RILA
RETAIL INDUSTRY LEADERS ASSOCIATION
Educate. Collaborate. Advocate.

The Evolving Role of Retail Finance

Senior Finance Executive Interview Findings on Financial Planning and Capital Budgeting

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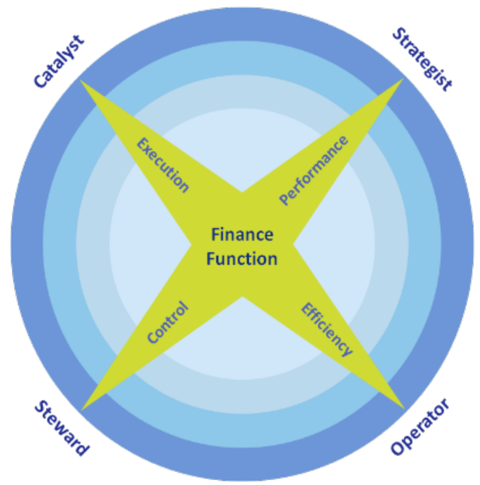
Better Buildings® U.S. DEPARTMENT OF ENERGY

This resource was completed with support from the Department of Energy's Office of Energy Efficiency and Renewable Energy and the Better Buildings Initiative to highlight innovative proven energy solutions from market leaders in the Retail sector. Find more ideas at the Better Buildings Solution Center at betterbuildingssolutioncenter.energy.gov

Background

Traditionally viewed as the financial gatekeeper who reported financial results and managed the efficiency of the finance organization, the role of the CFO has evolved to a strategic business partner and advisor to the CEO. In fact, in Deloitte's 2Q2016 North America CFO Signals survey, approximately 90% of the 19 retail and wholesale industry CFOs surveyed indicated that Financial Planning and Analysis (FP&A) functions report directly to them or via someone who reports to them, and over 50% said the same about strategic planning functions, which was up from the first quarter of 2011 (see Appendix A). As the role of the CFO continues to become more strategic with a focus on increasing value and innovation, planning and executing financial goals, and evaluating and executing on business strategies, it is becoming increasingly important for finance departments to adopt best practices in financial planning and capital budgeting.

Roles of the CFO



Deloitte Finance Framework, available on www.deloitte.com

The Challenge

As the retail industry continues to evolve in the face of ever-changing consumer demands and exponential advances in technology, that are expected to continue to drive changes in the industry[1], the importance of a company's strategic planning and capital allocation practices is growing. A potential barrier to optimizing capital allocation is that partners in the business who are submitting project proposals are not always fully aware of all the complexities of financial planning and capital budgeting. A lack of understanding between managers in the business and their counterparts in finance can lead to sub-optimal capital allocation.

Project Overview and Approach

RILA has teamed with Deloitte Consulting LLP to interview senior finance executives at retail companies to gather insights on financial planning and capital budgeting strategies at retailers with the ultimate goals of:

[1] Deloitte Retail Volatility Index

Sample Questions

Company Background

- ✔ How is financial strategy set?
- ✔ What are the key performance metrics that you use to measure projects and investments?
- ✔ Are these metrics different than what you would use to measure overall company performance?

Finance Timing

- ✔ What is your typical budgeting cycle? Annual, quarterly, rolling?
- ✔ If an initiative misses the planning deadline, are there opportunities to receive funding later in the year?
- ✔ What is one thing you wished people in the business knew about requesting funding?

Project Evaluations

- ✔ What information do you request from different areas of the business to inform your project evaluation processes?
- ✔ How are potential projects prioritized?
- ✔ What metrics are used to track the success of in-flight projects?

1) generating understanding for managers in the business looking to incorporate more investment projects into the financial planning process;
2) sharing knowledge and best practices among industry leaders; and,
3) improving relationship-building between executives in the business and their partners in the finance organization.

To generate a solid understanding of how retailers approach financial planning and capital budgeting, insights were gathered from interviews with a sample size of nine senior professionals, representing four levels of executive leadership across six different retail sub-sectors, within the finance department at retail companies.

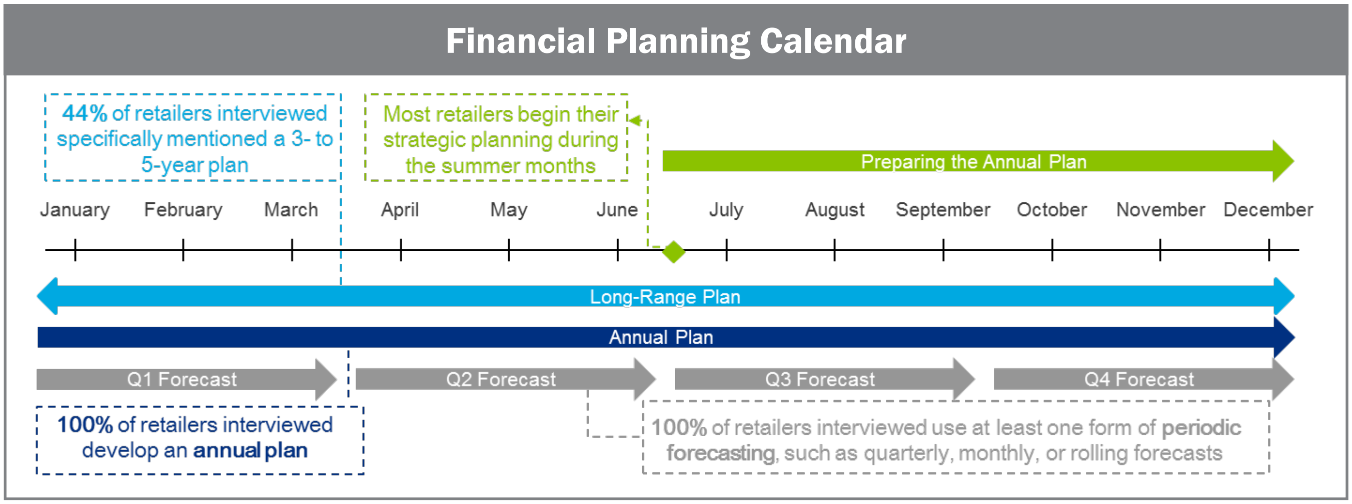
Questions focused on the overall company background, the timing of financial planning cycles, and general project evaluation practices, to get a better understanding of the financial calendar, capital allocation procedures, and key metrics used in decision-making. Further questions addressed intangible considerations.

Interview Content

1. Key Considerations Around the Financial Planning Cycle

Overview

Retailers' finance teams generally engage in a multi-year strategic planning process which becomes the launching pad for developing the annual financial plan and rolling forecasts. The majority of retail finance executives interviewed begin their planning process for the next fiscal year (which often begins on the first of February for retailers) in the summer months. Forty-four percent specifically mentioned that they focus on a 3- to 5-year plan and 100% develop an annual plan and use some type of periodic forecasting, such as quarterly, monthly or rolling forecasts.



Source: The Evolving Role of Retail Finance: Senior Finance Executive Interview Findings on Financial Planning and Capital Budgeting, Deloitte Consulting LLP, 2016

Insights

While the financial planning cycles are well-established and known within the finance department, internal partners in the business **may not always be aware of the planning cycle**. Untimely project submissions could mean that funds have already been allocated elsewhere. Another challenge is that there is not always enough time to fully evaluate a potential project by the time budget inputs are needed.

These challenges can be tackled by implementing best practices, particularly by **building flexibility into**

project planning. Several retail finance executives spoke of the benefits of implementing large-scale projects in waves and establishing periodic check-ins to measure the success of in-flight investments. Additionally, some interviewees mentioned that they don't allocate 100% of their planned capital budget during the planning cycle, in order to maintain the option to fund initiatives throughout the year.

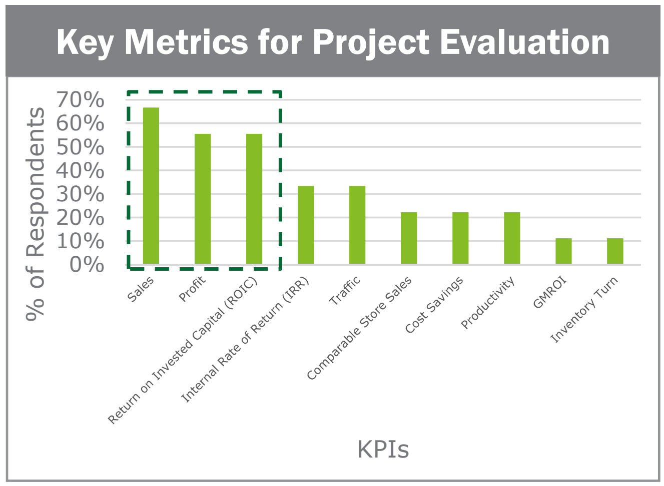
These practices allow retail finance teams to re-evaluate funding decisions throughout the year and make adjustments to the capital portfolio as necessary. Moreover, they provide additional **opportunities for collaboration** between business units and finance departments.

2. Notable Findings on Project Evaluation Processes

Overview

Capital budgeting is a critical process that determines how capital should be allocated to allow a company to meet its strategic objectives and financial performance targets.

During the planning phase, finance teams at retail companies use multiple tools and methods to evaluate potential investment projects. Retailers often define a set of metrics that align with company priorities and then apply various methods to evaluate those investments.



Source: The Evolving Role of Retail Finance: Senior Finance Executive Interview Findings on Financial Planning and Capital Budgeting, Deloitte Consulting LLP, 2016

Each retail finance executive interviewed listed a set of key performance indicators (KPIs) that is used when analyzing both company financial results and business cases for future projects. Factors such as industry sub-sector, company size, and strategic priorities influence that set of KPIs, though the most common KPIs specifically identified during the interviews were sales, profit, and return on invested capital.

Insights

Interviews with retail finance executives revealed that pain points in the project evaluation process can lead to sub-optimal capital allocation. For example, one interviewee cited that business cases can sometimes be "disjointed" from the overall company strategy, which ultimately stems from the fact that the **strategy is not adequately communicated** to all functions and levels of the business.

Another challenge is that some partners in the business may **lack an understanding of project evaluation** criteria that the finance team needs for their analyses, both in terms of content – which KPIs and context should be included – and company-specific tools and templates. One executive noted that the finance team could do a better job educating those who are involved in business case preparation and "provide more training" on the capital request form that is mandatory for submitting project proposals. Even companies that do use a standardized template may run into issues if that template does not require details on calculation assumptions. Sometimes, when the finance team only sees the final numbers without being able to verify the methodology used to produce them, they may question the accuracy of the inputs and become skeptical of submissions from certain departments.

This plays into another pain point: **a lack of strong relationships** and communication can also affect funding for potential investment projects. While the majority of retail finance executives interviewed discussed the strong collaboration that exists between the finance department and other business units in their organizations, a few noted areas for improvement. As one executive put it, the finance team should be able to free up resources to help aid

> **[Finance and Business Unit] Teams should be working collaboratively.**

the data gathering and evaluation of a project in its initial stages and that the "teams should be planning initiatives collaboratively...so that a lot of time is not spent working on evaluating opportunities which may not be feasible." Furthermore, if there is not a strong sense of **collaboration and communication** between finance and the business, there is a chance that people may try to "play the game" and request more funding for a certain project, rather than submitting a reasonable, realistic proposal.

Each of these pain points ultimately lead to challenges in securing funding for what may otherwise be a profitable, company priority-driven project. A proposal that does not tie benefits back to strategic priorities may be less likely to receive funding because the true value has not been fully captured in the business case; misunderstanding evaluation criteria means that time may be wasted preparing business cases for projects that don't meet minimum requirements; and, an absence of strong relationships between business units and finance teams can lead to a lack of trust and make it difficult to gain alignment and, ultimately, leadership buy-in on business cases.

However, pain points also provide an opportunity for companies to implement best practices that can improve mutual understanding and lead to better project proposals, thus improving the likelihood of securing funding for projects that may have been otherwise overlooked.

Interview responses showed that retail finance teams with more developed project evaluation practices go beyond typical return on investment (ROI) and payback period analyses – they perform rigorous scenario analyses, apply consistent frameworks tailored to their priorities, use standard tools and templates, and track progress to incorporate lessons learned on future projects.

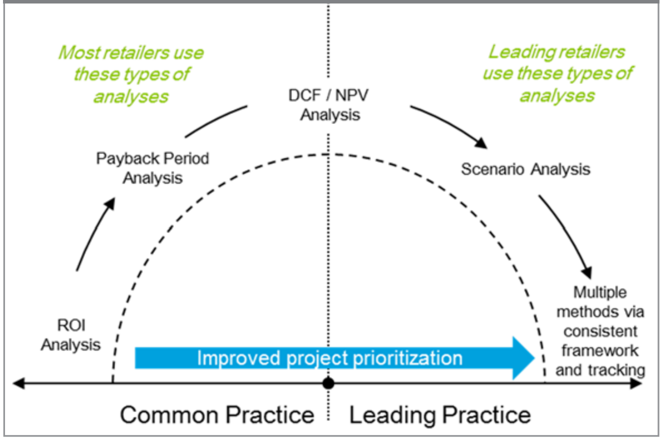
Pain Point	Impact on Projection Evaluation
Timing	Untimely project submissions could mean that funds have been allocated to other projects
Strategic Priorities	A proposal that does not tie potential benefits back to strategic priorities may be less likely to receive funding
Evaluation Criteria & Education	Time may be wasted on preparing business cases for projects that don't meet minimum requirements; mistakes in project proposals could lead to incorrect quantitative benefits, meaning funds get allocated elsewhere
Relationships & Communication	Weak relationships could make it difficult to gain alignment and buy-in on business cases; a lack of communication can lead to a lack of trust

Pain points in the capital budgeting process lead to challenges in securing funding for projects

Employing best practices, such as the examples cited in the table below, in the areas of consistency, flexibility, tracking, and business partnering can lead to improved project planning and prioritization and, ultimately, to an optimal capital portfolio.

These interview responses further support the notion that finance departments are evolving from using basic project evaluation practices toward the leading practices of evaluating projects using sophisticated methods and consistent frameworks (see Appendix B) as they move toward being a strategic partner and advisor the CFO. Moreover, the finance teams who are employing these best practices are better positioned to take advantage of disruptive technologies that are elevating the capabilities of the Finance function. Deloitte has found that advancements in digital finance tools and processes, such as predictive analytics and robotic process automation, allow Finance departments to integrate the budget and forecast with the strategic plan and the capital expenditure plan. Using technology to enhance analytical capabilities, CFOs and their finance teams can provide more insightful analysis to their partners in the business. Having a better understanding of drivers and patterns in financial data can not only lead to more accurate budgets and forecasts, but also to a better understanding of what leads to successful capital investment projects, paving the way for improved investment decisions.

Project Evaluation Methods



Source: Internal Deloitte framework

Project Evaluation Best Practices		
Type	**Examples**	**Benefits**
Consistency	• Employing a consistent evaluation framework to all potential investments • Adhering to stated timelines throughout the planning process	Enables managers outside of finance to better plan their proposals and prepare their business cases for evaluation
Flexibility	• Implementing large-scale projects in waves • Establishing periodic check-ins to measure the success of a project	Provides opportunity for collaboration between business units and finance organizations while also enabling the company to "pivot" and make adjustments to projects as necessary
Tracking	• Evaluating whether the benefits presented in the business case have been achieved • Using a defined and documented process to capture lessons learned	Provides further opportunity for interaction via follow-up sessions while also allowing the finance team to measure the P&L impact and highlight the return to shareholders
Business Partnering	• Collaborating throughout the budgeting process to ensure alignment - never just "Finance's numbers" • Emphasizing that Finance is a partner and there to help support business case development rather than "to police"	Improves communication and fosters trust, leading to smoother collaboration during analysis; ensures the right message and numbers are communicated to leadership

3. Views on Intangible Considerations

Overview

In addition to the quantitative metrics, retail finance teams also evaluate intangible considerations, such as customer satisfaction, brand equity, and corporate values.

Insights

When asked about the types of intangible considerations that are evaluated, fifty-six percent of interviewees specifically listed customer satisfaction and 44% specifically listed brand equity because, as one interviewee put it, “we are always thinking about how the customer perceives the brand.” Another noted that, “if it’s important to the customer, it’s important to us.”

Whether it’s recognizing the positive impact corporate social responsibility initiatives can have on brand loyalty, ensuring that employee wellness initiatives tie to corporate values, or thinking about an exciting customer shopping experience as potential positive publicity on social media, **leading retail finance teams incorporate difficult-to-quantify considerations into their evaluation framework**. Business units might also be able to identify benefits that are hard to quantify but that finance teams do not automatically recognize – such as how a more efficient light bulb in a store not only saves on energy and maintenance costs, but also means that associates can stay focused on sales rather than calling in repairs. Integrating qualitative benefits into the business case for potential investments not only helps to ensure that those projects tie back to the company’s strategic priorities, but also enables the finance team to **link intangible considerations to financial results.**

> **“If it’s important to the customer, it’s important to us.”**

Conclusion

Key Takeaways

- ✔ **Communication** is a central part of building and improving relationships; both retail finance teams and business partners can take steps to initiate or further develop these relationships by establishing regular communication.
- ✔ Retail finance teams should be sure to communicate the **financial calendar** to their partners in the business, who should always aim to plan project proposals according to that calendar.
- ✔ Retail finance teams should work with their business partners to ensure that those business partners who are developing business cases understand the **key metrics**, **tools**, and **templates** that finance uses to evaluate project proposals – and what kinds of intangible considerations are noteworthy.
- ✔ Implementing best practices in the areas of **consistent project evaluations**, **flexibility and tracking**, and **business partnering** can lead to **mutual understanding** between finance managers and business partners, leading to **improved likelihood of funding** for investment projects that may have been previously overlooked.

Applicability for Business Partners

By recognizing which of the issues identified earlier are most common in their organization, managers in the business can apply these strategies to improve communication, learn the financial planning and capital budgeting deadlines and the tools used in project evaluations, and track projects to measure achievements and document challenges faced. Taking advantage of these opportunities can help

Keys to Collaborating with Finance

Initiate communication with Finance
Whether completely introductory or to improve relationships, establishing communication is a critical step in improving planning for energy projects

Plan according to Finance's calendar
This will help to ensure that all project evaluation materials are prepared ahead of the funding decision deadlines

Track progress
Measuring actual outcomes to planned outcomes can lead to improved planning for future projects, as well as provide further opportunities for interactions with Finance

Learn the project evaluation tools and templates
Understanding how to use evaluation templates, what metrics to focus on, and how to tie quantitative and qualitative details to strategic priorities will lead to better project proposals

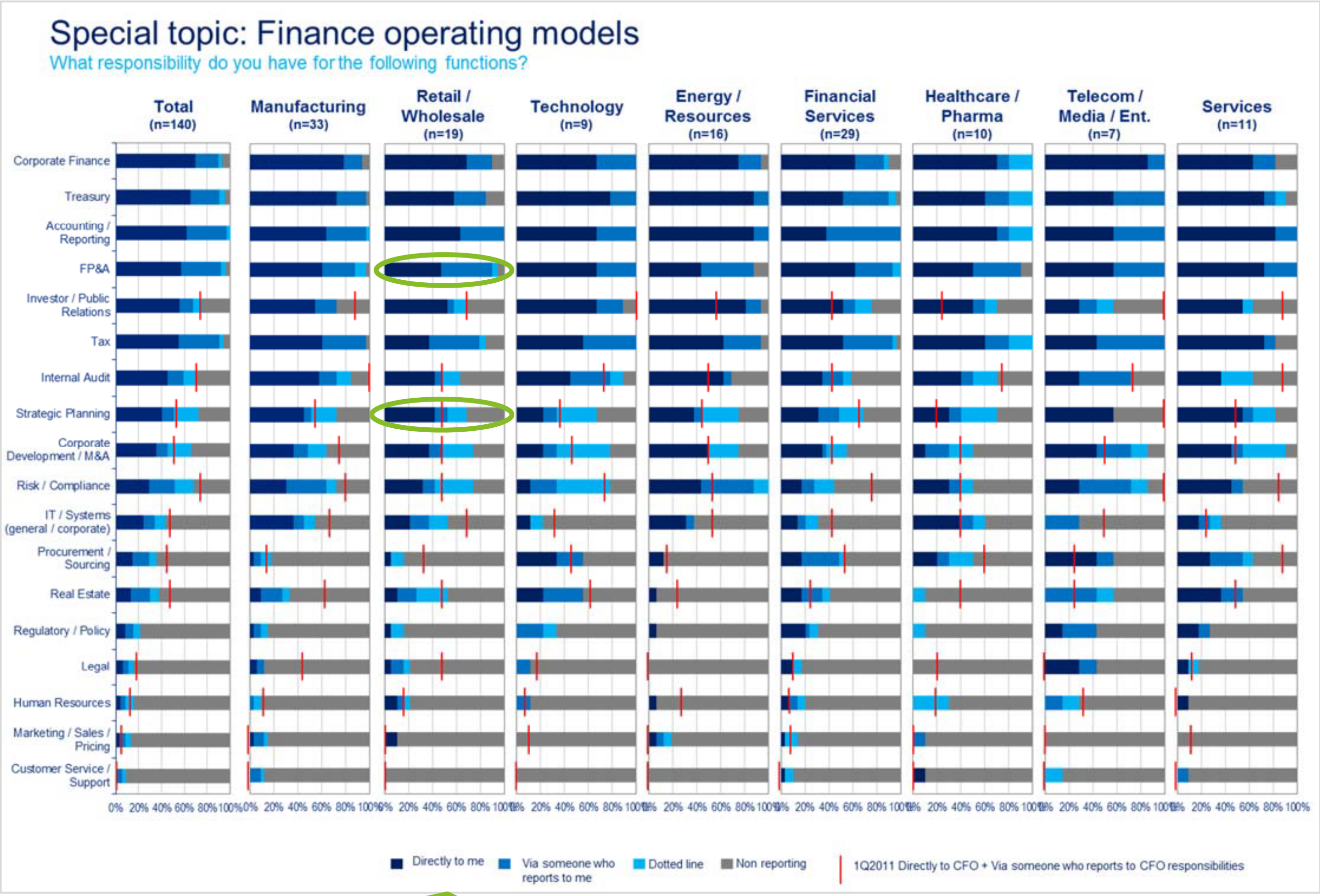
managers to bridge the gap between themselves and their finance counterparts and increase the likelihood of funding for projects that may have otherwise been overlooked, including sustainability and energy efficiency projects.

Closing Thoughts

In summary, interviews with senior finance executives at retail companies revealed common practices and opportunities with regard to financial planning cycles and capital budgeting processes. While pain points do exist, employing best practices can help retailers continue to improve their planning and investment processes while also enabling better business partnering and relationship building. Furthermore, Finance teams already employing leading planning and forecasting and project evaluation practices are well-positioned to implement new, digital finance technologies to continually increase their value as a business partner to the rest of the organization.

Appendix A

Data from the North America CFO Signals Second Quarter 2016 Full Report



Approximately 90% of retail and wholesale industry CFOs interviewed indicated that FP&A functions report directly to them or via someone who reports to them, and over 50% said the same about strategic planning functions, up from the first quarter of 2011.

Source: North America CFO Signals Second Quarter 2016 Full Report, Deloitte Consulting LLP, 2016

Appendix B

Sample developing, defined, advanced, and leading planning and forecasting practices

	Developing	Defined	Advanced	Leading
Planning	• Budgeting occurs with no formal recurrence	• Budgeting occurs annually	• Budgeting occurs on an annual basis with periodic re-forecasts	• An on-going rolling forecast is conducted monthly or quarterly and replaces the annual budgeting process
Planning	• Budgets are presented to executive leadership for approval with little discussion or challenge	• Budgets are discussed and then approved by executive leadership but without much challenge	• Budgets are challenged, revised, and approved by executive leadership without significant business unit engagement	• Budgets are challenged, revised, and approved after joint interaction with executive leadership and business unit leaders
Planning	• Large strategic initiatives are included in the budget but not tracked separately	• Large strategic initiatives are agreed upon and individually incorporated into the budget	• The strategic initiative portfolio is agreed at the business planning stage, incorporated in the budget, allocated to business units as appropriate, and re-optimized based on strategic direction and business performance	• The strategic initiative portfolio is agreed at the business planning stage and budgeted; a structure is in place for on-going approval of new projects and re-prioritization of in-flight projects and initiatives based on agreed performance metrics
Forecasting	• No formal re-forecasting process is in place	• A re-forecast of performance is prepared at least once during the year but without much impact	• A re-forecast of performance is prepared monthly or quarterly in a routine process which addresses performance opportunities & risks	• The budget and forecast processes are merged into an on-going rolling forecast, conducted monthly or quarterly and integrated into business operations
Forecasting	• Business planning is linked only loosely with strategic planning	• There is no structured business planning exercise with the intent of identifying key strategic initiatives	• Some or all business units undertake planning activities to identify potential strategic initiatives via different approaches and outputs	• Structured and consistent planning processes are in place across the business to drive initiatives required to deliver objectives defined in the business strategy

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