicts respondents who answered "High Growth Market" or "Moderate to High Growth."
**By taking a five-year view, we were able to identify which companies outperformed and underperformed the average compound annual growth rate (CAGR) for revenue and stock price appreciation. For this subset, we normalized stock price growth rates by analyzing difference between the company stock price and the relevant industry index to eliminate any potential industry specific variability. IFOs enjoy proportional representation across the data sample. Therefore, we believe IFOs are a better practice, not just a reflection of an enterprise structure, sector, revenue size or geography."*
Source: IBM Global Business Services, The Global CFO Study 2008; ThomsonFinancial; 2007 Wall Street Journal "Annual Industry Report."

Successful CFOs are leaders in enterprise integration and risk management

"I see a broader role for the CFO than just financial risk. The risk management role will include environmental and sustainability risks and security risks, for example. Projects will be evaluated across all functions of risk in the future."
– Financial executive

The Global CFO Study concludes that CFOs are uniquely positioned to provide the leadership necessary to:

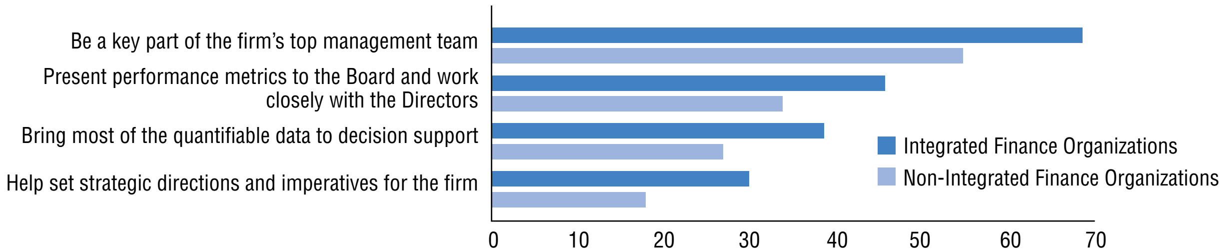
- *Drive information integration* to provide enterprise insight by *establishing global standards through process ownership* and *simplifying enabling systems and organizational structures*
- *Mitigate risk* by *orchestrating risk management* within the enterprise and *converging performance with risk management.*

In the past, a Finance organization's traditional role has been to record financial transactions – but recording history is no longer enough. What's needed is data turned into information that will provide the insight into the future direction of the C&P enterprise. With their already global and outwardly looking perspective, CFOs are uniquely positioned to define and guide the overall enterprise risk profile, as well as shape operational decisions and strategic direction to affect performance.

At their core, outperformance and risk management are about getting to the truth – a single set of facts about business reflecting the reality of the C&P enterprise's performance based on hard data within a standardized framework. Enterprise process and data commonality opens up new dimensions of understanding and allows the organization to define critical items consistently across the enterprise. CFOs with Integrated Finance Organizations understand their role to provide this insight (see Figure 4).

Figure 4. What is the relationship between CFO/Finance and others in the enterprise?

(Percent strongly agree)



Source: IBM Global Business Services, The Global CFO Study 2008.

Driving enterprise integration

"Our process is an obstacle to understanding our business due to the lack of standardization and multiple technologies. But our culture also presents an obstacle – we demand a return on business investment, and it is difficult to quantify the return on (a standardization) investment."

– CFO of global C&P enterprise

Two actions are essential to drive integration and provide this insight into the C&P enterprise's future direction:

- *Establish global standards through process ownership* – Global process ownership (as opposed to *process enforcement* or *process participation*) is key to getting past organizational and cultural boundaries and barriers. The CFO Study shows that IFOs in the global sample are 3.5 times more likely to employ global process ownership enterprisewide.

  Formal, standardized safety practices, for example, coupled with broadly communicated performance expectations, enable the analysis of safety across the enterprise. For instance, Management of Change (MOC) targets for engineering changes, such as "time to complete MOC work orders" or "percent complete MOC work orders," are explicitly stated, measured and analyzed across the enterprise to drive improved compliance. Global process ownership establishes responsibility and accountability for the consistent design and deployment of processes and the associated information.
- *Simplify enabling systems and organizations* – As one CFO shared, "Lack of information integration is our biggest headache." Enterprisewide process and data standards provide greater opportunity to simplify enabling systems and organizational structures for companies. Moreover, enabling technologies and delivery models help to maintain global standards while providing Finance with greater flexibility to adapt to changing business models.

Mitigating risk

"In the future, CFOs will be acting as initial detectors of risk within the organization. They will be positive agents, creating solutions and proposing different scenarios. The role will become increasingly important to risk management."
– CFO, Global industrial company based in Europe

The CFO Study findings suggest that in C&P enterprises, like most industries, CFOs perceive themselves as members of a partnership with other functional leaders, including the CEO, COO, and CRO, to provide leadership in risk management. And two actions are key to managing risk:

- *Orchestrating risk management* – Risk management is about orchestration and communication between the board level to middle management. The Global CFO study indicates that C&P CFOs are stepping up to a leadership role in risk management. C&P CFOs are also more likely to bring more quantifiable information to decision making and to influence strategic imperatives than the global industry sample. Across all industries in the CFO study, *effective* organizations are more likely to provide greater top-down direction about the enterprise's official position on risk appetite and tolerance from the board level to middle management.
- *Converging performance and risk management* – Both risk and reward can ultimately be defined in financial terms. The CFO study highlights that *effective organizations* proactively manage risks to close performance gaps. Across the board, it is clear they engage in more formal risk management activities than *less effective* organizations. Effective C&P enterprises, for example, are twice as likely to employ predictive analyses of risk or to embed access and process controls in risk management than less effective companies. But despite the high visibility of risk in the C&P industries, they are less likely to have risk indicators combined with performance monitoring than other industries. And less than 20 percent manage risk across functions. For C&P CFOs, as enterprise integration increases, it will create an opportunity to utilize risk as a greater factor in decision making.

"We need to know and ensure that our risk management processes are fit-for-purpose, flexible and continuously improving. To be effective, these processes must incorporate systems for identifying, assessing and responding to risks together with mechanisms for bringing sufficient issues to the attention of management."
– Chris N. Woodward of Shell[2]

Conclusion

The global business environment requires new thinking to take advantage of opportunities and prosper despite the risks. C&P companies are working towards enterprisewide standards to provide the governance, transparency and information integrity needed today. CFOs have an opportunity to provide greater leadership by:

- Taking ownership of their Finance processes horizontally throughout the enterprise, simplifying their technology and providing a new, single version of the truth to their enterprises
- Mandating common standards, a standard chart of accounts, common data definitions and processes across the Finance function to become IFOs that are more responsive, more flexible and strive to outperform their peers
- And formally defining and integrating risk programs, beyond financial risk, into the enterprise's performance management.

To live up to this vision, change and integration will need to come from all areas of the business, not just Finance. With this in mind, the CFO can come to the table, armed with the facts and ready to lead.

Get the full IBM CFO Survey 2008

Be sure to read the entire CFO study, "Balancing Risk and Performance in an Integrated Finance Organization – The Global CFO Study 2008" and take the opportunity to compare your enterprise to this global data set through our online assessment tool located at

ibm.com/gbs/2008cfostudy

To learn more about this IBM Institute for Business Value study, please contact us at *iibv@us.ibm.com*. For a full catalog of our research, visit

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Methodology and demographics

The study consisted of interviews of more than 1,200 CFOs and senior Finance professionals. The primary survey instrument was developed through extensive workshops with Finance professionals, practitioners, the Economist Intelligence Unit, Wharton School professors and other subject matter specialists. Thirty-four questions were developed and delivered to more than 1,200 CFOs and senior-level Finance professionals in five major sectors and 79 countries across the spectrum of enterprise revenue size. Experienced IBM financial management practitioners conducted 619 surveys via in-person interviews and 611 were administered by the Economist Intelligence Unit via an online survey tool.

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The IBM Institute for Business Value, part of IBM Global Services, develops fact-based strategic insights for senior business executives around critical industry specific and cross-industry issues.

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