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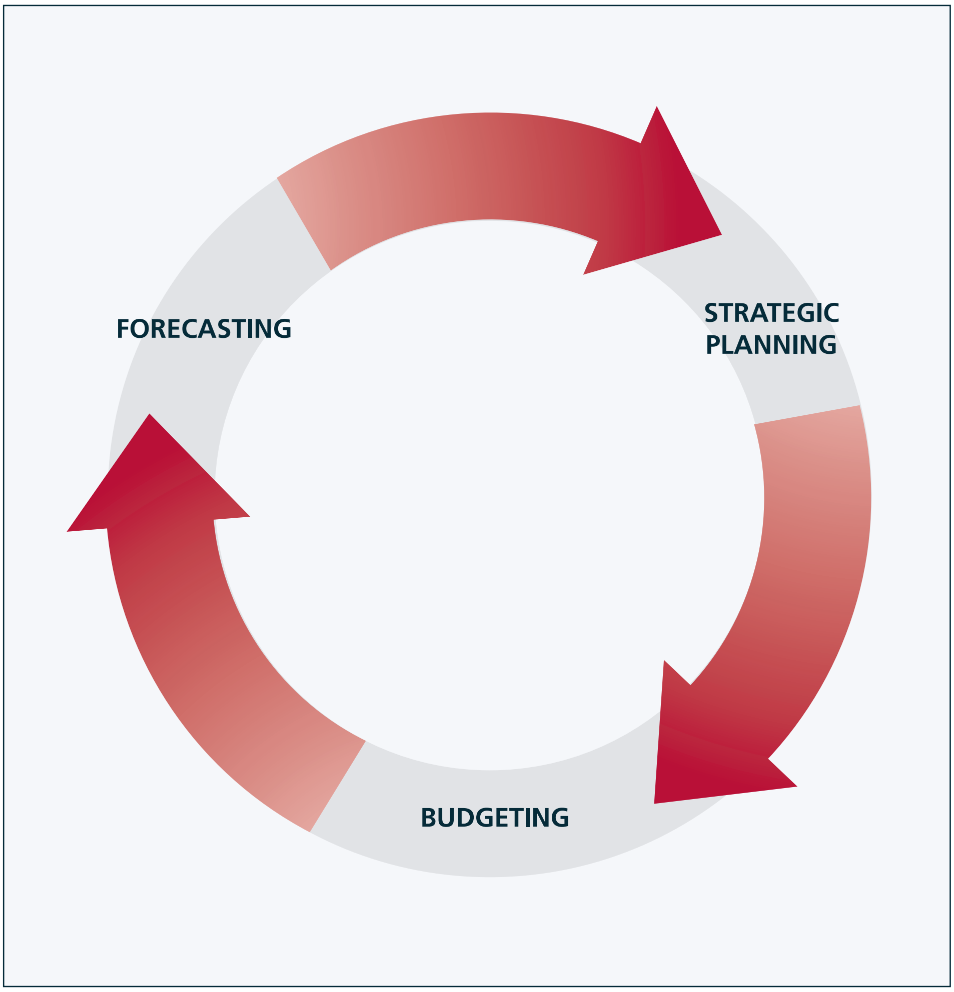
MANAGEMENT CONSULTING

BEST PRACTICE GUIDE
BUDGETING AND PLANNING SERIES

1.1 The Case for Change

Long hours, questionable accuracy, and the ever-present danger of the spreadsheet tower collapsing under the strain mean that most financial managers dread the planning process. In the first of a series of six articles, **Steve Bows** of **Cornerstone Management Consulting** examines aspects of a new process for the Twenty-First Century that combines best-practice techniques with the latest in enabling technology to help take the stress out of the planning cycle.

The Annual Planning Cycle



The requirement for accurate and timely forecasting of corporate results increases every day. Fuelled by the demands of the web-driven world for instant access to information, financial managers are expected to be able to predict the financial and operational impact of each big decision in days, or even hours. The truth is often far removed – most management accountants still rely on a planning methodology designed in the early Twentieth Century and a bewildering tower of spreadsheets.
Let's take a closer look at why planning processes and systems are failing to keep pace with current requirements.

The Planning Cycle

Most organisations currently plan their business on an annual cycle structured around the financial year – top-down strategic planning by senior management starts about six months out, leading into the annual budget, a detailed bottom-up exercise designed to align proposed cost centre expenditure with the top-down plan for the coming year. Once the new year starts, and the first month's actuals are in, the budget will start to be revised in a forecasting process that tends to be high-level, quarterly and less structured than the annual budget.

The issues here are deep-seated, ingrained as they are into corporate culture, but not insoluble. The consensus of management accounting theory is that it is essential to incorporate three aspects that are absent from the current model, namely:

- Collaboration
- Driver-based techniques
- Timely delivery

Out of these three distinct planning activities, it is the annual budget process that leads to most dissatisfaction amongst all concerned, and consumes most time and money. Based on an outdated model of a command-and-control business structure, the process engenders mistrust between senior and middle management as both sides engage in a highly-charged political battle to secure a lower or higher cost budget respectively for the year ahead. This battle can rage for months, distracting attention from external events and draining the energy of all involved.

Worst of all, the hard-fought budget outcome becomes redundant within a matter of months, being overtaken by back-of-an-envelope forecast calculations that are produced in a hurry by senior management, in response to changing market conditions or big new ideas. Often this forecast "process" is carried out without consulting the cost centres, further undermining the morale of middle management.

Towards Best-Practice Enterprise Planning

The issues here are deep-seated, ingrained as they are into corporate culture, but not insoluble. The consensus of management accounting theory over the past twenty years is that, to ensure the planning process is relevant, accurate, and most importantly, that it encourages business managers to deliver the right results, it is essential to incorporate three aspects that are absent from the current model, namely:

Collaboration

Where plans are developed in collaboration with business managers, they are far more likely to succeed than those built by finance or senior management in isolation. Ownership increases, and the planning burden is spread. This is of course much easier said than done, requiring as it does a level of mutual trust that has been systematically eroded by the old way of doing things. Much has been written on how to break through this barrier of mistrust and cynicism, most notably by Hope and Fraser in their seminal text *Beyond Budgeting*[1], and there are some outstanding examples of companies who have acted on these approaches and had dramatic success.

Driver-Based Techniques

Modelling the business using key drivers, such as sales volume and headcount, ensures that the plan is consistent and flexible, allowing faster and more accurate scenario modelling as all elements of the plan move in step with the change being modelled. Most financial managers these days have a good sense of the drivers involved in their business, but are often frustrated by the inability of their spreadsheet models to give them a true sense of the sensitivities involved, preventing them from giving clear guidance to operational managers. This is where multi-dimensional modelling technology can help, in combination with the rigour of Activity-Based Costing/ Management (ABC/ABM) approaches.

The idea is to gain a 'quick win' by enhancing the speed of the existing process, recognising that improvements in modelling techniques and the culture of collaboration will take longer to implement. This is a logical approach, and indeed, many of those adopting it have found that by laying the technical foundations of the new process at the outset, communications and transparency are improved throughout the organisation, making it easier to create the dialogue required for the next stage of the process.

Timely Delivery

A rough estimate delivered today is worth far more than a detailed plan that is three months out of date. The old budget model was built around the relatively static world of the early Twentieth Century, where market conditions were unlikely to change substantially from one year to the next. Budgets could safely be based on "last year + x%" as an incentive for managers to do a little better this year in what where assumed to be the same prevailing external conditions. The world has changed radically since then, and the pace of this change is increasing exponentially, requiring new approaches that can re-model a changing business quickly. The planning process must be streamlined, with as little time as possible spent on data collection and consolidation, and far more time on 'what-if' analysis and scenario planning.

It is worth spending some time looking at the characteristics of a solution to this last challenge, as most organisations, having committed to the vision of a Twenty-First Century planning process, choose to start here as their first practical step along the path to the realisation of the vision. The idea is to gain a 'quick win' by enhancing the speed of the existing process, recognising that improvements in modelling techniques and the culture of collaboration will take longer to implement. This is a logical approach, and indeed, many of those adopting it have found that by laying the technical foundations of the new process at the outset, communications and transparency are improved throughout the organisation, making it easier to create the dialogue required for the next stage of the process.

Beyond the Spreadsheet Model

Speeding up the planning process requires a revamp of the technology used to deliver it, and in particular the emphasis on the spreadsheet model, which has traditionally been the only tool available for quick financial and operational planning. Because it combines flexibility with ease of use for non-technical business staff, it has been embraced across whole organisations for a vast range of different modelling requirements. However, when deployed to meet the challenges of enterprise planning, the weaknesses of the spreadsheet model in the multi-user environment become apparent. These include:

No common database

Spreadsheet models require arduous manual procedures to consolidate them and keep them synchronised, and this can lead to errors as turnaround times become more demanding.

No common structure

Spreadsheet models are often designed (or modified) in different ways by different business units, leading to confusion and argument on consolidation. These structures are rarely sourced directly from the general ledger, leading to integration issues when the budget is finally agreed.

Outdated business assumptions

Once a spreadsheet model has been designed, it tends to become untouchable, bristling with complex macros and incomprehensible references. Extra pieces may occasionally be added to deal with changing business circumstances, often as hard-coded "miscellaneous" lines, but rarely is the model overhauled to truly reflect the current state of the business.

The technical solution to these issues requires a robust multi-dimensional data (and meta data) repository, but also the capability to make continual change to the models being deployed. Some implementations of planning technology have failed to live up to the vision because they have given undue prominence to one or other of these two (potentially conflicting) requirements, and not appreciated the importance of maintaining a balance between them, a balance that will be different for every organisation.

Best Practice Guides: The Budgeting and Planning Series

The aim of this series is to provide a few practical tips for those embarking on this first exciting stage in the overhaul of their planning process. The following articles will provide guidance on negotiatiating the common challenges of such a project, allowing financial managers to emerge with tangible benefits and the enthusiasm to push ahead with the next stage!

[1] "Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap", Hope J. and Fraser R., Harvard Business School Press, 2003

Further information

If you would like further information on any of the topics covered in this article, please contact us.

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