
Budgeting for Results 2008
Course 2
Navigating the Budgeting Process
March 19, 2008
Arlington, Virginia

John A. Miller

Instructor

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Welcome and Introductions

- Safety and Housekeeping
- Ground Rules
- Agenda Overview
- Program Overview
- Instructor
- Participant's Expectations

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Safety and Housekeeping

- Exits in case of emergency
- Breaks
- Restrooms
- Cell phones
- Your binder

Ground Rules

- Open, free flowing discussion is welcome and encouraged
- Ask questions and share concerns
- Challenge instructor and each other
- Bring in your experience
- Have fun

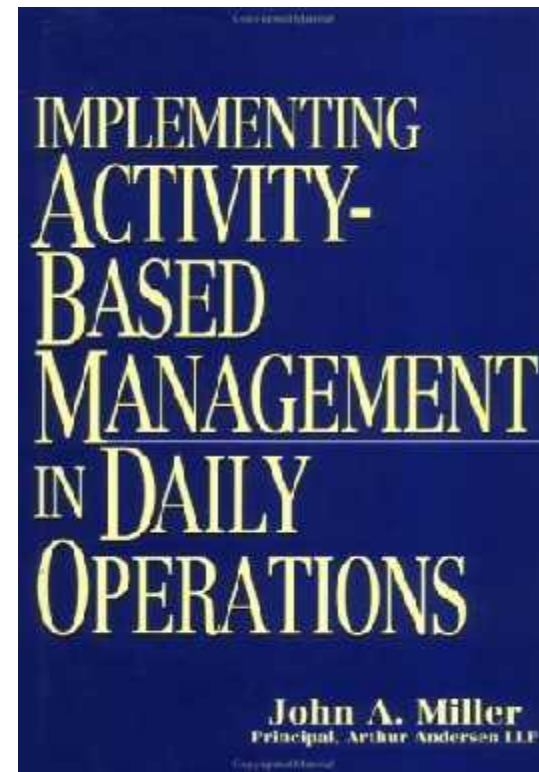
Agenda Overview

- **Navigating the Budgeting Process**

- Aligning Budgeting to Strategy
- Key Realities and Drivers of the Budget Process
- Budget Formulation: Estimating and Forecasting Budget Requirements
- Budget Justification: Building an Effective Case for New Initiatives
- Using Alternative Methods: Results-based Budgeting vs. Performance-based Budgeting
- Budget Execution: Tracking, Monitoring and Modifying

John A. Miller

- Recognized expert in performance management and measure
- Author of One Eighty, a biweekly newsletter for the performance management community
- Author of Implementing Activity-Based Management in Daily Operations (1996) and Passport to Activity-Based Costing (April 2008)
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- Program Director for CAM-I and Consultant Adjunct with the American Productivity & Quality Center (APQC)



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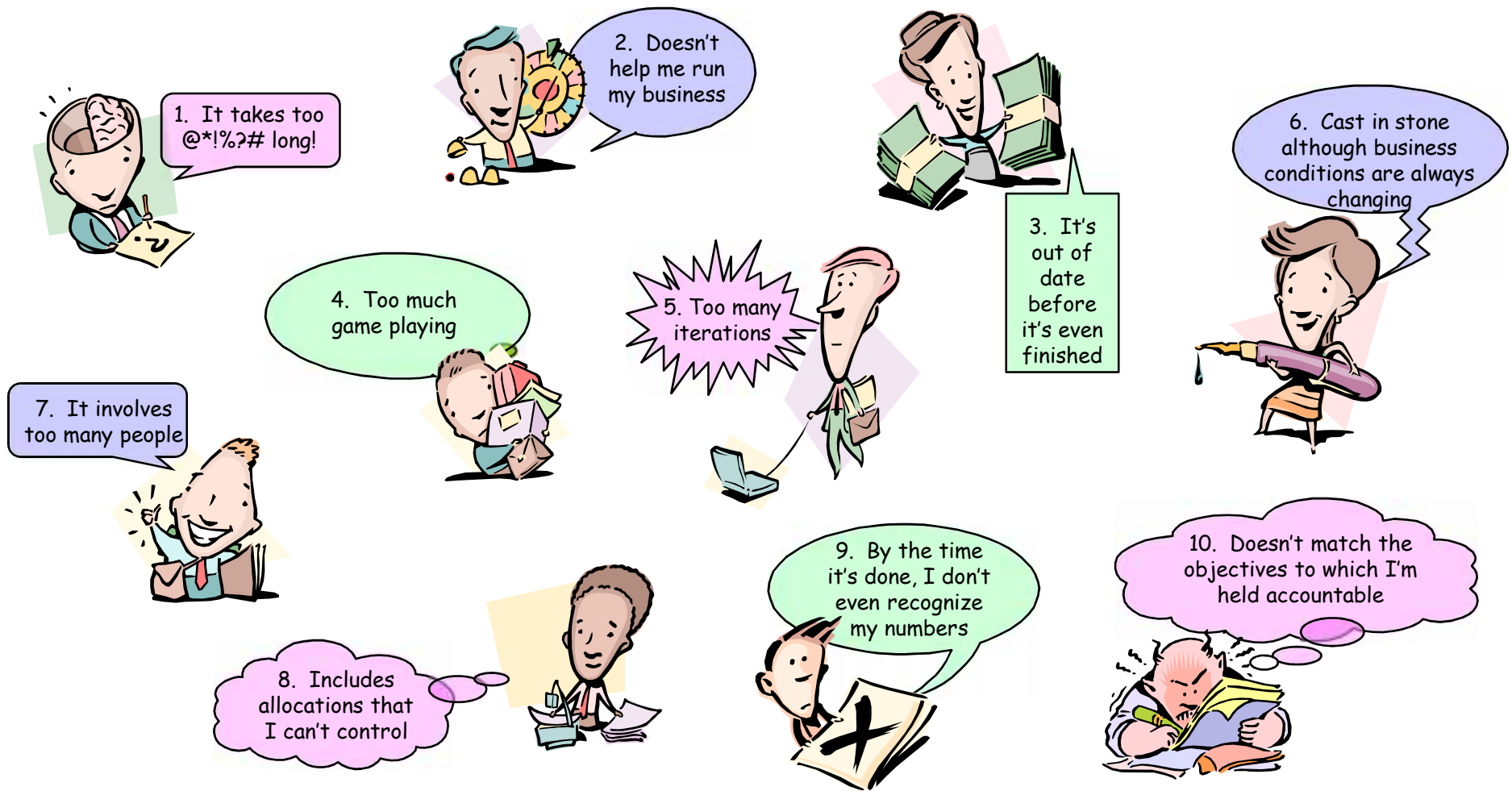
Session 1

Aligning Budgeting to Strategy

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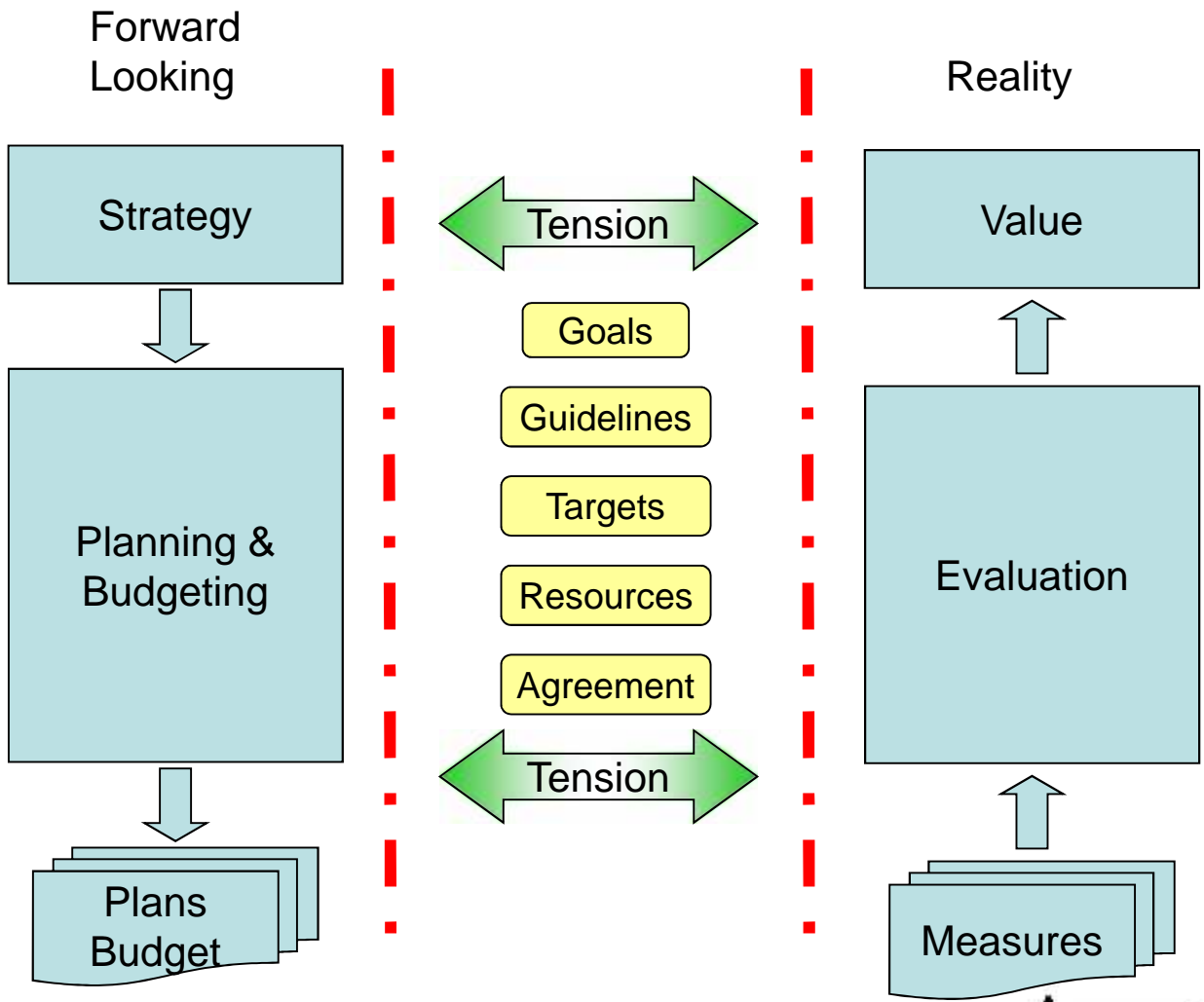
Outlining the Business Planning Process

Unfortunately, the process elements are all too often not designed for customer – here are 10 Top reasons managers hate the process!



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The Budgeting Process

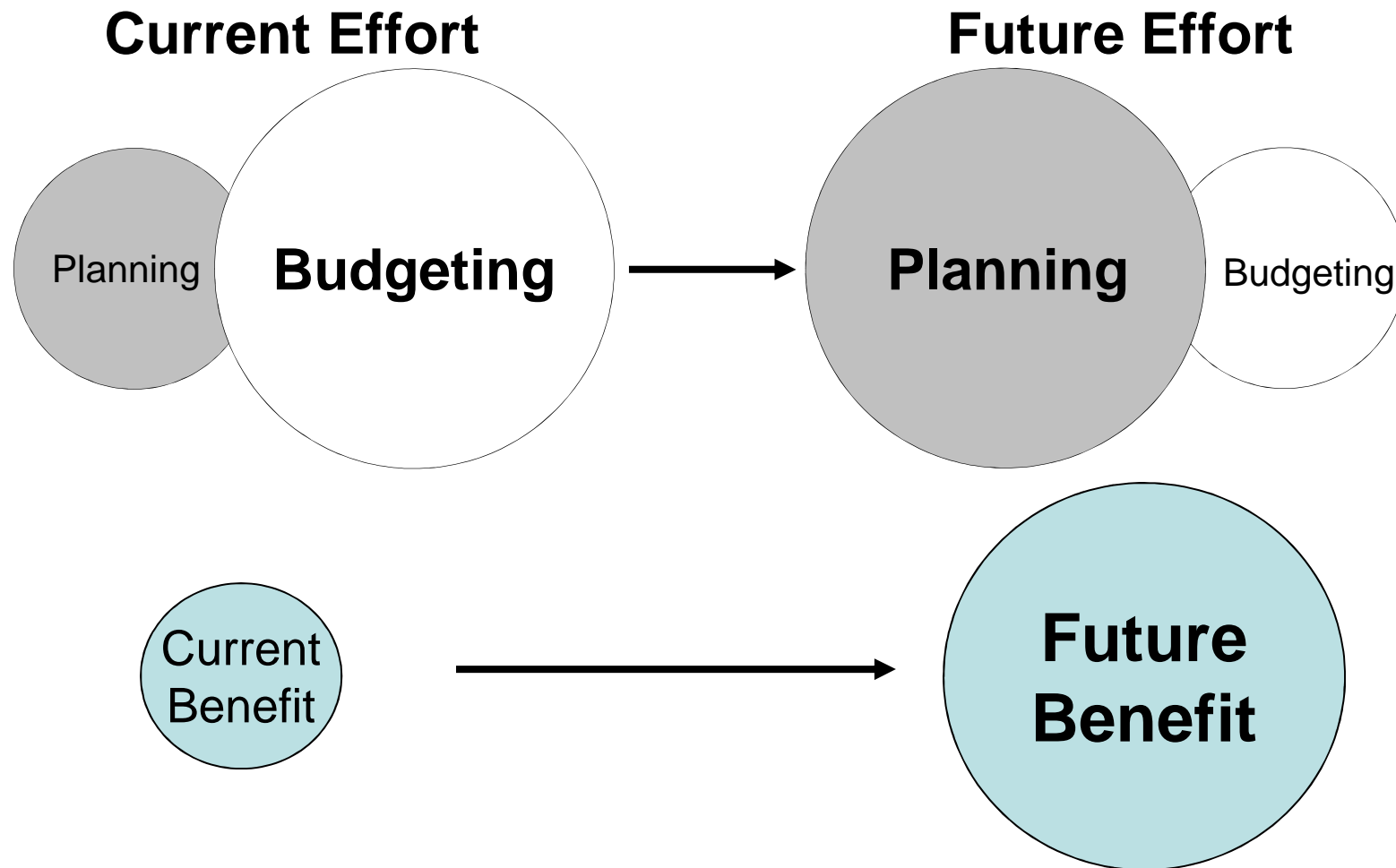


Competitive Disadvantage

In most organizations, planning, budgeting and performance management are sources of competitive **disadvantage**. Recent surveys conducted by the Beyond Budgeting Roundtable revealed the extent of the problems:

- 75% said their processes can't cope with unpredictable change
- 90% said they take too long and add too little value
- 85% said they don't focus enough on key strategic issues
- 75% said they cause dysfunctional, even unethical behavior
- 80% said they conflict with tools, such as the Balanced Scorecard

Shift from Budgeting Towards Planning



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Planning and Budgeting... Essential Business Processes

- Avoid mistakes and surprises
- Be more profitable
 - Where to put emphasis for the best bang for the buck
- Have a long range plan – know the direction you are going
 - Communicate so all head the same direction
 - Avoid one person's agenda
 - Avoid frivolous mistakes
 - Set baseline for comparison
- Make best use of the resources you have
 - Keep employees from being burned out (keep them happy too)
 - Avoid over-buying
- Prevent flip-flopping—over correction
- Take advantage of specials and in-season items
- Prepared for emergencies (contingency planning)

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Planning & Budgeting Process Integration

- Strategic Levels – Market, Customer, Product Segments
- Multi – Year
- Full Financial Statements
- Scenario & Ad Hoc Modeling



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Typical Budgeting Processes Lack Predictive Capability

Issues:

- Use “last year’s number +/- 5%
- Treating all functions equally
- Sandbagging
- Budget negotiations
- 20% Across the board cuts
- Iterations and updates
- Market dynamics
- Bonuses
- Lack linkage between Customers and Functional Resources

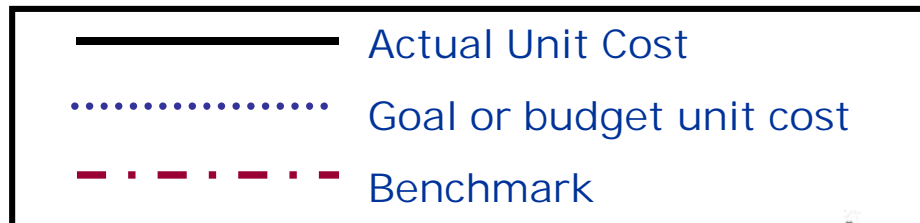
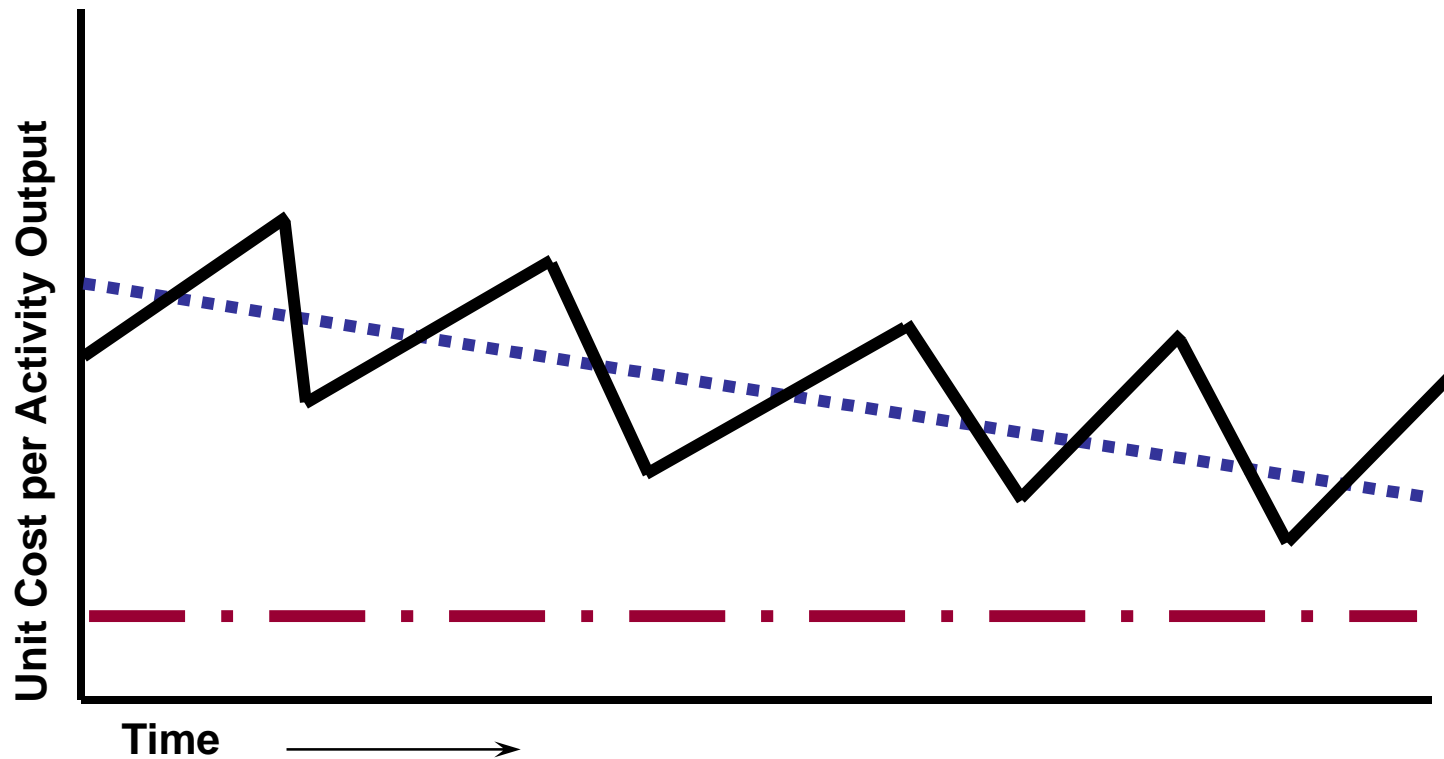
How does your budget process:

- Enhance visibility to business processes
- Enhance resource visibility
- Enable critical choices
- Feedback to strategy
- Enable agile decisions

What Do You Need to Know?

- **Product/Service profitability**
- **Customer/Customer Segment profitability**
- **Cost to serve customer segments and distribution channels**
- **Cost, capability, and capacity of significant business processes and activities**
- **Product/service quality**
- **Level of customer satisfaction**
- **Employee satisfaction and performance**
- **Market/industry outlook**
- **Asset utilization**
- **Capital turnover**
- **Capacity of physical assets**
- **Human capacity and utilization**
- **Channel profitability**
- **Customer needs and requirements**
- **Marginal and cash costs**
- **New product/service requirements**
- **Project and contract performance**
- **Supply chain performance**

Activity Performance



Linkages

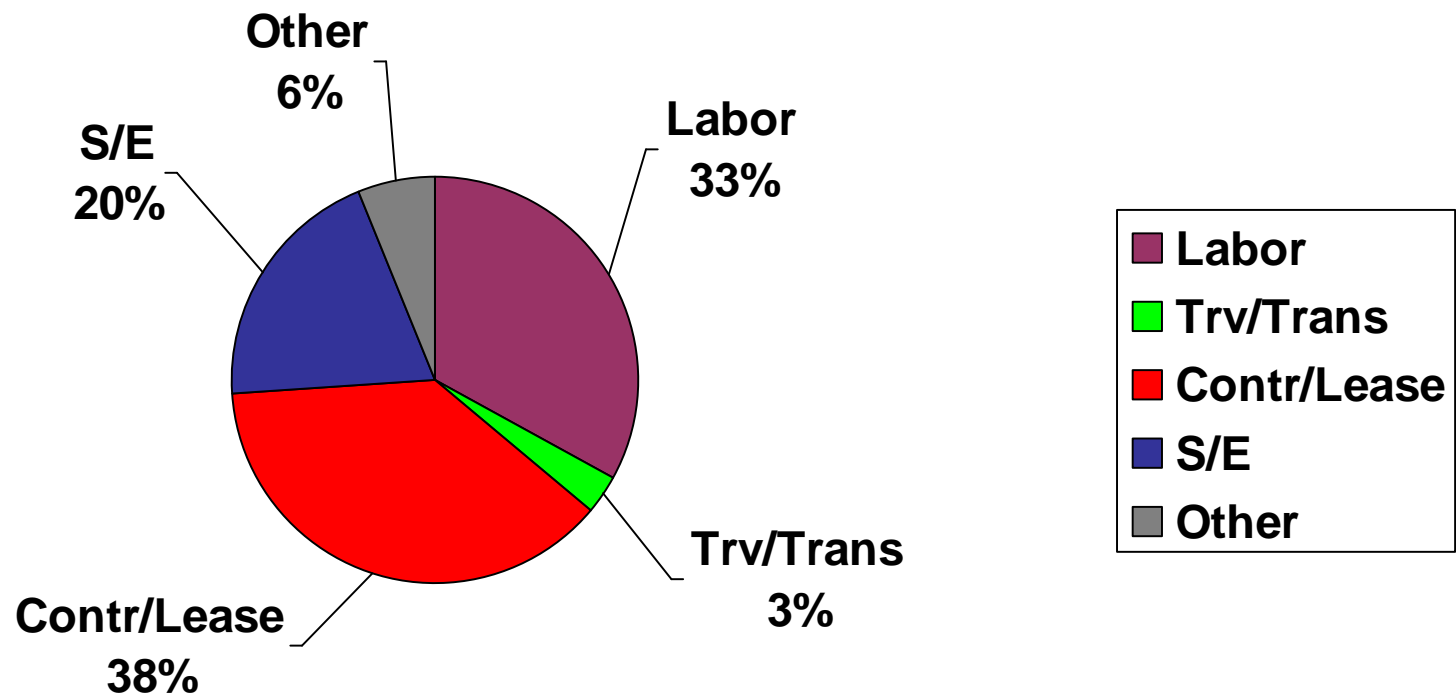
- Process improvement initiatives
- Performance measurement
- Strategic planning
- Operations planning
- Goals and objectives
- Compensation and rewards
- Capital justification
- Product/Service pricing and pricing models
- Cost estimation
- Capacity utilization
- Budgeting
- Management control systems

Link Performance Measures and Goals

	Goal 1	Goal 2	Goal 3	Goal 4	Goal N
PM 1	H	H	L	H	H
PM 2	L	L	L	L	L
PM 3	L	L	L	H	H
PM 4	L	H	L	L	L
PM N	L	M	L	M	M

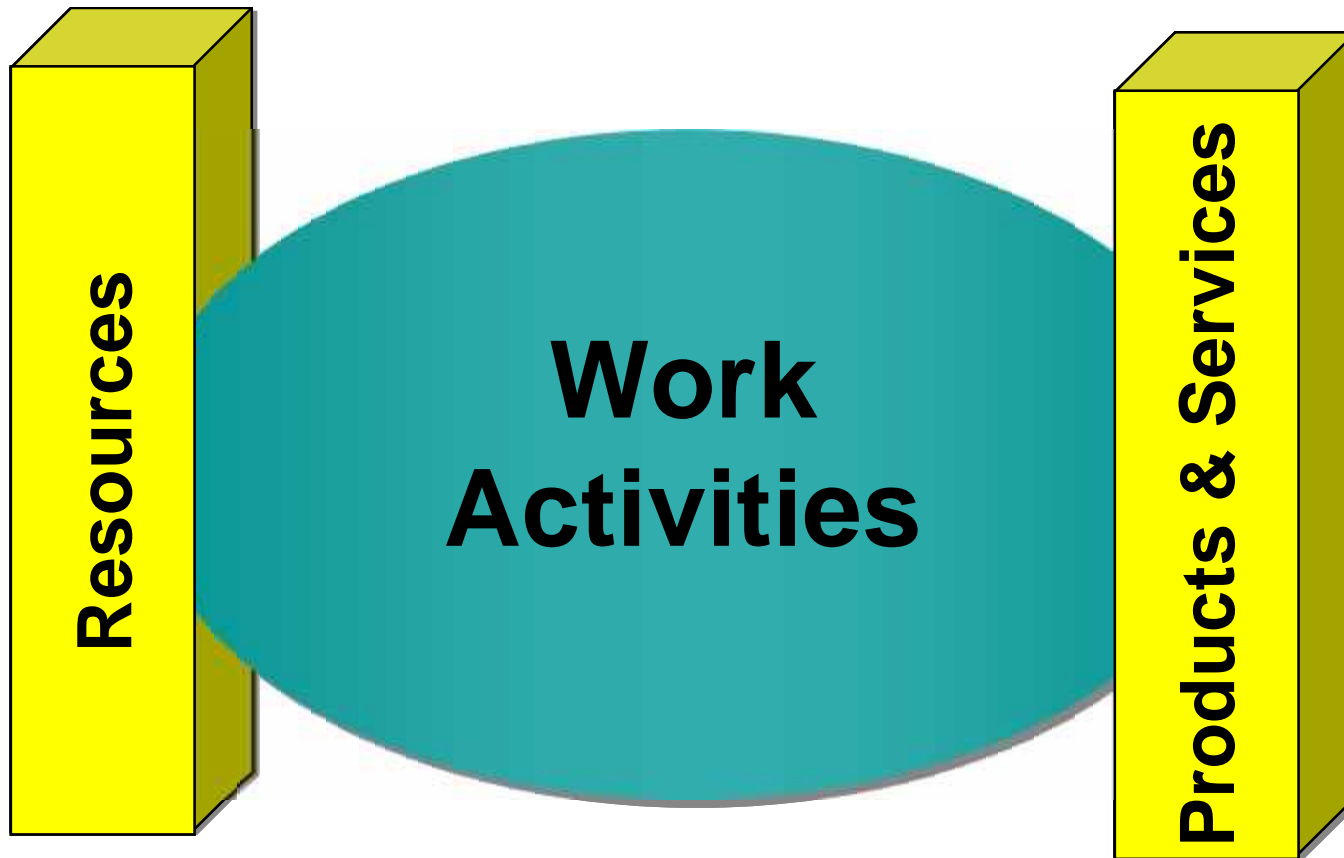
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Link to Cost Structure



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Business View



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Activity Attributes

- Value added
- Non-value added
- Intensity of fixed costs
- Primary activity
- Support activity
- Degree of customer interfacing
- Cost of quality
- Core competence
- Cost of non conformance
- Importance to strategy
- Importance to strategic and operational goals
- Importance to customers/end users
- Core, sustaining, and discretionary
- Cost drivers (causes of activity cost)
- Performance measures
- Potential to improve

Session 2

Key Realities and Drivers of the Budget Process (Workshop Exercise)

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Instructions

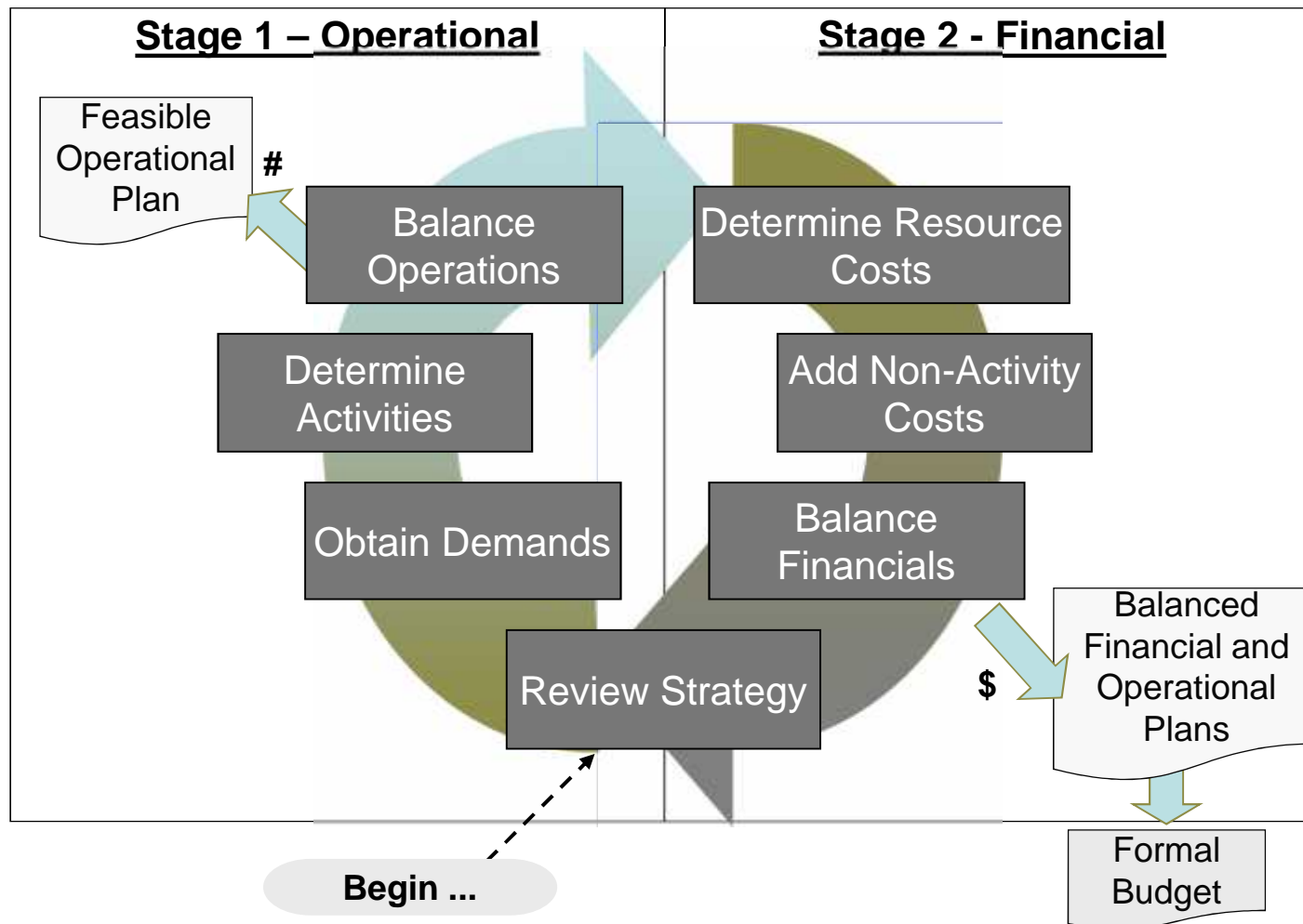
- Each participant takes 10 minutes to identify and write down key realities and drivers of your organization
- Instructor to divide participants into groups
- Each person shares the key realities and drivers with the group
- Identify common problems with the current budget process (workshop deliverable)

Session 3

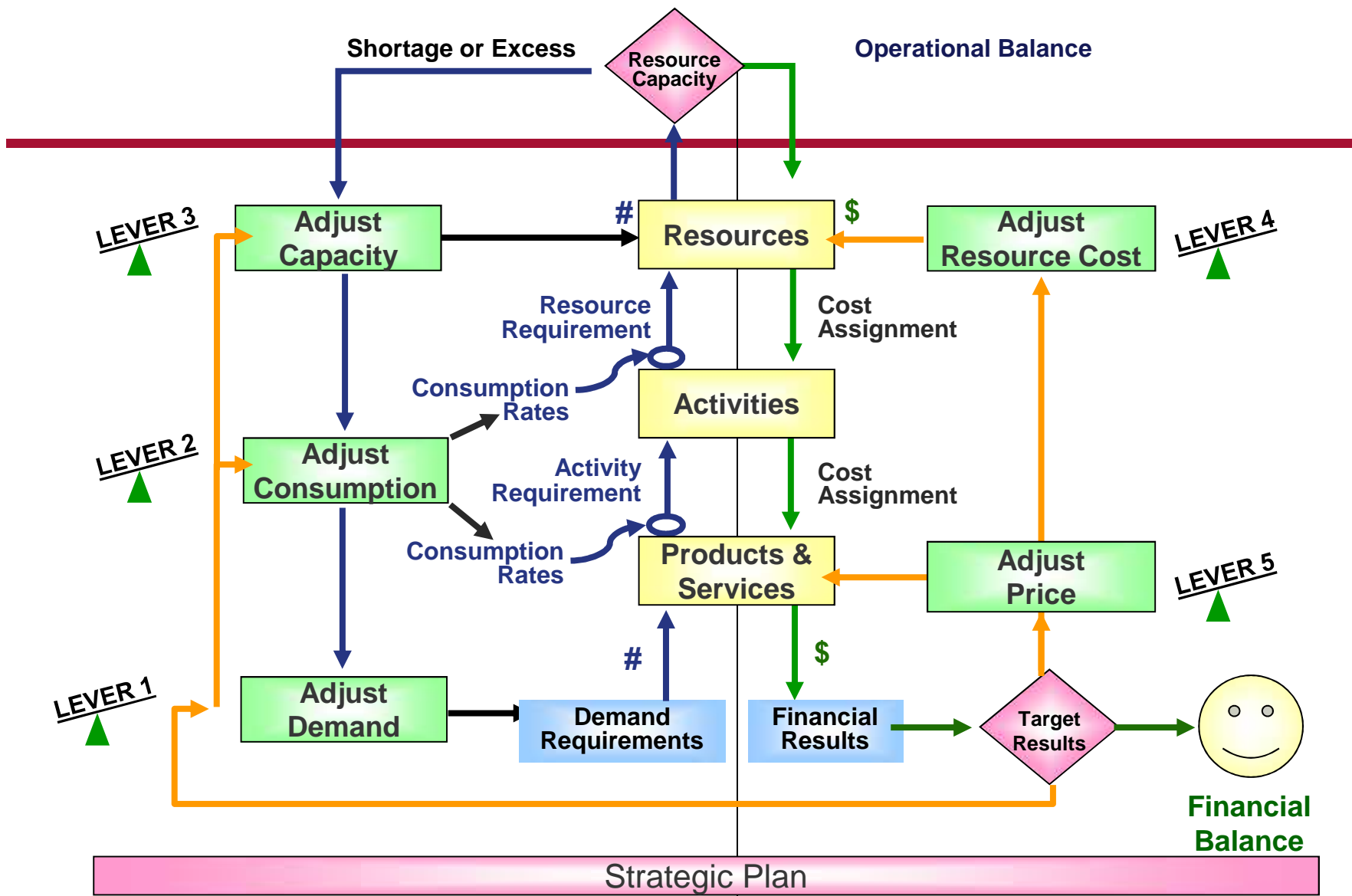
Budget Formulation: Estimating and Forecasting Budget Requirements

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Closed-Loop Planning Model



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Dynamic Integrated Costing Planning and Budgeting Provides:

- Actual Period Performance:
 - Line Item Costs by Department by Product and Customer
 - Process / Activity Costs and Rates by Product and Customer
 - Key Performance Metrics
 - Profitability by Product and Customer
 - Comparison of Actual to Plan (not shown in Illustration)
- Planned Performance:
 - Forecast Demand of Product and Customer Demand
 - Key Performance Metrics Driving Cost & Revenue
 - Resource Planning (Headcount, Period Fixed, Step-Fixed & Variable)
 - Predicted Line Item Costs by Department by Product and Customer
 - Process / Activity Costs and Rates by Product and Customer
 - Profitability by Product and Customer
 - Comparison of Plan to Previous Periods (not shown in Illustration)
- Collaborative, Cross Functional and Dynamic

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Integrated Costing and Planning / Budgeting

- An Integrated Modeling Approach Can Provide:
 - Analytics to Understand Drivers of Cost and Profitability:
 - Period Cost by Budget Line Item, and Profitability by Product & Customer
 - Operational Performance Metrics (Drivers)
 - Process & Activity Cost Analysis
 - Cross-Functional Planning Collaboration and Alignment
 - Interactive Planning Input and Analysis by Cross-Functional Managers
 - Dynamic Impact of Cross-Functional Performance Metrics
 - Capacity Utilization and Resource Planning
 - Consolidation and Analysis of Planned Performance
 - Planned Performance and Budget:
 - Demand Forecast Assumptions
 - Planned Key Performance Metrics
 - Planned Resource Capacity Utilization and Costs
 - Planned Projects and Other Spending Assumptions
 - Forecast Period Cost and Profitability by Budget Line Item, Product and Customer

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Insights Into Cost and Performance of Activities

Cost Drivers

- Age of equipment
- Experience of staff
- Availability of parts
- Maintenance schedule



Processes and Activities

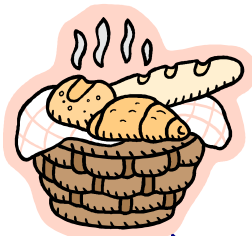
Perform Aircraft Maintenance

- Receive Request
- Schedule Work
- Perform Repair
- Document Work



Performance Measures

- Emergency response time
- Rework rate
- Customer satisfaction
- Productivity
- Cycle time



Operate Dining Hall

- Buy Food
- Prepare Food
- Serve Food
- Clean Hall



- Customer satisfaction
- Productivity
- Serving time
- How much is thrown out

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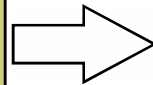
Cost and Performance Management

Says a lot about what was spent

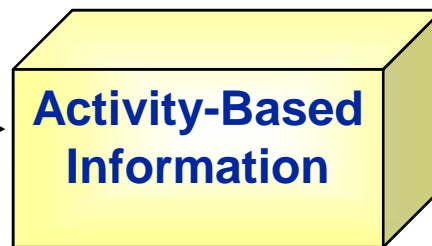


Usually reports on General Ledger account summary

Data

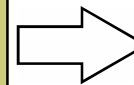


Need to know where it was spent



Financial data related to work performed in an organization; makes sense to most people

Work information



What we REALLY need to know is how effectively it was spent



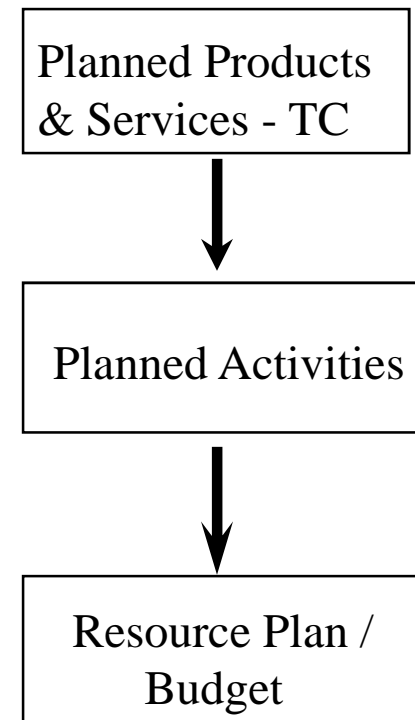
Allowing people to be effective managers of their respective areas, functions, divisions or Garrisons

Mgmt. Decision Support Information

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Budgeting/Target Costing

- Develop Activity Costs and Quantities – and understand drivers
- Apply Volumes
- Apply Economic Factors (e.g., material & labor rate changes)
- Incorporate Process Improvements
- Include Capital Purchases
- Iterate



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Performance Measurement

- Measure the right things at the right time for the right people
- Simple, but not simplistic
- Accurate and credible
- Balanced
- Flexible
- Linked to strategy
- Controllable
- Integrated
- Comparable to something
- Cost effective to produce and maintain
- Drive improvement
- Actionable
- Realistic

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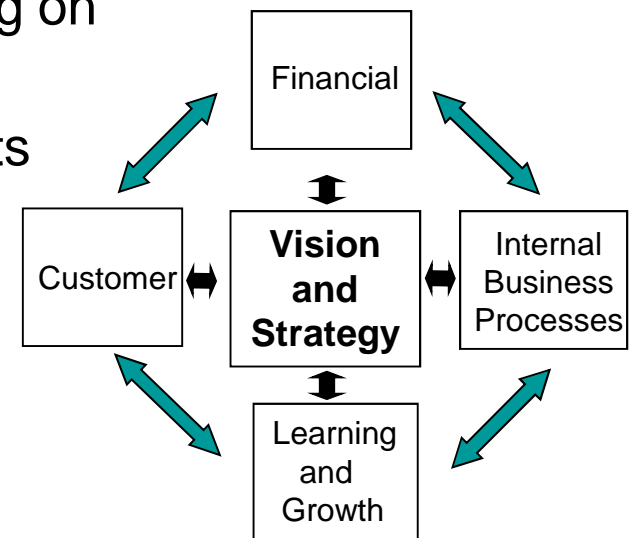
Key Operational Performance Measures

	Cost	Quality	Time/ Throughput
Select Suppliers	# hours to maintain list #manual vs auto updates	% change in suppliers % supplier problems	# suppliers in master list
Procure Material	\$/Automated PO \$/Manual PO	# Blocked POs # Returned items	Transaction time/PO # Annual receipts
Certify Vendors	Cost to certify	# Contracts let to certified vendors	# Weeks to Certify
Expedite Materials	Cost/expedited PO % add'l \$/item	# Material returns % Supplier Caused	# POs expedited
Resolve Problems	# hrs spent on problems #manual vs auto updates	Survey Results	# Problems Time to unblock PO
TOTAL	Average Cost/PO % Auto vs manual POs	Total # Blocked POs	Total number of PO's % auto vs manual

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Balanced Scorecard Review

- Performance management framework for communicating, measuring and focusing on core/long-term strategies
- Translates strategies into measurements
 - Quantitative and Qualitative Measures
 - Lagging and Leading Indicators
 - Financial and Non-Financial
- Aligns organization to a single strategy
- Measure what should be measured versus what could be measured
- Translates strategies into actions



Balanced Measurements

- Past**
- Financial Measurements - Are we making money?
 - Customer Measurements - How do our customers feel about our products and services? Will they continue to buy from us?
 - Internal - Are we improving our processes to become / remain competitive?
- Future**
- Learning & Growth - Is our organization learning and developing new products and services to meet future customer requirements?



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Session 4

Budget Justification: Building an Effective Business Case for New Initiatives (Workshop Exercise)

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Session 5

Using Alternative Methods: Results-Based Budgeting vs. Performance-based Budgeting

(Instructor will Provide Materials)

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Session 6

Budget Execution: Tracking, Monitoring and Modifying

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Background

This instructional material features:

- The research of the UK based Beyond Budgeting Round Table (BBRT). The BBRT is at the heart of a new movement that is searching for ways to build lean, adaptive and ethical planning and budgeting processes
- APQC Best Practice Consortium Study, **Planning, Budgeting, and Forecasting for Superior Business Execution**

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Beyond Budgeting

- The delegation of decision-making and spending authority has always been one of the key functions of budgeting. However, this delegation usually occurs strictly within a regime of compliance and control
- It differs significantly from the approach taken by "beyond budgeting" organizations which have gone much further and transferred power from the center to operating managers and their teams, vesting in them the authority to use their judgment and initiative to achieve results *without being constrained by some specific plan or agreement*.
- Thus, devolution of responsibility is about enabling and encouraging local decisions, not dictating and directing them.

Principles of Beyond Budgeting

- Base evaluation and rewards on relative improvement contracts with hindsight.
- Make action planning a continuous and inclusive process.
- Make resources available as required.
- Coordinate cross-company actions according to prevailing customer demand.
- Base controls on effective governance and on a range of relative performance indicators.

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Benefits

- Setting stretch goals
- Reducing gaming
- Encouraging ambitious strategies and fast response
- Reducing waste
- Improving customer service
- Promoting learning and ethical behavior

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Results

- Clear governance framework leads to the acceptance of local decision making by front-line teams throughout the organization
- High-performance climate leads to sustained competitive success
- Freedom to decide fosters innovation and responsiveness
- Team-based responsibility results in a greater focus on creating value and reducing waste
- Customer accountability builds more commitment to satisfying customers profitably
- Information culture based on openness and "one truth" promotes ethical behavior.

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Leadership Principals

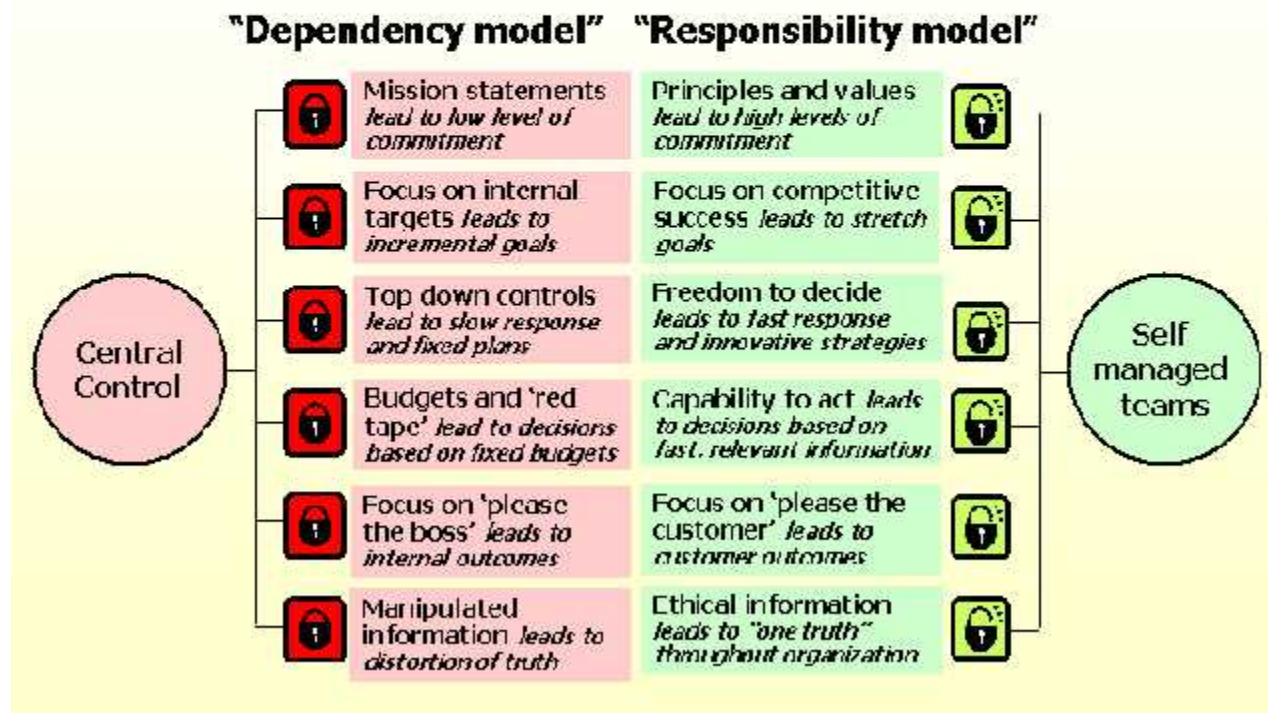
- Create a high-performance climate based on relative success.
- Provide a governance framework based on clear principles and boundaries.
- Give people freedom to make local decisions that are consistent with governance principles and the organization's goals.
- Place the responsibility for value creating decisions on front line teams.
- Make people accountable for customer outcomes.
- Support open and ethical information systems that provide "one truth" throughout the organization.

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Relative Improvement Contract

- Performance management process based on a *relative improvement contract* rather than on a fixed performance contract
- It assumes that it is not wise to make managers commit to a fixed target and then control their future actions against it
- The implicit agreement is that executives will provide a challenging and open operating environment and that employees will deliver continuous performance improvement using their knowledge and judgment to adapt to changing conditions
- It is based on mutual trust, but it is not a soft alternative to the fixed performance contract
- High visibility of individual and team performance offers no hiding place.
- Managers must perform to high levels of expectation (relative to peers) or face the consequences

Principles of the Devolved Organization



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Principles of the New Performance Contract

