6 steps for linking corporate strategy to the budget

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The budget is supposed to be the tool by which an organisation transforms its strategy into action. Unfortunately, up to 60 percent of organisations do not link their corporate strategy to their budget. This paper will show you how to link these related management processes and strengthen your business performance management capabilities.

Why budget?

Ask any three people in an organisation why they budget and you are bound to get three different answers. They usually include such statements as, "It is something we do every year," "It is a big stick we use to cane those who don't perform," and "It is the mechanism for setting the managers' bonuses." Is this really the intended purpose of budgeting? Consider the typical budgeting cycle. It lasts four months—up to 25,000 person-days per year for the average billion-dollar company—and starts with senior managers asking the rest of the organisation to "guess" the financial numbers that they already hold for next year. That guessing is facilitated by a set of spreadsheets that are handed out to budget managers for completion. Once completed, the spreadsheets are returned and numbers are consolidated, only to reveal that the budget managers' guesses weren't right.

So the second round starts with senior managers asking budget managers to guess again. This time, the budget managers are now focused on what set of numbers senior managers hold and whether they can guess the right ones. Strategy-the "how" of achieving the numbers-has been replaced by a numbers guessing game. If the organisation is fortunate, then senior managers will reveal their guess by doing a top-down pass to the budget holders-who now have a great excuse for missing the budget: it wasn't their guess.

With this type of process in place, it is no wonder, then, that no one says they budget in order to direct the way in which their organisation will achieve its strategic goals-the intended purpose of the budget. According to data cited by Kaplan and Norton, creators of the Balanced Scorecard, 60 percent of organisations do not link strategy to their budgets. For budgeting to become the relevant process it was meant to be and can be, this gap must be fixed.

Sixty percent of organisations do not link strategy to their budgets and this gap should be fixed.

The role of budgeting in performance management

TThe budget is similar to a car's gearbox: it doesn't work in isolation. A gearbox's function is to transfer the power of an engine to a chassis so that the driver can move towards a predetermined destination. If the gearbox is designed without reference to the engine that will power it, the car won't work and the driver won't go anywhere. Similarly, 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.

Budgeting is part of a larger, closed-loop process called "performance management" Performance management is a holistic approach to the way organisations direct and manage resources to achieve objectives. 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 Weich (New York: Harper Business, 2005) 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 organisations concentrate on two questions: "How can we beat last year's performance?" and "What is our competition doing, and how can we beat them?"

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 organisation implement its strategy.

Best practices in strategic and operational planning

Most organisations have plans. There is, however, a huge difference between a good plan and a bad plan. A bad plan, for example, is one that consists only of costs and revenues. This plan provides no guidance for the organisation regarding how it is to achieve the revenue targets. There is no linkage between the highlevel goals and the day-to-day activities necessary to achieve them.

Performance management is all about managing the activities that generate results. Those activities should directly support the organisation's strategic objectives. Therefore, a good plan acts as a road map, showing the organisation 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.

When one looks at best practices studies such as those conducted by The Hackett Group, an Answerthink company, and research reported in the book The Strategy Gap, eight planning best practices of high-performance organisations present themselves:

• **Good plans answer key directional questions.** Some are, "Where are we going?," "How are we going to get there?," and "What happens if things do not turn out as planned?" High-performing organisations do not assume that Plan A will always work. Instead, they prepare alternatives in case they are needed.

• **Good plans typically address three activities.** They are how the organisation will maintain current operations, how it will improve the effictency of current operations, and which new ventures or initiatives the organisation will implement. In this way, any change in performance can be assessed in terms of the type of activity.

• **Good plans-and organisations-are focused.** High-performing organisations do not plan in detail. For example, they may plan around 40 accounts compared with 220 accounts for the average organisation. More detail does not equal more accuracy. More detail does, however, negatively affect the time available for analysis.

• **Good plans include all aspects of the business.** In addition to detailing how goals will be achieved, good plans also describe how the organisation can continue to be effective and generate programs into the future. In Norton and Kaplan's Balanced Scorecard methodology, these areas form part of the "internal business process" and "learning and growth" perspectives. 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 for any organisation. In fact, this value can be as much as 75 percent of the total value of the organisation. This is perhaps the greatest reason why organisations cannot use their general ledger to collect and hold a performance management budget..

• **Good plans link strategies to activities.** Activities in a high-performing organisation are linked into a causeand-effect hierarchy (Figure 1) because the achievement of an objective is the result of doing the right things well. Activities as well as their impact on achieving strategic goals are monitored. By understanding these relationships, organisations begin to understand-and can build on-the true drivers of success.

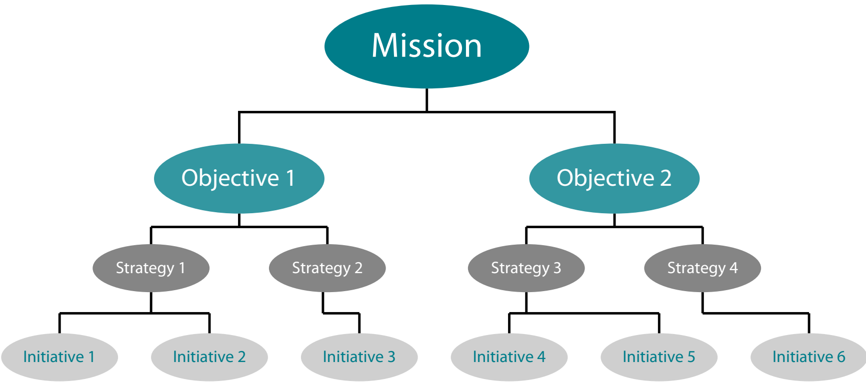


Figure 1. Good plans establish cause-and-effect linkages

• **Good plans are measurable.** Objectives and strategies have measures of success, while activities have measures of implementation. In this way, the completeness of an activity can be correlated with the success of an objective.

• **Good plans include assignments for accountability.** In high-performing organisations, specific people are made responsible for individual activities. They are empowered, rewarded, and have control of the resources to ensure the deliver of the activity.

• **Good plans include the recording and monitoring of assumptions.** High-performing organisations monitor a range of business assumptions that are tied to the targets set for corporate objectives. If the organisation discovers that their business assumptions are incorrect, they reconsider the associated plan targets and adapt accordingy.

The process for linking strategy to the budget

Given the preceding best practices, it is obvious that the creation of a good 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:

Senior Management (Corporate) Activities

1. Define key objectives.
2. Identify strategies 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 finalise it

Let's look more closely at each one.

Step 1: Define key objectives

The first step, a senior-executive activity, is the setting of short-and long-term objectives for each portion of the strategic plan. In Figure 2,the objectives are revenue growth and operating efficiency. Executives also assign a value (i.e., a measure) that denotes the success of each objective. Most organisations establish between five and seven of objectives.

Step 2: Identify strategies and impact

The second step, also for senior executives, is to describe the strategies that, when executed properly, will enable the organisation to achieve its objectives. For example, in Figure 2, the strategies for obtaining the revenue growth objective include maintaining the base (measured by number of distributors maintained) and achieving new sales (measured by revenue from new contracts).

Executives should assign and record the percentage weight (i.e., the influence) each strategy has on achieving an objective. The total 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.

Next, the executive team should note which department(s) is responsible for implementing each strategy. The team also should determine how they will measure the success of each strategy.

Name	Object	Measure	Wgt	Unit(s) Assigned	Responsibility
Strategic Plan		R.O.C.E			
Revenue Growth	Objective	Revenue targets	40		
Maintain Sales	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	
Retails Mindshare	Strategy	Avg.shelf space per retailer	35	Sales units	
Internet Sales	Strategy	% good sold via website	30	Marketing	

Figure 2. Defining objectives and strategies.

Further reading:

Step 3: Document assumptions

Next, senior executives document the key assumptions and measures about business environment factors that could affect the organisation's ability to successfully achieve its strategic objectives (Figure 3). If the strategy is to control costs, for example, one assumption might be that inflation remains steady (the assumption) at two percent (the measure). If the objective is revenue growth, an assumption could be that the number of distributors remains the same in the coming year, whatever that number may be.

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	
Satisfied Customers	Assumption	Customer satisfaction rating			
New Sales	Strategy	Revenue from new contracts	40	Sales unites	
Market Growth	Tactic	response rate per issue			

Figure 3. Documenting assumptions.

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. For each tactic they should record the following:

- A measure that will be used to monitor the implementation of the action.
- The weight (i.e., impact) of each tactic on achieving the success of the strategy.
- The person responsible for carrying out the action.
- The time scale being set (i.e., the start date and the duration, because not all tactics are of the same duration).
- The frequency of measurement (e.g., calls per hour, revenue per month).
- The type of activity (i.e., whether it is an activity for sustaining the business, improving the efficiency of an existing activity, or something completely new). This delineation will help to identify what kinds of activities are having the most impact.
- The estimated cost and revenue impact of executing each tactic. Look at these groupings (we'll call these "variables" later on) such as salaries, material costs, equipment, etc.

In Figure 4, the objective is revenue growth and the strategy is to maintain the base. Marketing is responsible for executing this strategy. The operational manager from marketing has recorded three supporting tactics: a communication program, a conference, and a loyalty program.

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 distribution signed up	40	Marketing	Jenny Chaucer	Month	Apr 2006 9

Figure 4. Developing tactics.

Step 5: Assess and mitigate Risks

Once operational managers have developed their tactics, the completed plan can be assessed. Ask the following questions:

- Is the plan realistic? Make sure that the planned tactics will really help to make the strategy successful.
- Is the plan affordable? Make ertain that the financial benefits will oweigh the costs.
- What risks do you run in implementing the plan and how can you negate those risks?
- 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 organisation may need to create an alternate version of the complete tactical plan.

Step 6: Check the plan for completeness and fialise it

The last step is to come to agreement on the amended tactics and the 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.

Cause-and-effect visibility and role of technology

You have a plan. You have a budget that supports it. Only one thing is missing: a way to easily view and analyse the cause-and-effect relationships beween all the plan elements and the resources that support them. This is a common complaint among senior executives who are responsible for managing and reporting on the execution of corporate strategy.

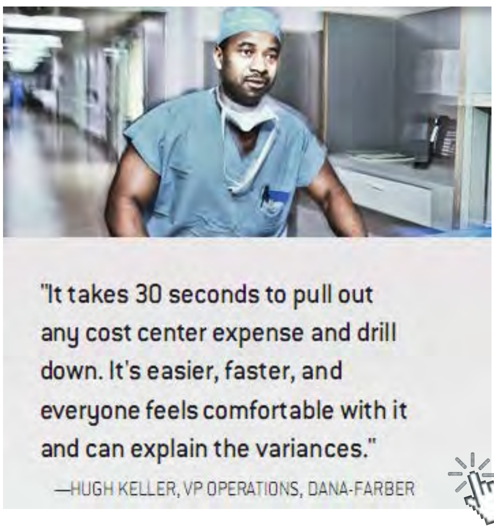
Technology often complicates the situation. For example, organisations typically create their strategic and operational plans using a word-processing application. The documents are owned and stored by a single user, cannot be easily updated to support the monitoring process, and have no analytical or version control facilities. Similarly, organisations may use spreadsheets—still the most popular tool for collecting financial data—to create and maintain their budgets. Although spreadsheets are much easier to update than text documents and they may provide analytical capabilities, they typically cannot handle the "soft" side of the plan such as descriptions, comments, nonfinancial measures, and the impact of cause-and-effect relationships. As a result, these documents do not provide a clear and visible way of showing how user activity is impacting both financial results and strategy.

On the other hand, planning and budgeting software, usually part of a whole Performance Management suite, addresses all the shortcomings of the other planning and budgeting solutions.

Planning and budgeting applications help enterprises:

- Enhance collaboration through web-based access and central data reponsitory.
- Test "what-if" scenarios.
- Achieve financial goals by calculating impact of key performance drivers.
- Streamline tasks associated with budgeting, using automation and guided workflows.
- Maintain visibility with exception alerts and status monitor.
- Improve date integrity.
- Implement different types of budgets and plans, such as zero-based, historical-based and roling.

Case Study:



Why linking strategy to the budget makes sense

There is evidence to support the contention that organisations that focus on performance management outperform those who don't. In a survey of 437 publicly traded organisations, those that had structured performance management systems (205) produced better results than those who didn't (Figure 5). Industry analyst group Gartner predicts that enterprises that effectively deploy corporate performance management (CPM) solutions to support a performance-driven culture will outperform their industry peers by 30% through 2015. Moreover, despite constrained budgetary environments, the CPM software market still recorded a 16.4% growth increase in 2011.

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 groth in emplyees	0.0%	1.1%
Sales per emplyee	$169,900	$126,100
Income per employee	$5,700	$1,900

Figure 5. Financial performance of firms with and without performance management systems.

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Infor d/EPM - Planning and Budgeting also enables organisations to transform budgeting into a collaborative and meaningful process that reflects their real-world needs. With this software, companies can design any number of zero-based, historical-based and rolling budgets and plans.

Incorporating a Microsoft Excel interface on top of a central database, Infor d/EPM's budgeting functionality lets companies retain the familiar look and feel of spreadsheets while eliminating the drawbacks and ensuring a single version of the truth.

When a business change occurs, businesses can easily adjust the budget and save it to the database, relying on the system to automatically update numbers and reports affected by the change.

Infor d/EPM - Planning and Budgeting not only helps companies improve the quality of plans and significantly reduce budgeting cycle time, but also enables them to access accurate data and reports on demand to support business analysis and decision making.

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