



Integrating budgets and entity strategy



ICAZ CFO Forum 14.11.13

How we shall move to the promised land

- ▶ Introduction and Background
- ▶ Challenges faced in practice
 - ▶ Around budgeting
 - ▶ Link with strategy
- ▶ 8 Best Practices in Strategic and Operational Planning
- ▶ The 6 Step Approach - Extensity™
- ▶ Wrap up



INTRODUCTION AND BACKGROUND

Strategy and budgeting

Honestly...

- ▶ Is this another case of perception vs. reality?
- ▶ What challenges are we facing in linking our budgets to our strategy?



Budgeting and strategy?



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Strategy

- ▶ “Stratego” – Greek for general (dual meaning).
 - ▶ Top military leader in war.
 - ▶ All matters in his responsibility you may consider as strategy.
 - ▶ Contrast to detail.



Strategic objectives – not planning

- ▶ The making of
 - ▶ an integrated set of choices
 - ▶ that collectively position the firm in its industry
 - ▶ so as to create sustainable advantage
 - ▶ relative to competition and
 - ▶ deliver superior financial returns.



Strategy

- ▶ Once made clear to line managers,
 - ▶ they recognise that strategy is not just fancily-worded **budgeting** and
 - ▶ they get much more interested in it.
- ▶ Obviously, you can't execute a strategy without initiatives, investments, and budgeting.
- ▶ 1st get your managers focused on strategy to ensure coherence with their initiatives.



The 5 questions for strategy objectives

- ▶ **It is one integrated set of choices:**
 - ▶ what is our winning aspiration?
 - ▶ where will we play?
 - ▶ how will we win?
 - ▶ what capabilities need to be in place?
 - ▶ and what management systems must be instituted?

- ▶ The five questions can easily be answered on one page and if they take more than five pages then your strategy is probably morphing unhelpfully into a more classical strategic plan.



Some of the challenges faced in practice

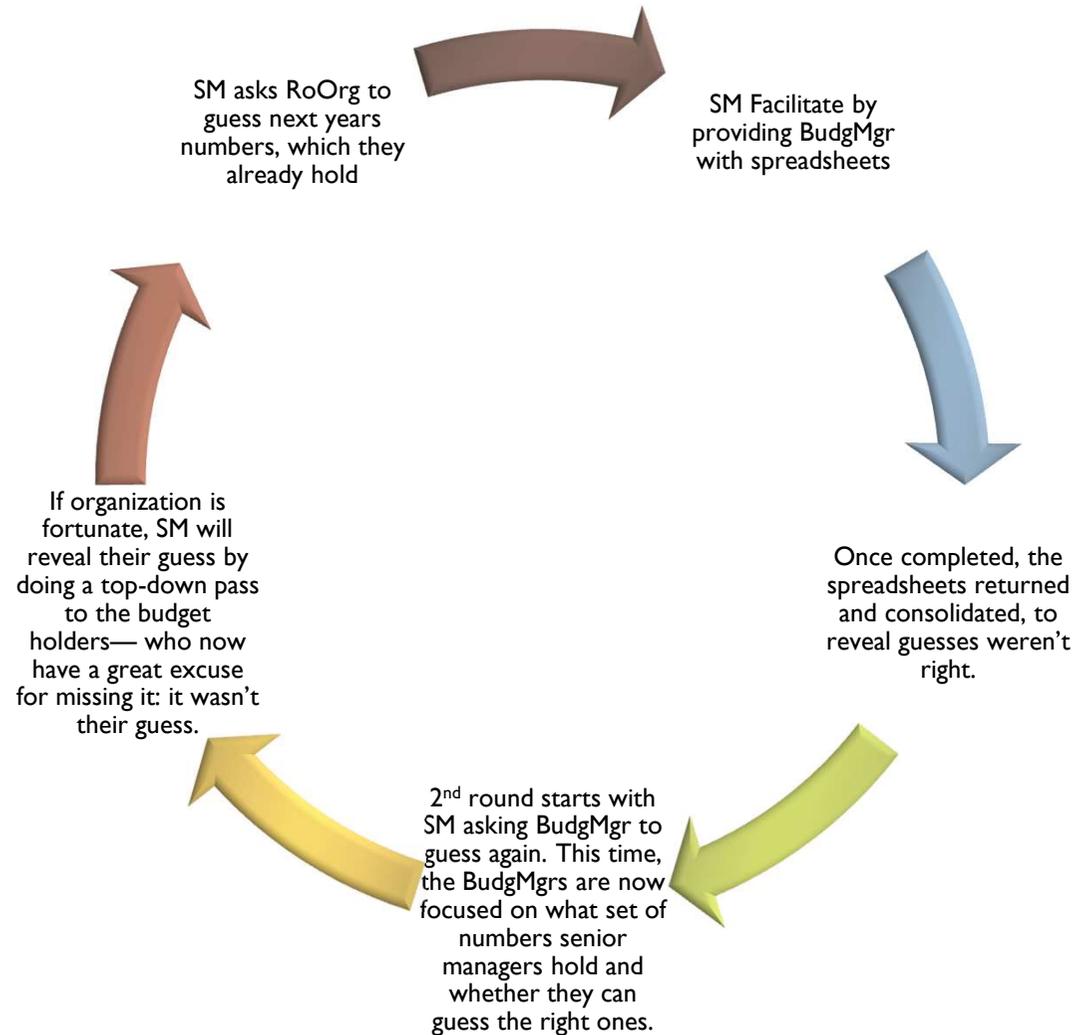
Budgeting and the link to strategy

Why do you budget?

- ▶ Simple exercise, ask the person next to you?
- ▶ Assignment: When you get back to your organisation, kindly ask any three of your departmental managers why they participate in your organisation's budgeting process?
 - ▶ Annual event?
 - ▶ Rod?
 - ▶ Bonus setting?



Budgeting Process: Classical



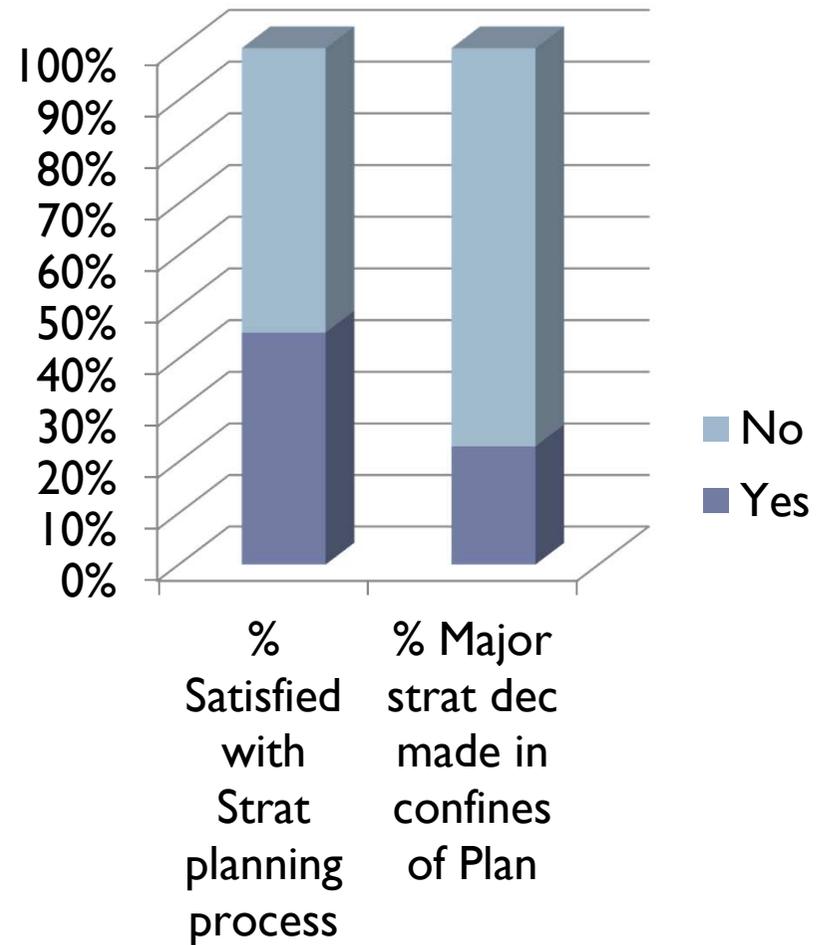
Budgeting Process: Classical

- ▶ With this type of process in place, can you really say you budget in order to direct the way in which your organization will achieve its strategic goals
- ▶ For budgeting to become the relevant process it was meant to be and can be, this gap must be fixed.



McKinsey says...

- ▶ A recent *McKinsey Quarterly* survey of nearly 800 executives revealed:



Honestly...

- ▶ Let's face it — budgeting isn't going to make the top of any manager's “Favourite Things to Do” list.
- ▶ Yet each year, companies make substantial investments in
 - ▶ developing a comprehensive annual budget,
 - ▶ staff overtime and temporary help for data entry.

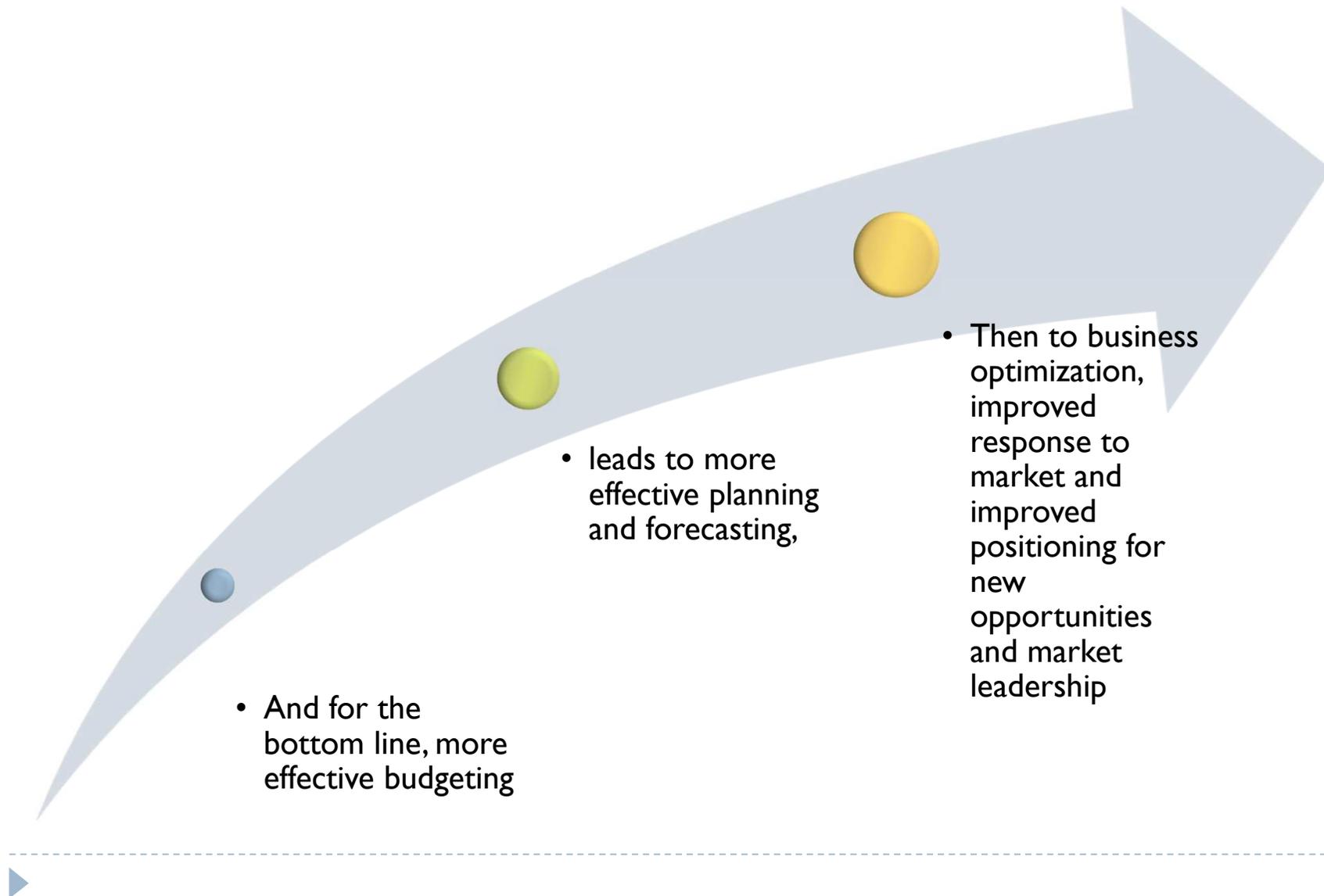


Budgeting takes FOREVER

- ▶ According to CFO Research, 60% of companies say the budgeting and planning process takes too long.
- ▶ Unfortunately, companies often lack the systems necessary to accelerate the process and ensure it is consistent with company strategies.



Call for effective budgeting

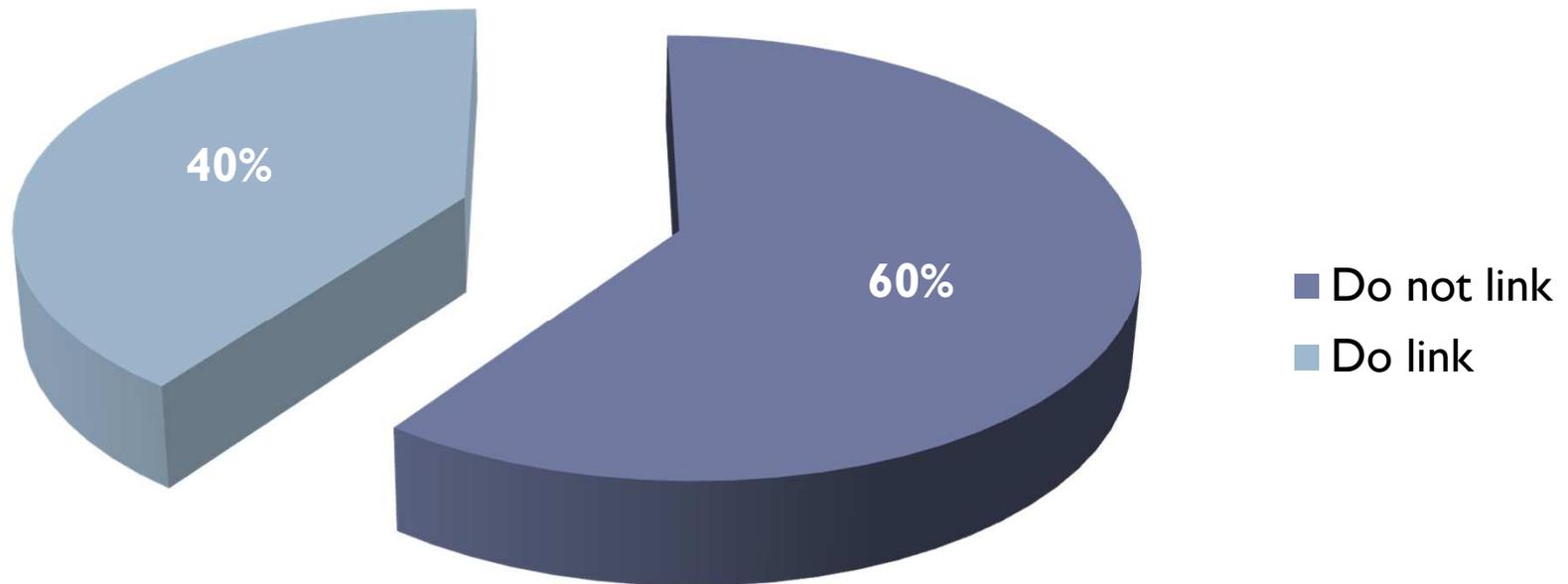


Weakest link

- ▶ “the alignment of business strategy and financial budgets – widely recognised as being a notorious weak link in the wider ambition of successful strategy execution.”



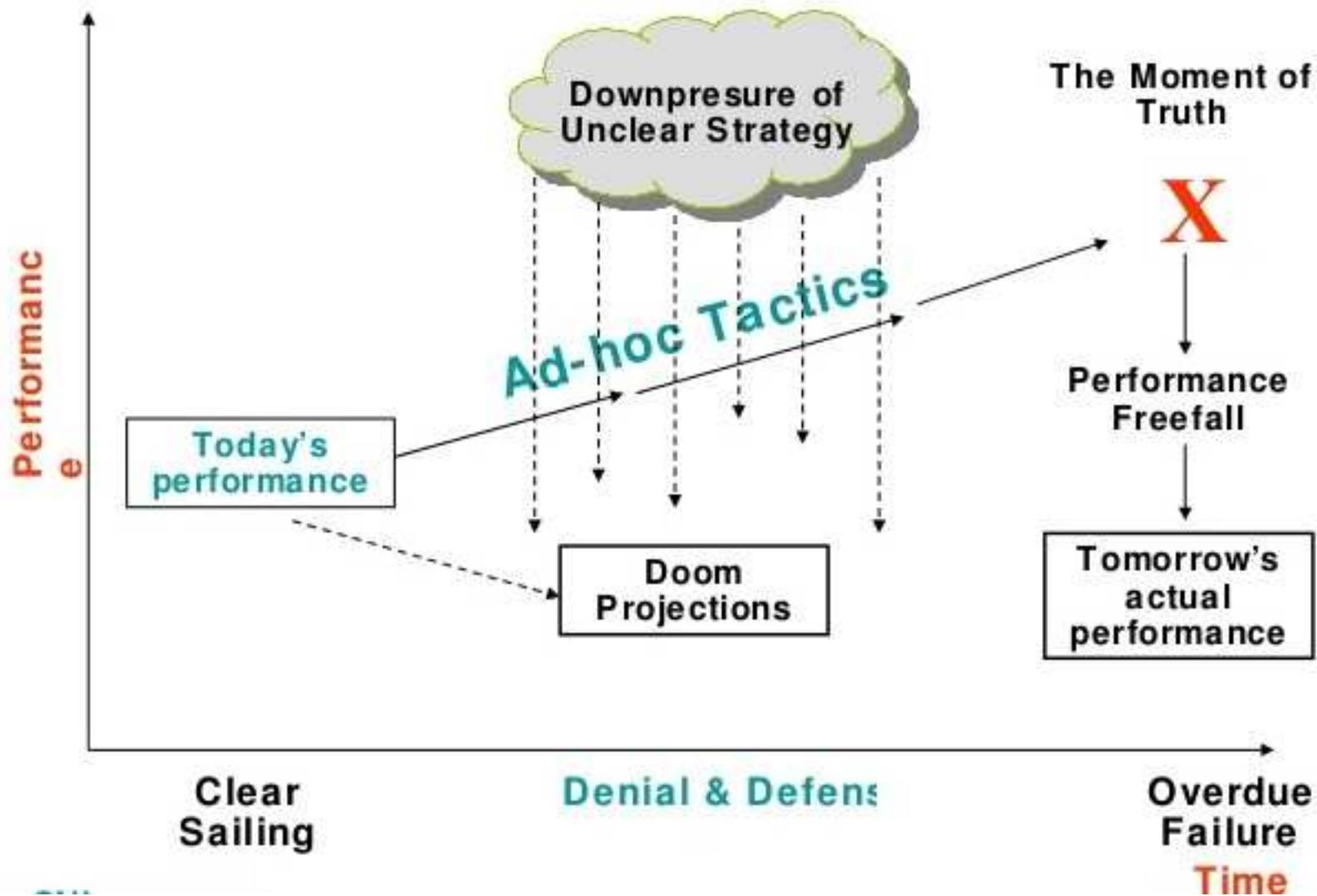
% Organisations who link their strategy to their budgets – Kaplan and Norton



The need to link budgets and strategy

- ▶ Linking strategy to budgets is one of the most challenging of all management activities.
- ▶ In the absence of this link, budgets become an exercise in generating variances that have no **FOCUS**.
- ▶ If a budget is designed without reference to the strategies it is supposed to support and the resources available, the corporation will not move towards its desired goals.
- ▶ Gearbox





Budgeting and performance management

- ▶ Budgeting is part of a larger, closed-loop process called “performance management.”
- ▶ Performance management is a holistic approach to the way organizations direct and manage resources to achieve strategic objectives.



Performance management

- ▶ In the context of performance management, budgeting's central role is to support execution through the allocation of resources to the activities that drive value.
- ▶ Jack Welch suggests that budgeting
 - ▶ can be a *productive* and “*wide ranging, anything-goes dialogue between the field and headquarters about opportunities and obstacles in the real world*”
 - ▶ if organizations concentrate on two questions:
 - ▶ “How can we beat last year's performance?” and
 - ▶ “What is our competition doing, and how can we beat them?”



Performance management

- ▶ The answers to these key questions typically appear in a strategic or operational plan, against which budgets can be set and monitored for effectiveness. But if that plan is vague or incomplete, the resulting budget will not help the organization implement its strategy.



Island (vacuum) mentality

- “It’s not really good value our competitor is offering, because it doesn’t include a lot of our features.” - ABC vs Air Asia
- “It’s good value but not in our preferred customer market.” - ABC vs Toyota
- “Sure they’re hurting us, but with their unfair advantage, what can we do?” – ABC vs MILO
- “The rules we are playing by have always worked before” – AMEX vs VISA



8 Best Practices in Strategic and Operational Planning

Best Practices in Strategic and Operational Planning

- ▶ Most organizations have plans.
- ▶ There is, however, a huge difference between a good plan and a bad plan.
- ▶ A bad plan - consists only of costs and revenues.
 - ▶ provides no guidance for the organization regarding how it is to achieve the revenue targets.
 - ▶ No linkage between high-level goals and day-to-day activities necessary to achieve them.



Best Practices in Strategic and Operational Planning (cont.)

- ▶ A good plan (performance management)
 - ▶ all about managing the activities that generate results.
 - ▶ activities should directly support the strategic objectives.
- ▶ Therefore, a good plan acts as a road map,
 - ▶ showing the organization how it should move from its current level of performance to the desired level of performance,
 - ▶ based on the perceived economic environment.
 - ▶ The plan accounts for the activities, dependencies, assumptions, time scales, and resources necessary to support an overall strategic objective.



1. Good plans answer key directional questions.

- ▶ “Where are we going?”
- ▶ “How are we going to get there?”
- ▶ “What happens if things do not turn out as planned?”

- ▶ High-performing organizations do not assume that Plan A will always work.
- ▶ Instead, they prepare alternatives in case they are needed.



2. Good plans typically address three activities.

- ▶ (1) how the organization will maintain current operations,
 - ▶ (2) how it will improve the efficiency of current operations, and
 - ▶ (3) which new ventures or initiatives the organization will implement.
-
- ▶ In this way, any change in performance can be assessed in terms of the type of activity.



3. Good plans—and organizations—are focused.

- ▶ High-performing organizations do not plan in detail.
 - ▶ For example, they may plan around 40 accounts compared with 220 accounts for the average organization.
- ▶ More detail does not equal more accuracy.
- ▶ More detail does, however, negatively affect the time available for analysis.



4. Good plans include all aspects of the business.

- ▶ **In addition** to detailing how goals will be achieved, good plans also describe how the organization
 - ▶ can continue to be effective and
 - ▶ generate programs into the future.
- ▶ In Balanced Scorecard methodology, these areas form part of the
 - ▶ “internal business process” and
 - ▶ “learning and growth” perspectives.



4. Good plans include all aspects of the business. (cont.)

- ▶ Interestingly, this means that many of the measures within a plan will not be financial.
 - ▶ Employee knowledge,
 - ▶ customer relationships, and
 - ▶ the culture of innovation
 - ▶ may create the bulk of value (as much as 75%) for any organization.
- ▶ Perhaps greatest reason why organizations cant use their general ledger to collect and hold a performance management budget



5. Good plans link strategies to activities

- ▶ Activities (which can be budgeted) are
 - ▶ linked into a cause and-effect hierarchy
 - ▶ because the achievement of a strategic objective is the result of doing the right things well.
 - ▶ monitored as well as their impact on achieving strategic goals.
- ▶ By understanding these relationships, organizations begin to understand—and can build on—the true drivers of success.



Link between strategy and activity budgets



Figure 1: Good plans establish cause-and-effect linkages.



6. Good plans are measurable.

- ▶ Objectives and strategies
 - ▶ have measures of success.
- ▶ Activities
 - ▶ have measures of implementation.
- ▶ In this way, the completeness of an activity can be correlated with the success of an objective.



7. Good plans include assignments for accountability.

- ▶ In high-performing organizations,
 - ▶ specific people are made responsible for individual activities.
- ▶ They are
 - ▶ empowered,
 - ▶ rewarded, and
 - ▶ have control of the resources
- ▶ to ensure the delivery of the activity.



8. Good plans include the recording and monitoring of assumptions.

- ▶ **High-performing organizations**
 - ▶ monitor a range of business assumptions
 - ▶ that are tied to the targets set for corporate objectives.

- ▶ If the organization discovers that their business assumptions are incorrect,
 - ▶ they reconsider the associated plan targets and
 - ▶ adapt accordingly.





6 Step Approach

Linking strategy to budgets

Link effectively of strategy to budget

The creation of a good strategy and implementation plan requires far more than just collecting a set of financial estimates.

To achieve a best practices plan that is linked to a budget, use the following six steps:



The Process for Linking Strategy to the Budget

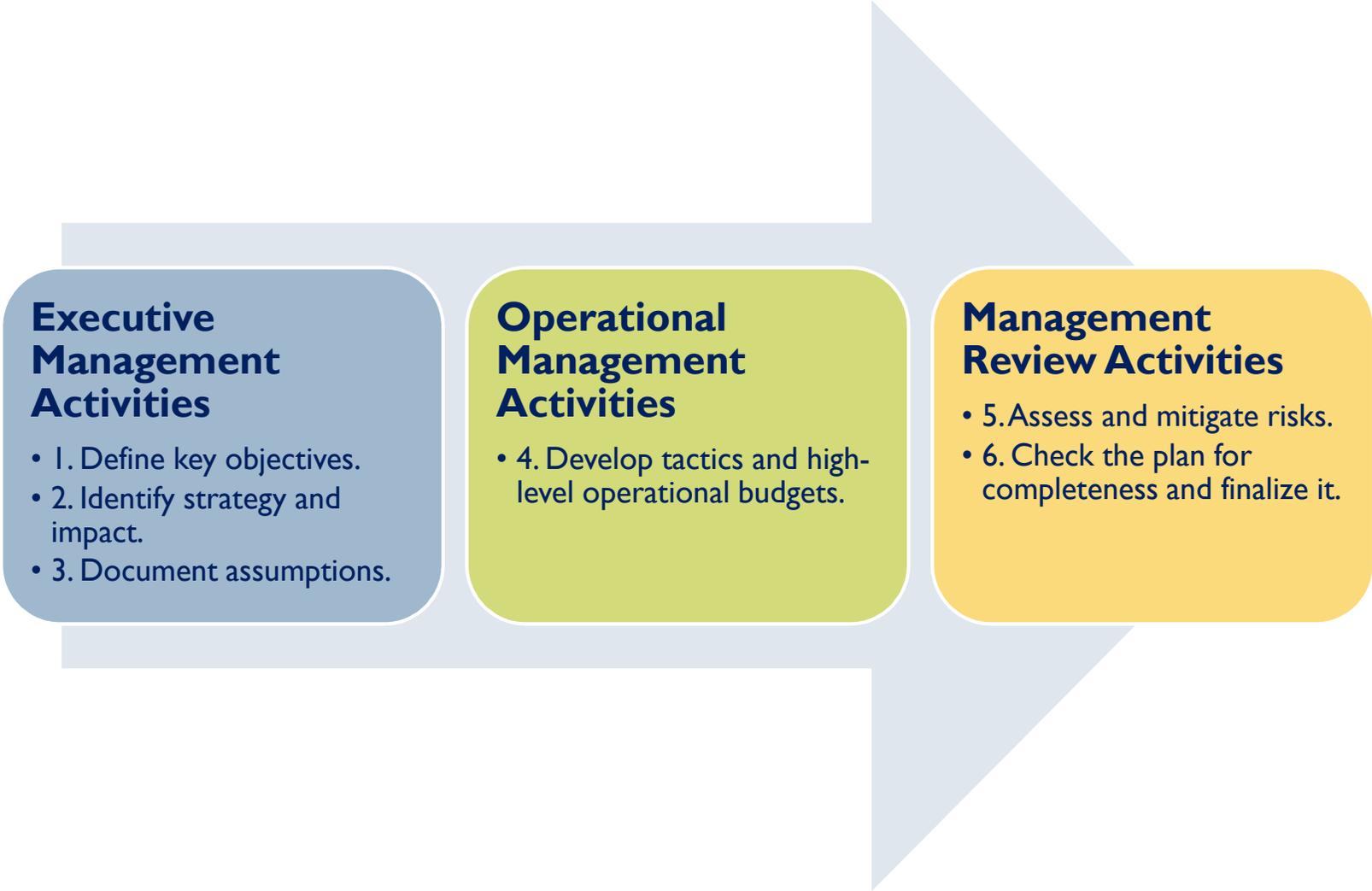
Executive Management Activities

- 1. Define key objectives.
- 2. Identify strategy and impact.
- 3. Document assumptions.

Operational Management Activities

- 4. Develop tactics and high-level operational budgets.

Management Review Activities

- 5. Assess and mitigate risks.
 - 6. Check the plan for completeness and finalize it.
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Step 1: Define Key Strategic Objectives

- ▶ Setting of short- and long-term objectives for each portion of the strategic plan.
- ▶ Also assign a value/measure that denotes the success of each objective.
- ▶ Most organizations establish less than seven of objectives.
- ▶ Strategic objectives can be for example
 - ▶ revenue growth and
 - ▶ operating efficiency



Step 2: Identify Strategies and Impact

- ▶ Describe the strategies that, when executed properly, will enable the organization to achieve its objectives.
- ▶ Executives should assign and record the percentage weight/influence each strategy has on achieving an objective.
- ▶ Sum of all strategies for a given objective must equal 100 percent.
- ▶ Team members use their experience and business understanding to assign the relative importance of each strategy.



Step 2: Identify Strategies and Impact

► Practical example

Name	Object	Measure	Wgt.	Unit(s) Assigned	Responsibility
Strategic Plan		R.O.C.E.			
Revenue Growth	Objective	Revenue targets	40		
Maintain Base	Strategy	No. of distributors retained	60	Marketing	
New Sales	Strategy	Revenue from new contracts	40	Sales units	
Operating Efficiency	Objective	Costs as % of turnover	40		
Control Costs	Strategy	Costs at same level as last year	35	All	
Retailer Mindshare	Strategy	Avg. shelf space per retailer	35	Sales units	
Internet Sales	Strategy	% goods sold via website	30	Marketing	



Step 3: Document Assumptions

- ▶ Document

- ▶ key assumptions and
- ▶ measures

about business environment factors that could affect the organization's ability to successfully achieve its strategic objectives.

- ▶ **Practical application**

- ▶ If the strategy is to control costs, for example,
 - ▶ Steady inflation at two percent
- ▶ If the objective is revenue growth,
 - ▶ number of distributors remains the same in the coming year



Step 3: Document Assumptions

Name	Object	Measure	Wgt	Unit(s) Assigned	Responsibility
Strategic Plan		R.O.C.E.			
Revenue Growth	Objective	Revenue targets	40	Marketing	
Maintain Base	Strategy	No. of distributors retained	60		
Satisfied Customers	Assumption	Customer satisfaction rating			
New Sales	Strategy	Revenue from new contracts	40	Sales units	
Market Growth	Assumption	Market size			



Step 4: Develop Tactics and High-Level Operational Budgets

- ▶ At this point, senior executives give the plan to the operational managers, who are responsible for implementing the documented strategies.
- ▶ For each strategy, operational managers must develop tactics to implement their part of the strategic plan.



Step 4: Develop Tactics and High-Level Operational Budgets

- ▶ For each tactic, record the following:
 - ▶ A measure to be used to monitor the implementation of the action.
 - ▶ Weight of each tactic on achieving the success of the strategy.
 - ▶ Person responsible for carrying out the action.
 - ▶ Time scale being set
 - ▶ The frequency of measurement
 - ▶ The type of activity to identify activities with most impact
 - ▶ for sustaining the business,
 - ▶ for improving the efficiency of an existing activity, or
 - ▶ something completely new
 - ▶ The estimated cost and revenue impact of executing each tactic.



Step 4: Develop Tactics and High-Level Operational Budgets

Name	Object	Measure	Wgt	Unit(s) Assigned	Responsibility	Freq.	Start Date and Duration
Strategic Plan		R.O.C.E.				Annual	From 2006
Revenue Growth	Objective	Revenue targets	40			Qtr	From Qtr 1
Maintain Base	Strategy	No. of distributors retained	60	Marketing		Qtr	From Qtr 1
Satisfied Customers	Assumption	Customer satisfaction rating				Qtr	
Communication Program	Tactic	Response rate per issue	40	Marketing	Geoff Warren	Month	Jan 2006 4
Conference	Tactic	No. of attendees signed up	20	Marketing	Jenny Chaucer	Month	Apr 2006 3
Loyalty Program	Tactic	No. of distributors signed up	40	Marketing	Jenny Chaucer	Month	Apr 2006 9



Step 5: Assess and Mitigate Risks

- ▶ Once operational managers have developed their tactics, the completed plan can be assessed.
- ▶ Ask the following questions:
 - ▶ Is it realistic?
 - ▶ Make sure that the planned tactics will really help to make the strategy successful.
 - ▶ Is it affordable?
 - ▶ Make certain that the financial benefits will outweigh the costs.
 - ▶ What risks do you run in implementing the plan and
 - ▶ how can you negate those risks?



Step 5: Assess and Mitigate Risks (cont.)

- ▶ How far will you let variances go before taking action?
 - ▶ Setting up “best case,” “expected,” and “worst case” scenarios for each measure can help support those decisions.
- ▶ What alternative plans are there for overcoming the biggest risks?
 - ▶ The organization may need to create an alternate version of the complete tactical plan.



Step 6: Check the Plan for Completeness and Finalise It

- ▶ The last step is to come to agreement on the
 - ▶ amended tactics and
 - ▶ costs/revenues assigned to each activity.
- ▶ Once completed, the plan can now serve as the starting point for a more detailed budget breakdown, *if required*.
- ▶ The high-level costs and revenues from the plan become **budget targets**.



Effective linking is beneficial

Three-Year Growth Rates	Firms with Performance Management	Firms without Performance Management
Total shareholder return	7.9%	0.0%
Return on equity	10.2%	4.4%
Return on assets	8.0%	4.5%
Cash flow ROI	6.6%	4.7%
Real growth in sales	2.1%	1.1%
Real growth in employees	0.0%	1.1%
Sales per employee	\$169,900	\$126,100
Income per employee	\$5,700	\$1,900

Quest for Balance, André A. de Waal; Copyright © 2003 by John Wiley & Sons, Inc.

Figure 20. Financial performance of firms with and without performance management systems.



In conclusion...

- ▶ **Six steps**
 - ▶ Define key objectives
 - ▶ Identify strategies and impact
 - ▶ Document assumptions
 - ▶ Develop tactics and high level operational budgets
 - ▶ Assess and mitigate risks
 - ▶ Check the plan for completeness and finalise it
- ▶ **Eight lessons from high performing businesses**



Key resources

- ▶ [Harvard Business Review: Roger Martin Blog](http://blogs.hbr.org/2013/02/dont-let-strategy-become-plann/)
<http://blogs.hbr.org/2013/02/dont-let-strategy-become-plann/>
 - ▶ <http://www.iirme.com/alignbudget#sthash.DXhazDbq.dpuf>
 - ▶ Financial Performance Management – 6 Steps for Linking Corporate Strategy to the Budget – *Extensity Inc. US*
 - ▶ Driving Value Through Strategic Planning and Budgeting – *Accenture in Association with Cranfield University School of Management*
 - ▶ Best Practices for Planning and Budgeting – *Prophix Canada*
 - ▶ Rethinking Planning, Budgeting and Forecasting – *A Deloitte Perspective*
 - ▶ Corporate Budgeting: supporting strategy and financial management - *PricewaterhouseCoopers*
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