
Planning, Budgeting, and Forecasting for Superior Business Execution

Final Report

A Consortium Benchmarking Study Conducted By:



In Conjunction With:



Subject Matter Expert:

Steve Player

Beyond Budgeting Round Table

**PLANNING, BUDGETING, AND FORECASTING
FOR SUPERIOR BUSINESS EXECUTION
CONSORTIUM BENCHMARKING STUDY**

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SUBJECT MATTER EXPERTS

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Project Overview

STUDY SCOPE

Drawing on input from the study advisers, study sponsors, and secondary research literature, the APQC and BBRT study team identified four key areas for research. These areas guided the design of the data collection instruments. The study focused on:

1. designing an efficient and rapid planning, budgeting, and forecasting process that balances competing influences;
2. regularly refreshing the plan to reflect shifting goals and variable external conditions;
3. using the plan to drive and measure performance throughout the organization; and
4. using technology to support an effective planning process.

STUDY OBJECTIVES

Defined at the beginning of this study, the objectives of “Planning, Budgeting, and Forecasting for Superior Business Execution” are to enable participants to learn how leading organizations:

- craft plans and budgets to facilitate business execution,
- update plans throughout the year to reflect changing realities (without forcing managers to spend an inordinate amount of their time planning),
- use plans to measure performance and make course corrections during the year, and
- use technology to support an effective planning process.

ORGANIZATION OF MATERIALS

These meeting materials serve as a guide for participants in the “Planning, Budgeting, and Forecasting for Superior Business Execution” consortium study. Materials include best-practice organization presentations, as well as charts and tables from the study’s quantitative detailed questionnaire.

PARTICIPANT INFORMATION

The following organizations and individuals participated in this consortium study.

Sponsor Organizations

CPS Energy
Prudential Financial
Teva Neuroscience
U.S. Government Agency
VeriSign Inc.
Wells Fargo Services

Best-Practice Partners

Bank of America
Emerson Electric Company
Nestle Purina Pet Care
Wachovia

Special Guest Speakers at Knowledge Transfer Session

Dr. Charles Horngren, Edmund W. Littlefield Professor of Accounting, Emeritus,
Stanford University

Spencer Van Ness, Southwest Airlines

Subject Matter Experts

Dr. Charles Horngren, Edmund W. Littlefield Professor of Accounting, Emeritus,
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Steve Player, North American program director, BBRT

Project Team

Gerry Swift, project manager, APQC

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Participant Background

Figure E.1 depicts the industry breakdown for the organizations participating in the detailed questionnaire. All four of the best-practice partners and all six of the sponsors completed the questionnaire.

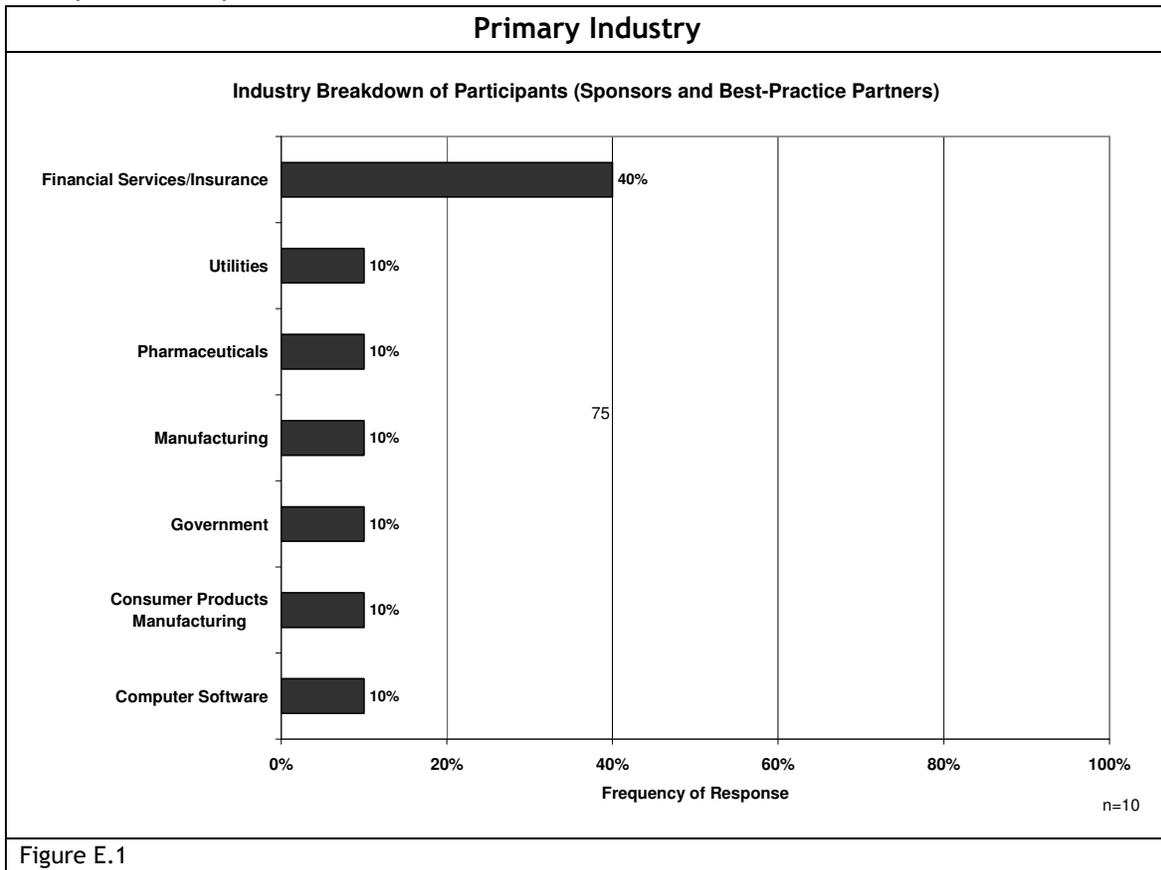


Figure E.2 illustrates the unit of participation for the organizations that completed the study's quantitative survey, be it enterprise-wide or within a division/business unit.

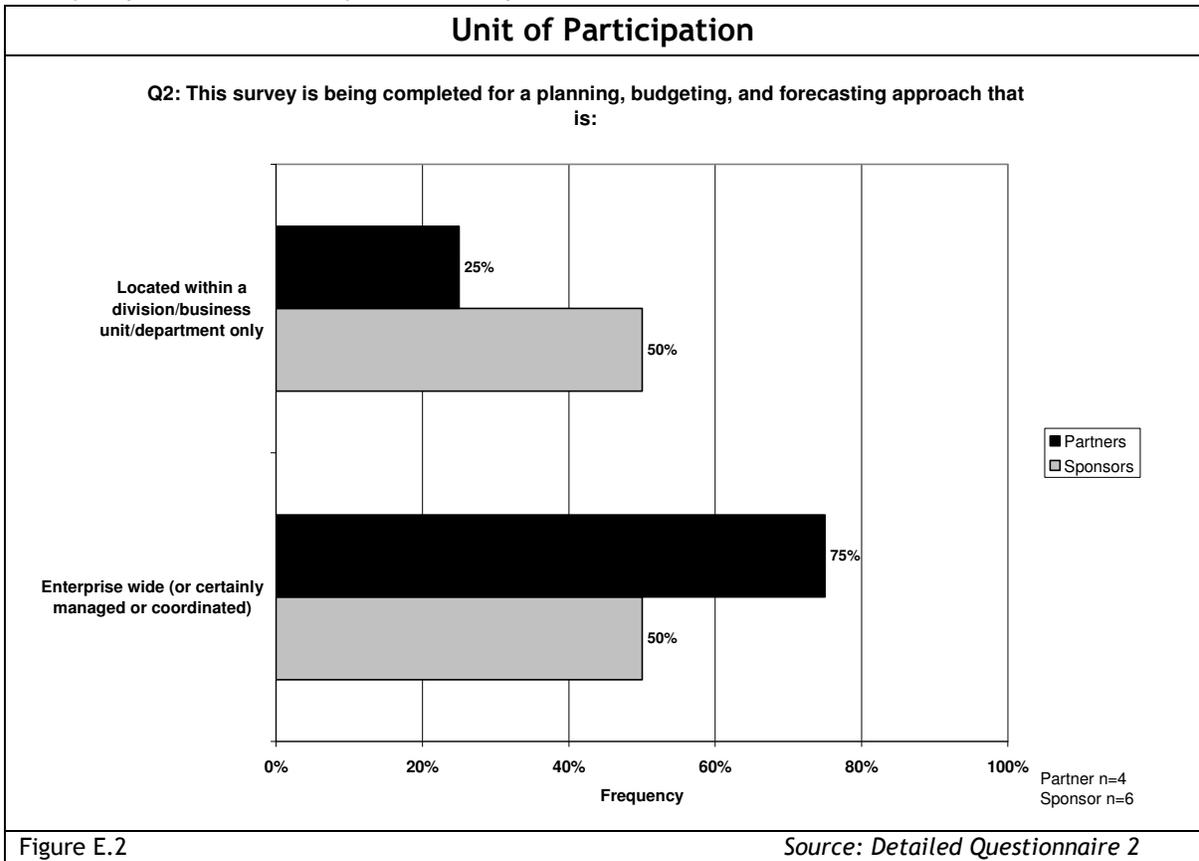


Figure E.2

Source: Detailed Questionnaire 2

APQC'S CONSORTIUM BENCHMARKING METHODOLOGY

APQC's consortium benchmarking study methodology (Figure E.3) was developed in 1993 and serves as one of the premier methods for successful benchmarking in the world. It was recognized by the European Center for Total Quality Management in 1995 as first among 10 leading benchmarking organizations' models. It is an extremely powerful tool for identifying best and innovative practices and for facilitating the actual transfer of these practices.

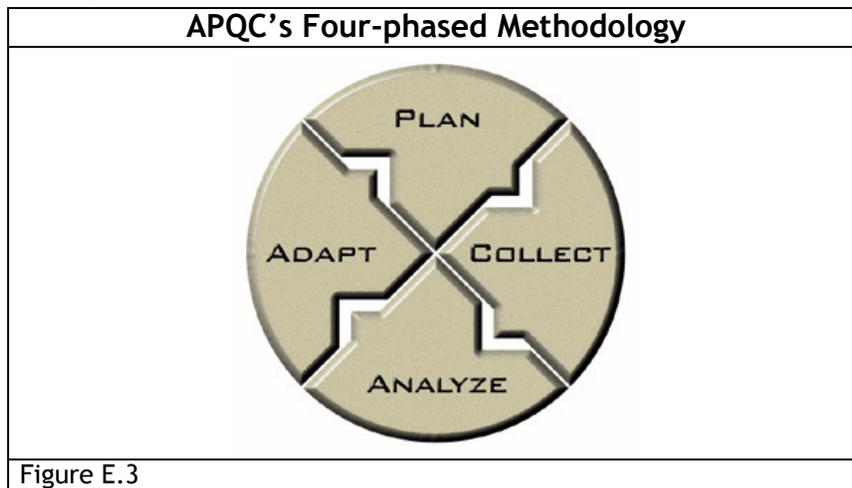


Figure E.3

Phase 1: Plan

The planning phase of this study began in February 2005. During this phase, research conducted by APQC was used to help identify innovative organizations to participate as best-practice candidates (the partners). In addition to this research, APQC and BBRT staff members, the subject matter experts, and sponsoring organizations identified potential participants based on their own experiences and knowledge. Each recognized organization was invited to participate in a screening process. Based on the results of the screening process, as well as organization capacity or willingness to participate in the study, a final list of potential partner candidates was developed.

The study kickoff meeting was held June 9, 2005, during which the sponsors refined the study scope, gave input on the data collection tools, and indicated their preferences for site visits to partner organizations. Four organizations ultimately hosted site visits: Bank of America, Emerson Electric Company, Nestle Purina PetCare, and Wachovia.

Phase 2: Collect

Three tools were used to collect information for this study:

1. screening questionnaire—qualitative and quantitative questions designed to identify best practices within the candidate partner organizations;
2. detailed questionnaire—quantitative questions designed to collect objective, quantitative data across all participating organizations; and
3. site visit guide—qualitative questions that parallel the areas of inquiry in the detailed questionnaire and that serve as the structured discussion framework for all site visits.

The partner organizations selected for continued participation in the study responded to the screening questionnaire, and all four of them completed the detailed questionnaire as well. All six sponsors completed the detailed questionnaire. Additionally, each of the four best-practice partner organizations hosted half-day site visits attended by sponsors and members of the study team. In addition, Southwest Airlines agreed to share their practices at the knowledge transfer session.

Phase 3: Analyze

The subject matter expert and APQC analyzed both the quantitative and qualitative information gained from the data collection tools. The analysis concentrated on examining the challenges organizations face and the enablers the best-practice partners employ in the four study focus areas.

Tab 2 includes aggregated and blinded responses to all questions in the detailed questionnaire shown in charts.

Phase 4: Adapt

Adaptation and improvement, stemming from identified best practices, occur after the sponsors apply key findings to their own operations. APQC and BBRT staff members are available to help sponsors create action plans appropriate for their organizations based on the study.

SUBJECT MATTER EXPERTS

Dr. Charles Horngren

Dr. Charles Horngren, Edmund W. Littlefield Professor of Accounting, Emeritus, is considered a pioneer in the use of managerial decision making, which he developed in the early 1960s. He transformed and expanded the teaching of modern management accounting and thereby forever changed how accounting is taught. He has remained one of the most influential teachers of accounting over the last 40 years. The American Accounting Association has inducted Dr. Horngren into The Accounting Hall of Fame (1990) and recognized him with The Lifetime Contribution to Management Accounting Award in 2004. Most CFOs will remember Dr. Horngren's textbook *Introduction to Management Accounting* (now in its 12th edition) as well as his five other widely used accounting textbooks. He has been a member of The Stanford Graduate School of Business faculty since 1965.

Steve Player, Beyond Budgeting Round Table

Steve Player is the North American program director for BBRT and has more than 20 years' experience in implementing performance management, strategic planning, and process improvements. He is also the founder of the Activity-Based Management Advanced Implementation Group and the co-author/editor of four books on Activity-Based Management. Player is also the former managing partner of Arthur Andersen's Advanced Cost Management Team.

ABOUT APQC

A recognized leader in benchmarking, knowledge management, measurement, and quality programs, APQC helps organizations adapt to rapidly changing environments, build new and better ways to work, and succeed in a competitive marketplace. For more than 25 years, APQC has been identifying best practices, discovering effective methods of improvement, broadly disseminating findings, and connecting individuals with one another and with the knowledge, training, and tools they need to succeed. APQC is a member-based nonprofit serving more than 500 organizations around the world in all sectors of business, education, and government. Learn more about APQC by visiting www.apqc.org or calling 800-776-9676 or 713-681-4020.

ABOUT BBRT

The Beyond Budgeting Round Table is a supported network of member companies with a common interest in improving planning and control practices. Many organizations spend tremendous efforts in setting strategic plans only to have them strangled by an annual budgeting process. Research efforts include how to replace fixed budget measures with relative targets, prevent gaming of executive compensation, and respond faster to change. By using rolling forecasts and relative targets, organizations are able to focus on strategy and value drivers and even decentralize performance, rather than debating annual, fixed budget targets. BBRT's purpose is to help organizations introduce ways to achieve more adaptive control and continuous planning. For more information, please visit www.bbrt.org.

ACKNOWLEDGMENTS

The project team, APQC, and BBRT would like to thank the participants in the “Planning, Budgeting, and Forecasting for Superior Business Execution” consortium study. Throughout the study, the sponsor representatives provided valuable input into the data collection tool design, partner organization selection, and site visit participation. The enthusiasm and dedication of the sponsor group ensured a successful study.

A special thank you is extended to the partner organization representatives who have taken time out of their busy schedules to participate in this study. The representatives receive no compensation or reimbursement for their time or travel. Each member of the partner group has gone out of his or her way to ensure the success of this study.

SUMMARY OF KEY FINDINGS

The top 10 key lessons follow.

1. Your planning, budgeting, and forecasting processes (PBF) must fit with your organizational culture.
2. Comprehensive PBF processes provide excellent methods to effectively convert strategy into action.
3. Care should be taken in regard to providing earnings guidance.
4. Use relative targets to overcome the dangers of fixed targets which can sub-optimize performance and lead to ethical challenges.
5. Align incentives to reaching optimal performance rather than negotiated targets.
6. Effective PBF processes provide ways to continuously update action plans to adapt to changing conditions.
7. Flexibility can be maintained by making resources available as required, as opposed to a fixed annual process.
8. Leading organizations use their performance measurement systems to understand facts and understand cause-and-effect relationships.
9. Use a continuous rolling forecast to provide forward visibility and coordination instead of merely forecasting to the end of the fiscal period.

10. Leading organizations remain coordinated by extensive communication using multiple methods.

THE PARTNERS

The best-practice partners were selected due to the combination of strong results while using very different approaches to planning, budgeting, and forecasting.

Emerson Electric demonstrates effective use of a traditional approach to planning and budgeting. Nestle Purina Pet Care links its planning processes to its use of a balanced scorecard. Bank of America utilizes a Hoshin planning process to support its implementation of Six Sigma. Wachovia's retail bank division has successfully eliminated traditional budgeting, showing how to achieve continuous planning and adaptive control. A fifth organization, Southwest Airlines, spoke at the knowledge transfer session and uses quarterly budgets to continuously update its plans. Further details on the four best-practice partners are noted below.

Emerson Electric Company

Emerson Electric Company is a worldwide manufacturing organization whose product offerings include process control systems, climate control technologies, power technologies that safeguard the Internet, phone and computer networks, energy-efficient electric motors that run many home appliances, and a range of other products that bring efficiency, organization, convenience, and comfort to homes and to the workplace.

Emerson includes more than 60 divisions that operate approximately 250 manufacturing locations worldwide and markets products in more than 150 countries. The organization employs about 110,000 people.

Emerson's rigorous use of its traditional budgeting system has enabled the organization to deliver consistent results while maintaining their best cost producer strategy. It demonstrates how a traditional budget can be used to plan, budget, and forecast and become a dynamic tool by which to operate the organization.

Emerson's success is due to the extreme discipline with which they follow their management process. It directly supports the types of mature businesses they operate, where cost leadership and dominant market position are keys to winning on a consistent basis. Management's execution is enhanced by the longevity of key officers who spend far greater time on planning, budgeting, and controlling processes than is typically found in most other organizations. In fact, Emerson's CEO spends two-thirds of his time in these areas.

Emerson's success is founded upon a corporate culture that fosters a strong sense of loyalty and trust within the organization. An even higher level of management integrity is embedded in the organization's planning process. Through their planning, budgeting, and forecasting program, Emerson has realized benefits such as empowerment, accountability, dynamic planning, and desired results. Another key benefit has been the depth of knowledge and understanding among and about the divisions that permeates the organization. This "braintrust" is a powerful tool that helps Emerson maintain its leading position in the global manufacturing business.

Emerson makes traditional planning, budgeting, and forecasting work. They do it with a focused discipline that few other companies have been able to achieve. The five-year strategic plan and profitability plan starts the budget. Everyone is involved in the process. Both the division implementers and the corporate executives vet the plan so that objectives are aligned and risks understood. These preliminary meetings are confrontational and often result in heated debates regarding what activities should and should not be undertaken by the organization. Managers are called to task and forced to justify their unit's performance against the competition. These sessions forge a plan that has both commitment and accountability. The linking of rewards to performance results in very few exceptions.

Emerson has experienced many benefits from their approach to planning, budgeting, and forecasting. First and foremost, the process is dynamic, not static like many traditional forms of budgeting. It takes into account the need for continuous planning by featuring a five-year back and five-year forward look. Even though the program is calendarized, monthly reviews and adjustments allow the system to be both action- and results-oriented.

The process also allows for maximum empowerment and buy-in by employees, since the people who do the planning are the people who execute the plan. Success at the division level is paramount; leaders and those who work with them clearly understand and support the goals at every level of the organization. Along with implementation, they also share accountability for performance and execution.

Using a best-cost producer strategy, Emerson follows guidelines of continuous cost reduction, open communication, high standards of quality, knowledge of competitors, a focused manufacturing strategy, and a commitment to use capital investments to drive improvement. Emerson also operates with a strong commitment to planning, effective controls, and follow-up. It is an action-oriented organization that has created an environment where people can and do make a difference.

Additionally, Emerson's process works because of its action-oriented approach. Management believes that while many organizations have sound strategy, they fall short on execution. Emerson, however, purposefully maintains a simple approach to management. Using a management style that reaches devolution in an unusual way, Emerson leaves key decisions to the front-line personnel. Those who plan are also charged with executing. This allows the organization to have an extremely high degree of interaction between corporate and the divisions. Yet, the front line is free to implement needed changes based on the voice of the customer and simultaneously ensure that ownership is instilled throughout the organization.

There are several reasons why the Emerson model works. The following reasons are among those most noteworthy and distinguish Emerson from its rivals.

1. Divisions have a high autonomy with strong division organizations. The corporate infrastructure is focused on supporting the divisions.
2. Planning at the divisional level is close to markets and customers. Divisional managers are responsible for both planning and implementing. There are no intermediaries.
3. Planning is geared toward quantitative measurement.
4. There is intimate involvement at all levels in the organization comparing performance to plan. The full divisional team attends review sessions. Everyone is involved in details.

5. There is a culture of discussion and dialog. It is confrontational by design, but the objective of rigorous review and discipline is understood. Respect and understanding allow this approach to achieve a devolution of power while sharing ownership of the plans.
6. Compensation is tied to performance against the plan, so there is rigorous attention to detail, helping to overcome much of the gaming relevant in traditional systems.
7. The Emerson system is not easily duplicated. It takes rigor and discipline to achieve and is the result of decades of diligent practice.

Bank of America

Bank of America is one of the nation's largest banks. It serves more than one in four households, has more than \$1 trillion in assets, and has more than 5,700 branches. The bank is headquartered in Charlotte, N.C., and its 177,000 employees handle more than 150 customer transactions per second. The bank also operates an ATM network exceeding 16,700 and was the first to operate from coast to coast.

Bank of America Corporation comprises four main divisions: Global Consumer and Small Business Banking, Global Wealth and Investment Management, Global Business and Financial Services, and Global Capital Markets and Investment Banking.

Bank of America leverages Hoshin Kanri philosophy, Six Sigma, and a fully integrated planning process to drive sustained long-term success. The organization uses a planning, budgeting, and forecasting (PB&F) process that achieves the following:

1. top-down strategic planning that permeates the organization down to day-to-day activities,
2. a fully integrated approach to planning and forecasting that fosters cross-communication and commitment from the corporate level to the front-line workers,
3. a PB&F process that produces well-defined goals and uses a Hoshin philosophy and Six Sigma approach to achieve strategic goals and eliminate waste, and
4. a rewards system that encourages employees to "take care of the customer and do the right thing."

The bank uses established performance management tools to accurately measure performance. Such measurements help the organization to accurately assess the employees' contribution to the overall achievement of success and reinforce the linkage between success and individual output.

Bank of America presents an innovative and refreshing approach to planning on a three-year cycle, which integrates Hoshin Kanri planning with Six Sigma efficiency. The bank's approach has been successful in the dynamic financial service industry, which places emphasis on stretch targets for growth and earnings as well as measuring performance with formal metrics. Bank of America strongly believes that its approach to planning is key to its success.

The top three management techniques that the bank attributes its success to are:

1. clear top-down direction and expectations,
2. coordinated approaches between business representatives and finance, and
3. an established and well-understood performance measurement tool.

Bank of America uses Six Sigma to support its strategic planning. Although commonly used in the manufacturing arena, Six Sigma has rarely been used successfully in a service organization setting. This approach uses DMAIC and drivers, facts, and data to eliminate waste and defects. DMAIC stands for define, measure, analyze, implement, and control. Bank of America looks at how it can reduce the defects, improve customer service, and provide higher quality to customers and associates, all in a way that increases value for its shareholders.

The bank has also adopted “Process Excellence,” specific performance measurement tools that help employees understand their customers and the tasks that are important to keeping their customers satisfied. Process Excellence is based on the Six Sigma approach and provides a mechanism for the organization to focus on planning, budgeting, and forecasting with an eye on customer satisfaction and shareholder value. By constantly working for specific performance targets, as refined under the Six Sigma approach, employees are given clear guidance on ways to achieve the corporate vision and know exactly what measures are going to be used to judge their actions. This formal measuring system has been attributed to the bank’s forecasting accuracy being consistently on target

The use of a Six Sigma-like approach allows Bank of America to evaluate core processes by establishing a measurement framework based on customer-driven criteria that are deemed critical to quality (CTQ). The bank’s CTQs are effective and timely communication of deliverables, minimization of forecast variance, and minimization of rework.

In 2005 Bank of America’s forecasting process was certified, which enabled it to standardize its communication procedures, improve forecast accuracy, establish measurement processes, and reduce re-work and other non-value added activities. This ability to track forecast accuracy has significantly improved Bank of America’s ability to predict changing financial conditions and has reduced the cycle time needed to respond to such changing conditions. It has also resulted in building confidence with Sr. Executives and helped them rely on the forecasting analysis with confidence.

Nestle Purina PetCare

Nestle Purina PetCare Company (hereinafter “Nestle Purina”) is the leader of the pet products industry. The organization not only leads the industry but also has developed a strong reputation for improving the lives of cats and dogs through quality nutrition and care. Nestle Purina was formed in 2001 when Friskies PetCare (owned by Swiss-based Nestle) and Ralston Purina merged. The organization is a wholly owned subsidiary of Nestle and has its headquarters in St. Louis. The organization is also the world’s largest pet food provider, operating 26 manufacturing facilities and marketing pet products in 75 countries around the world.

Nestle Purina’s planning, budgeting, and forecasting processes are anchored by use of a balanced scorecard called the Blueprint. This tool links the organization’s

strategy to its performance and execution. The Blueprint forms the basis for Nestle Purina's performance measurement and constantly reminds management which activities are vital to achieving success. The key areas of the scorecard are discussed below.

While the Blueprint serves as the anchor for Nestle Purina's performance management process, the drivers are the depth of understanding by all managers and how the organization gets close to their customers. The organization's customer knowledge extends to both the consumer who buys the pet food and the outlets that serve as middlemen and distribute the products to the consumers.

The Blueprint provides integration and collaboration across all functions. It converts key elements of the departmental process and strategic plans into actionable work plans that can be accomplished on a regular basis. These plans can be, and are, periodically adjusted for business volatility. The Blueprint is a tool for eliminating gaps, redundancies, and non-integrated departmental hurdles. It enables managers to take more timely corrective actions and it provides a common communication tool to better understand the linkage between strategy and action.

Nestle Purina works very hard to stay focused on consumer needs and desires through continuous, detailed customer analysis. After conducting extensive market research, management uses a planning/scorecard-type process to achieve and maintain an extremely efficient alignment of resources and an unwavering commitment to its consumers and distribution partners. This alignment and unwavering commitment helps keep Nestle Purina "best in class" in the pet food industry.

Nestle Purina also works extremely hard to integrate its finance organization into business operations. Finance members play a co-pilot role that embeds them in the organization's different businesses. This allows finance to better serve and support the financial needs of each operational unit.

The organization engages in weekly, monthly, and quarterly rolling forecasts. Weekly forecasts are done and are used as look-ahead schedules for front-line managers. These weekly forecasts are used to cover a six-week period allowing managers visibility and providing valuable lead times in ordering key equipment and supplies.

The monthly and quarterly forecasts cover an 18-month window. This allows management to see where the organization is headed. The quarterly forecasts are forwarded to the parent organization. They are extensively reviewed by upper management and generally are the subject of designated meetings. Purina's forecasting factors include historical data, cost of production, weather patterns, fixed overhead, and consumer demands. The review meetings are designed to foster a team environment allowing honest and frank discussions of deficient areas and enabling corrective action to take place.

The organization recognizes that it has four distinct groups of stakeholders: the consumer, the customer (stores where the pet food is sold to consumers), the employees, and shareholders. Fortunately for Nestle Purina, the organization has substantially exceeded industry standards for the last few years. This is due to its focus on setting strategic goals and action plans. These strategic goals and detailed action plans are clearly communicated throughout the organization's work force and distribution system. Most importantly, the organization consistently executes and achieves these plans.

Developing the annual Blueprint requires (1) a clear communication and understanding of Nestle Purina's goals, (2) making front-line workers think about and clearly understand how they are responsible for achieving these goals by hitting growth targets, and (3) establishing a formal monetary incentive for every employee based on how well the organization meets its goals

The organization has relatively low overhead and fixed manufacturing costs. Its major products are literally pulled off of the customers' shelves and automatically re-ordered. This results in a fairly predictable flow with low buffer stocks. As a result, the product characteristics makes forecasting sales a little less challenging than in other industries. This automated replenishment system posts orders electronically and helps eliminate human error. This system is also linked to the forecasting system and aids in the production of timely, accurate forecasts.

Nestle operates in a market with relatively fixed costs. The organization has focused strongly on keeping its overhead low. This allows Nestle Purina to rapidly grow profits by growing sales. Nestle Purina then uses its consumer and customer research to develop market knowledge that enables the organizations to produce sustained sales growth and set profit margins that most of its competitors can only dream about.

In terms of the strategic targets, the numbers given as expectations are negotiated as part of the overall process and generally exceed industry averages. This results in goals that include continuous gains in market share. Nestle Purina strongly believes that increasing sales is the key to sustained profitability and has repeatedly shown that, as an organization, it can successfully execute and validate this assumption.

Wachovia

Formed in 2001 when First Union bought venerable Wachovia and took the smaller firm's name, the organization is now the fourth-largest bank in the US behind Citigroup, J.P. Morgan Chase, and Bank of America. It has more than 3,200 locations that offer retail and corporate banking services in 16 eastern and southern states. Wachovia boasts prowess in wealth management (through subsidiary OFFITBANK), mutual funds (through Evergreen Investment Management), insurance, and corporate finance. The organization has arranged to buy Westcorp and the Asian business of UnionBanCal.

Wachovia Corporation is a diversified financial services organization that provides a broad range of banking, asset management, wealth management, and corporate and investment banking products and services. Wachovia is one of the largest providers of financial services in the United States, operating as Wachovia Bank in 15 states from Connecticut to Florida and west to Texas and serving retail brokerage clients under the name Wachovia Securities nationwide as well as in five Latin American countries. The corporation also serves investment banking clients in selected industries nationwide, and provides global services through 40 offices around the world.

- Assets: \$521 billion
- Average deposits: \$320 billion
- Stockholders' equity: \$48 billion

- Ranking: Fourth-largest bank holding organization in the United States based on assets.
- Third-largest U.S. full-service brokerage firm based on client assets.
- Financial Services: Full financial services through offices in 15 states—Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Tennessee, Mississippi, Texas—plus Washington, D.C. Full-service retail brokerage with offices in 49 states through Wachovia Securities LLC. Provides investment banking products and services in selected industries nationwide and global services through 40 international offices.
- Customers: 13 million households and businesses; 10.5 million online product and service enrollments; 3.2 million active online customers.
- Employees: 94,000

Financial Centers: Personal service and advice through 3,131 financial centers and 719 retail brokerage offices. These staffs include nearly 10,500 registered representatives.

ATMs: Convenient access to 5,119 automated teller machines

Wachovia has chosen to manage by rolling forecasts rather than traditional budgeting. The planning process consists of a three-year forecast concentrated on the next six months with single multi-year planning processes. The forecast is updated monthly. The organization uses a dynamic planning process that eliminates separate planning processes for each banking unit and traditional budgeting.

Wachovia has realized tremendous efficiency and time savings as a result of managing by forecasts instead of budgets. Where a Wachovia division uses two analysts for forecasting, many comparable organizations will use anywhere from 10 to 40 analysts to perform the same role. While Wachovia did downsize the organization somewhat, they were able to deploy other resources to decision support and driving business performance roles, giving finance a more strategic role in Wachovia's success.

Wachovia's approach frees up valuable human resources and time that was spent on budgeting and instead focuses them on active planning and consulting. This, in turn, has resulted in Wachovia experiencing historical and incremental growth. Forecasting over a long-term period; setting dynamic targets that can be adjusted as market, business, and economic conditions change; and measuring performance relative to current and prior-year results has enabled Wachovia to achieve its objectives.

Wachovia's forecasting strategy has been successful due to several factors. First, its leadership's willingness to experiment and provide a supportive environment enabled Wachovia to take steps necessary for implementing a fundamental change in its approach to financial planning. Second, Wachovia's creative team used effective principles to make the transition to (and create buy-in for) a radical shift in the management of the business. The approach did more than shift the how they do banking; it changed the organization's mindset.

KEY LESSONS FROM BEST-PRACTICE PARTNERS

Each of the best-practice partner organizations was selected because they exhibited outstanding performance in planning, budgeting, and forecasting while leveraging different approaches. Our study deliberately sought these differences to examine what could be learned from these different approaches. Their individual cases highlight their unique aspects. We were able to identify key lessons to consider in evaluating planning, budgeting, and forecasting processes even though the ways these processes are achieved may vary from organization to organization.

ORGANIZATIONAL CULTURE

Your planning, budgeting, and forecasting processes (PBF) must fit with your organizational culture.

While the practices at each of our partner companies differed, they each utilized processes that supported the organizational culture driven by management. In many ways these processes were a dominant element driving that culture.

Emerson Electric utilizes very a detailed approach to planning and control. Each of their more than 60 divisions complete the same standardized planning package. This planning package has more than 300 schedules emphasizing a culture of attention to detail. Many of the schedules have the same format of an 11-year view point (five-year look back, the current year, and a five-year look forward). This detail enables senior management to help coach the organization. They participate in a strenuous annual review process designed to test the planning assumptions and rigor of analysis. It provides the means by which Emerson achieves its “best producer cost” strategy.

Nestle Purina Pet Care has built a culture of serving the needs of pets and pet owners. Its approach to planning through the use of the balanced scorecard allows them to integrate their key strategic themes into their PBF processes. This approach is highly customizable to reinforce culture.

Bank of America has shifted their planning process to adopt a Hoshin Kanri approach that supports its three year effort to convert to Lean Six Sigma. The shift to this approach was viewed as a necessary step in the continued development of the firm’s shift to Six Sigma management and to a firm that manages based on facts. The planning process now helps drive this continued development.

While also in the banking industry, **Wachovia’s** General Bank (its retail banking unit) has been able to operate even leaner and became more adaptable by eliminating detail budgets. They use considerably fewer resources but have been able to continue to achieve outstanding results. They operate on a simple philosophy to “deliver good service and increase customer satisfaction and the rest will follow.” Their key seems to be how they can simultaneously empower their front lines to act while challenging them to exceed analysts’ expectations and competitors’ performance. This has helped reinforce their culture as a nimble innovator.

While each of these organizations has built an outstanding organization, their approaches are very different. The key point is to develop an approach that supports your culture and is designed to reach you key objectives. This point is further illustrated by Andrew Campbell in the *Harvard Business Review* article “Tailored, Not Benchmarked: A Fresh Look at Corporate Planning” from March-April

1999. Campbell compares the planning processes at Emerson Electric, Granada, and Dow Chemical concluding that while each organization's system works well for them, moving one to the other would most likely destroy value due to cultural differences.

STRATEGY DEPLOYMENT

Comprehensive PBF processes provide excellent methods to effectively convert strategy into action.

The prime reason for planning is to define what actions will be taken to reach your strategic objectives. The partner companies illustrate a variety of ways of achieving this through deployment of strategy.

Nestle Purina Pet Care's use of the balanced scorecard provides explicit linkage of strategy to action plans focusing on the customer (both pet and pet owner). It is developed using an integrated team of managers to develop the five-year plan called the "Market Business Strategy" or MBS. This contains the organization's vision and policy-like pillars to address different stakeholder groups. The management team then develops action plans (called the "Blueprint") of how the work force will implement and achieve the strategic goals set out in the MBS. Use of the Blueprint and the balanced scorecard helps Nestle Purina set and reach high performance goals. Their strategic differentiation enables higher margins by emphasizing the beneficial aspects of their products. The balanced scorecard focuses management on understanding their customer and what needs to be done to successfully reach them. This approach has a high degree of flexibility in modifying the key areas of emphasis as the environment changes.

Three years ago **Bank of America** was forced to change strategies. Having been built through acquisition, the organization's share of total U.S. bank deposits was approaching the 10 percent limit imposed by bank regulators. As a result, they shifted their strategy from being a serial acquirer to becoming a more efficient operator of the business they owned. This was done by implementing Six Sigma techniques throughout the bank. As this implementation occurred, it was extended into the planning processes where Hoshin Kanri planning was adopted to align resources and incorporate financial concerns, people, and risk planning into one framework. They also utilized their Six Sigma process excellence techniques to improve forecasting. These changes were necessary to reinforce their overall management approach.

Wachovia's General Banking Unit was given the freedom to experiment with alternatives to traditional budgeting. They responded by consolidating several units, decreasing overhead staff, converting finance into a key driver of the business, and giving managers the freedom to act to reach growth targets. This enables their strategy of responding to customers. Its approach is to keep front-line managers focused on key metrics and enable them to rapidly respond to opportunities and threats. Their planning process is "light touch," which enables them to rapidly respond to consumer demands. It also makes them very low cost in the planning area.

Emerson's strategy is to have the best producer costs. Their planning practices provide rigorous analysis to reach that goal. The continued focus on cost improvement across multiple divisions helps Emerson to share ideas, which allows

divisions to leverage the cost reduction ideas of the group as a whole. They also use planning councils to develop strategies that benefit multiple divisions. It creates a very powerful system for an organization that thrives in mature products where Emerson's divisions are positioned as a dominant player (either number one or two in each industry), and low cost is the prevalent strategy for winning,

EARNING GUIDANCE

Care should be taken in regard to providing earnings guidance.

One argument for the annual budgeting process is to provide support for earning guidance to public stock markets. While this practice is optional, the majority of publicly held organizations do provide earnings guidance. However, providing earnings guidance in today's financial environment can be much riskier due to the requirements of Sarbanes-Oxley and the related regulatory climate.

The recent trends are toward providing less guidance. Many organizations (such as Coca-Cola and Berkshire Hathaway) have stopped providing guidance. Some have taken a similar step by providing a range of earnings guidance instead of point estimates. Others offer only an annual estimate or the upcoming quarter but not both. The key question is whether senior management should provide an earning prediction in today's highly unpredictable world. Many people do not think so.

While earnings guidance was not a prominent part of any of our partner organizations, it was very interesting to see how it influenced their decision making. All sought to grow faster than their underlying markets.

At **Bank of America** and **Nestle Purina PetCare**, plans are driven by publicly announced revenue growth goals. Bank of America seeks revenue growth of 7 percent to 9 percent and earnings per share growth of 10 percent annually. Nestle Purina has an overriding goal of beating the competition by a certain percentage. These overarching factors drive their planning.

Wachovia monitors the comments and predictions of investment analysts noting their composite estimates. They then use these expectations as a way to motivate their business units to reach for stretch targets, using the targets to motivate their units to beat the market's expectations.

Until 2001 **Emerson Electric** had maintained a continuous streak of growing revenues and profits for 41 years. In the late 1990s Emerson moved into the telecom sector to achieve higher growth rates. When this sector collapsed in the first half of 2001, senior management made the courageous decision to announce the end of the earning streak rather than try to extend it through hasty asset sales. The senior management team at Emerson Electric continued to focus on the best interests of their shareholders.

Walt Galvin CFO of Emerson Electric did provide one strong reason for providing earnings guidance: He noted that "if you are a small publicly traded company, providing earnings guidance can help you maintain coverage of your stock by investment analysts." This broader exposure helps attract more buyers for your stock and interest from investment banks. This additional exposure can potentially save 100 basis points or more in your cost of capital.

TARGETS

Relative targets can be used to overcome the dangers of fixed targets, which can sub-optimize performance and lead to ethical challenges.

While targets can be powerful tools, you need to be careful in how you use them. Quality guru W. Edwards Deming cautioned that setting fixed targets or quotas may appear to inspire people to reach those targets even when doing so destroys their organization. His point is that fixed targets establish fear that causes workers to tamper with the production system rather than understand and improve it. Eliminating this fear is critical to understanding what the system is capable of producing and to optimizing and improving the system.

Jack Welch has similar criticisms of traditional budgeting calling it “an enervating exercise in minimization.” In his latest book *Winning*, he states:

The budgeting process at most companies has to be the most ineffective practice in management.

It sucks the energy, time, fun, and big dreams out of an organization. It hides opportunity and stunts growth. It brings out the most unproductive behaviors in an organization, from sandbagging to settling for mediocrity.

In fact, when companies win, in most cases it is despite their budgets, not because of them.¹

These problems can be overcome by eliminating fixed targets or by use of relative targets. As noted above, **Wachovia** merely uses investment analysts’ estimates as a guide to what the market expects of them. This creates a natural stretch goal that can not be manipulated by manager negotiation. Wachovia focuses its expectations on doing better than it has historically and in beating the competition. They compare themselves to five or six peer companies to see how they are doing globally. Internally the organization separates its 35 geographical markets into three market segments (metro, secondary, and community rural). The individual market teams strive to be number one in their segment.

Emerson Electric has overall corporate growth targets that provide guidelines for the individual business units. These units are managed in a continuous process of reviews and monitoring steps. This has led to a history of steady single-digit growth, profitability, and strong cash flow.

Nestle Purina seeks to lead its market by beating the competition by a certain percentage. It then integrates retailers’ growth and profit targets into their targets because it has an overriding belief that growth in sales achieves increased profits. All targets are set in conjunction with retailer goals. These are measured against the MBS and are linked to financial incentives for employees. Once targets are set, they are not changed.

Bank of America uses its risk and capital committee to establish targets. Using front-line managers for input regarding historical perspectives and customer desires, the committee molds upper management’s strategic plans into specific

¹ Welch, Jack. *Winning*. Harper Business, 2005.

business plans for each unit. This allows the bank to use stretch goals and targets in developing performance expectations. It also allows the employees, at every level, to develop formal action plans for their department.

INCENTIVES

Incentives should be aligned toward reaching optimal performance rather than negotiated targets.

One common complaint of the traditional budgeting process is that it results in negotiated targets that provide incentives to minimize goals to make it easier to reach incentive bonuses. This creates tension throughout the organization with lower levels trying to minimize expectations and hide cushions. This is the complete opposite of the transparency that recent financial management reforms (such as Sarbanes-Oxley) seek to achieve. The gaming and other ethical problems caused by linking incentive compensation to fixed targets is perhaps the most damaging issue with traditional budgeting practices.

To avoid this problem, organizations should decouple incentives from the budgeting process. Instead, rewards should be based on the value created with a focus on optimizing performance.

Wachovia bases rewards on performance results, which are compared to historical performance and the competition. This shift dramatically changed the culture. Managers have the freedom and capability to act to keep reaching higher. They focus on reaching strategic objectives rather than a fixed number. They focus on getting better and on beating the competition.

In contrast, **Emerson Electric** uses a traditional budget approach. However, they are unique and demonstrate what is required to overcome the problem of negotiated targets. The sheer discipline and rigor of Emerson's budgeting process provides an extensive view of what performance is possible. Key factors include the following.

- Utilizing more than 300 detailed planning schedules with an 11-year view of the past and the expected future
- Each business sector contains multiple business units, which provides senior management with multiple opinions of business conditions.
- Use of a deeply experienced top-management team (only three CEOs in the last 45 years) to review plans
- Senior management spends two-thirds of their time on planning, forecasting, and control activities.
- Structurally, Emerson operates mature businesses where they are number one or two in their industry.

These factors eliminate almost all of the negotiation from Emerson's incentives. Senior management has the deep knowledge necessary to set appropriate targets.

Bank of America takes a similar detailed approach basing incentives on achieving fact-based actual performance outcomes in comparison to hard targets. Management is rewarded on a strict pay-for-performance basis which formally awards monetary rewards based on the degree of risk involved as well as the degree to which actual performance met, exceeded, or failed to meet expectations.

Nestle Purina collectively rewards employs for achieving growth targets based on how well the organization performs. These are on an across the board basis.

ACTION PLANNING

Effective PBF processes provide ways to continuously update action plans to adapt to changing conditions.

Action plans are used to bridge the gulf between the strategic objectives with their desired performance targets and the current state of the business. These plans tell employees what must be achieved and by when. These plans are more effective when they can be continuously updated to adapt the changing business conditions.

Nestle Purina uses its Blueprint to align all action plans in support of the five-year business plan. They continually survey customers and consumers to identify emerging trends and to evaluate performance. Consumer wants and desires are used to identify opportunities and risks.

Bank of America develops specific business plans for each unit. This process begins with the overall strategic goals of corporate management. Although the board of directors and the CEO determine the ultimate strategy objectives, they receive input from virtually every level of the organization.

Bank of America uses a Hoshin Kanri process to develop specific action plans for achieving its strategic objectives in the daily a management of bank operations. The Hoshin side of the process consists of setting the organization's direction and aligning resources. Whereas, the Kanri side provides for measuring performance and achieving desired performance. This Hoshin Kanri process results in a natural alignment of resources that the bank has cited as a key to its success.

Wachovia's action planning is focused on achieving the "five-way double." This is the organization's shorthand for saying they want to achieve double-digit growth in checking accounts, core deposits, loans, revenue, and controllable operating earnings. While these measures provide a common benchmark, each of the business units are given autonomy in reaching their five-year strategic objectives.

Emerson Electric's action plans are defined very far in advance. The structure of their planning documents identifies their required improvements five years into the future. It specifies current-year actions. The monthly president's operating report (POR) analyzes results and requires a walk forward of changes from the prior period expectations. The consolidated PORs show the overall direction. If shortfalls are identified, management looks to the planned future improvements to see which can be pulled forward.

RESOURCE AVAILABILITY

Flexibility can be maintained by making resources available as required as opposed to a fixed annual process.

Many organizations use the budgeting process to authorize a defined level of resources. The problem with this approach is that it requires assumptions about what levels of output are required. When actual demand is less, it results in underutilized resources. When actual demand is more, it requires additional costs or deteriorates service levels.

The initial reaction is to try to improve forecasting. While some techniques will yield closer results, the fact is that today's business environment is rapidly changing in ways that are very difficult to predict. This is particularly true when operating on an annual cycle. The underlying question: Should you build a management system based on the need to predict the future? As an alternative, we find organizations maintaining flexibility by making resources available as required.

Wachovia's budgetless process maintains maximum flexibility. Plans can constantly be changed to adapt to changing business conditions. Control is maintained by comparisons such as expense ratio analysis, relationship to prior periods, and benchmarks against peers and competitors.

Bank of America uses its Hoshin Kanri process to provide a logical allocation of resources based on the corporate vision and strategic goals that have been set. They then use a Six Sigma process to work on elimination of waste and to ensure that the proper resources are being used to achieve customer satisfaction.

Nestle Purina uses Lean approaches to remain adaptive. The customers literally pull the key products off the shelf. These are automatically reordered. Its production plants are geared to continuously replenish these products. Merchandising calendars are used to coordinate promotion and production plans.

Emerson Electric's businesses are typically more stable and predictable. This allows them to establish firm plans that can be adjusted for demand fluctuations. Emerson's environment is one of incremental change.

MEASURE TO OBTAIN FACTS AND UNDERSTAND DRIVERS

Leading organizations use their performance measurement systems to understand facts and understand cause-and-effect relationships.

A striking commonality in each organization examined was the degree to which their performance management systems emphasized measuring data to establish facts and how those measurements were used to identify cause-and-effect relationships. In effect, these systems sought to validate that their action plans were being achieved and that those achievements were progressing to the realization of the organization's strategy.

Bank of America has integrated Six Sigma into its processes. Previously, they viewed measurement as the "missing piece" to achieving success. Their approach has five steps—design, measure, analyze, produce, and control (DMAIC). It focuses on using fact-based measures to reduce waste and inefficiencies. In addition to the constant measurement of performance, they also continuously survey customer and employee satisfaction.

Emerson's detailed planning schedules provide evidence of their measurement culture. In addition to annual reviews and monthly president's operating reports, the business units participate in divisional planning conferences, divisional profit reviews, organizational reviews of personnel, quarterly presidents' councils, and the corporate planning conference. The 11-year schedules provide detail measure of most significant items.

Nestle Purina utilizes segmentation studies to focus in on the key consumers. They use special sales and marketing teams with emphasis on making their top customers happy. Targets and actual achievement is tracked for organic growth,

real internal growth, earnings before interest, taxes, amortization and royalties, and working capital.

Wachovia focuses measurement on the five-way double. This helps individual units clarify how they are doing based on their ranking within their segment. It also key areas for improvement.

ROLLING FORECASTS

Use a continuous rolling forecast to provide forward visibility and coordination instead of merely forecasting to the end of the fiscal period.

Many organizations claim to forecast but they are often unclear about the purpose of the forecast. It is typically assumed that the forecast is to provide visibility of expected future activity, which can then be used to coordinate actions and revise plans. In actual practice, this exercise has been an interim performance evaluation with the objective of merely validating that the original targets will still be achieved. When this happens, forecasting is often an obtuse exercise in sandbagging and shading the truth.

A related problem with forecasts is organizations that only forecast to period end. This approach is called “forecasting to the wall.” This approach is only concerned with the period end numbers (as if a wall stopped the organization at period end). It likewise results in sandbagging and shading the truth.

Organizations can overcome these problems by moving to a continuous rolling forecast to provide visibility and coordination. This approach is characterized by a consistent look-forward period and avoiding the constant questioning of period end numbers by senior management. The objectives must be visibility and coordination and be separated from performance evaluation. This separation is necessary to make sure forecasts provide the best estimates of likely outcomes (Performance evaluations should be reserved to the actual results delivered).

Wachovia maintains a three-year forecast with primary emphasis on the next six months. They use dedicated two person teams to determine and analyze projections for each division. They look at key factors such as checking account acquisitions, deposit growth, loan growth, and the impacts on revenue and earnings. These forecasts provide guidance for daily operations. These forecasts allow the Bank to more quickly respond to competitive threats and to seize opportunities for growth.

Emerson’s president’s operating reports continuously update their forecasts. They require detailed explanations of changes in key items using a walk forward approach. Emerson takes a long-term view by constantly looking at the rest of the current year plus the next five years.

Nestle Purina uses weekly forecasts at the department level that serve as look-ahead schedules for front-line managers. Monthly forecasts are formally made to update the parent organization. Quarterly forecasts are extensively reviewed by upper management. These meetings are used for frank discussions of what corrective actions need to be taken for weak performing areas.

Bank of America used process excellence to improve forecast accuracy by standardizing communications, establishing accurate measurement frameworks for rework and other non-value added activities, and reducing rework. These changes

dramatically improved Bank of America's ability to predict changing financial conditions and reduced response time to those changes. They now consider forecasting accuracy as one of their greatest strengths and measure it monthly using eight key measures.

COMMUNICATION

Leading organizations remain coordinated by extensive communication using multiple methods.

The ultimate objective of planning, budgeting, and forecasting processes is to help managers guide and direct their organizations. This requires effective communication of desired directions and progress. All of the partner organizations exhibited outstanding communication techniques.

The most developed system of communication was found at **Emerson Electric**. This results from years of following the same process. The planning schedules have become so ingrained that managers often talk in terms of schedule numbers (and they all know exact what is on each key schedule). While these schedules still slowly evolve, they represent hundreds of man-years of institutional knowledge that is tightly embedded as the fabric of the management system.

In addition to the planning schedules, Emerson has several recurring meetings that bring management together. These face-to-face meetings provide an excellent source of interaction and dialogue. While Emerson's culture can be confrontational, they have established a system wherein strong managers are expected to challenge and debate each other. This rigor pushes them forward.

Nestle Purina shows us some newer ways to reach similar objectives through the use of the balanced scorecard. Their two key planning documents are the Market Business Strategy (which is their five-year strategic plan) and their Blueprint. The development of these documents forces employees to clearly understand and verbalize the organization's strategic objectives. Organizations with balanced scorecards can use this tool to clearly communicate strategy to lower levels of the organization.

Communication implies a two-way flow of information. Nestle Purina establishes this through extensive surveys of its customers and employees. Links with the extended value chain are established by ongoing communication of common sales, profit, and growth targets.

Bank of America publishes a corporate vision statement with strategic objectives for everyone to see. Various levels of management negotiate action plans. Quarterly performance reviews are used to make sure everyone knows their performance targets and related incentive programs. This process reminds everyone of their role and importance in achieving organizational success.

Wachovia communicates with dialogue instead of fixed targets. They track forecasts and actual results in comparison to prior periods, peer performance and competitors. Finance personnel work closely as part of their operational teams, in effect, creating communication by embedding themselves in operations.

Additional Materials for Further Study

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