CORPORATE AND FINANCIAL PLANNING

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ABSTRACT: *It has become fashionable to attack formal planning as a source of competitive ills. Many managers and authors are vocal in criticising companies and public organisations for adhering to excessively rational planning systems that are time-consuming, divorced from reality and, worst of all, conducive to a dangerous short-term financial orientation in management.*

Yet for all this criticism, most organisations continue to practice and value a co-ordinated planning approach. Rather planning systems often break down because of faulty preparation and implementation and are non-committal of management. These problems can be overcome by involving line managers in the planning process, defining business units correctly, outlining action plans in detail and integrating the strategic plan with organisational controls.

1. INTRODUCTION

Planning is a word familiar to all of you here, and I suspect that there are many different impressions and meanings as to exactly what planning is. So I will not try to impose one of my definitions on you, but I do believe that we all could agree that planning deals with the future. By the future, I mean not only future decisions, but future implications of past and present decisions, irrespective of whether we are in Government or in private enterprise. When we think about what is going to happen in the future, we have to project the future consequences of present thinking. Something like a present value analysis in order to convert possible future events to a decision that must be made now.

Planning in itself does not necessarily ensure success, nor does lack of planning automatically mean failure, but what it does do, is ensures that the events associated with planning are more closely associated with predictability and probability. Many companies and Government organisations operate without a clearly defined plan and many of them do quite well, but it is becoming more and more difficult to run a business without a plan, because the cost of being wrong is becoming prohibitive. Planning, therefore, increases the probability of success. As I stated, it will not ensure success, but it will improve the odds.

Planning forces one to take a step back and look at the forest, instead of the trees. Most line managers are so immersed in the day to day operations of fire-fighting, the crises of the moment and the urgency of making this month's sales, profit, plans, deficits, whatever the case may be, that they don't conscientiously and systematically take a look at the bigger picture.

- Where have we been?
- Where are we?
- Where are we going?

Planning is the process which enables managers to control the future by anticipating it and managing change.

It provides a reference point for managers at all levels to make sure that their departmental plans and operations are in synchronisation with the rest of the company. Finally, a written plan provides a measurement and control tool, which should be updated periodically so that it becomes a dynamic working document, with flexibility built in to be responsive to change.

We've all heard of the sayings from the frying pan into the fire, let sleeping dogs lie, and you can't teach an old dog new tricks

These are all sayings born out of the fear of change. When people are threatened with change in organisations, similar maxims about certain people and departments are trotted out to prevent an alteration in the status quo. Fear of change is understandable, but because the environment changes rapidly, and it has been doing so increasingly, organisations cannot afford not to change.

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PROFIT FROM THE NEW."

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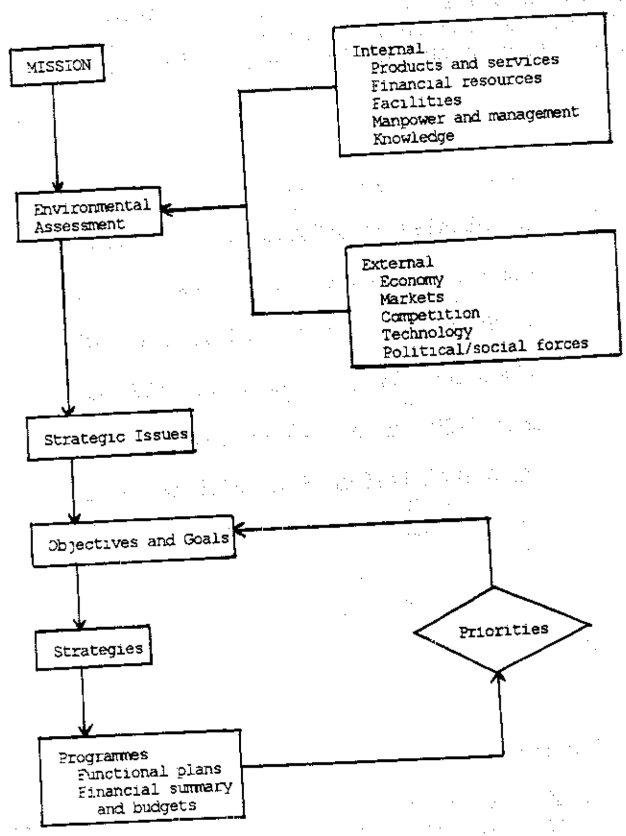
PLANNING PROCESS

I will now give a rather brief outline of the complete planning process. The planning process begins with the mission of the organisation, the overall purpose. This is in the form of a charter or statement of business and should be set by the executives of the organisation as it provides the broad direction.

THE PLANNING PROCESS



2.1 Mission

In the Department of Transport, for instance, our mission statement could be "to develop the most innovative, cost-effective and beneficial transport system of any Australian State by the turn of the century."

The mission statement, therefore, defines the boundary conditions within which the organisation will do business.

2.2 SWOT

The next phase of the planning process is the environmental assessment, also known as a SWOT analysis. Strengths, Weaknesses, Opportunities, Threats. This assessment can be conveniently divided into two major sections, the internal environment and the external environment. An internal analysis would include products and services, financial resources, facilities, manpower and management, and knowledge, which can more or less be controlled by management. The complete analysis of the internal environment will yield a summary of the organisation's strengths, competitive advantages, weaknesses, or its competitive handicaps.

The external environment comprises those elements outside of the organisation's control that affect industry, market demand and supply. Important elements include markets, competition, technology, and political and social forces. These will all have a significant effect on the demand for the organisation's products.

Any comparison of the external environment with the internal environment inevitably reveals an area of tension or lack of congruence, i.e. the requirements of the environment are not matched by the resources of the organisation and requires response from the entire organisation, especially in the setting of objectives, goals and strategy.

2.3 Objectives and Goals

Objectives and goals describe where the organisation is going. In any organisation we may find a hierarchy of objectives and goals, ranging from the abstract to the concrete and specific. For instance:

- increase earnings per share (objective);
- increase earnings per share to $4 by 1990 (goal).

Generally it is preferable to define objectives as the broad, general and enduring statements of purpose which the organisation wishes to reach, in contrast to goals which are more specific. For instance, a broad objective within the Department of Transport could be "to ensure that transport systems meet community and business needs at acceptable cost", or "to ensure that transport enhances the State's economic performance nationally and internationally".

2.3.1 Goals

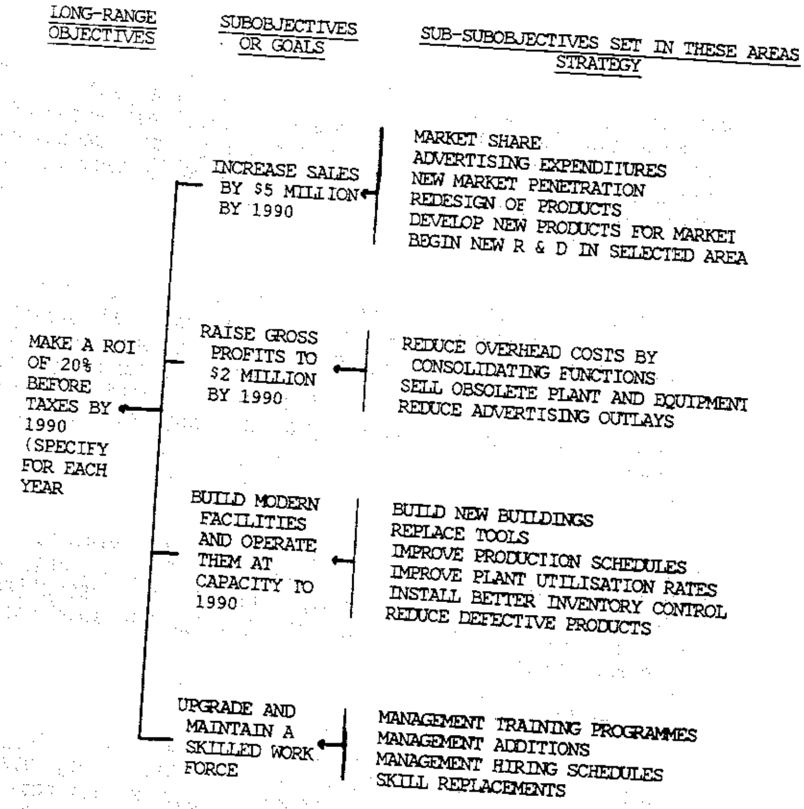
The goal then represents a measurable result to be achieved at a specific time. An organisation's goals lay the groundwork for the organisation's strategies. Goals must strike a balance between what the organisation would like to do and what it is capable of doing, given its resources and the realities under which it operates. To be useful in planning, goals must be significant, they must have a real impact on the success of the organisation's mission.

Goals must be set high enough so that your people have to work hard to achieve them. Easy goals do not always bring out the best in an organisation.

Goals must be specific and measurable. A successful goal for planning might be something such as "to achieve a 17 per cent penetration of the minicomputer market by the end of 1989".

All goals must be time related. Getting 17 per cent of the market is a fine goal, but it may not be of much significance if it is going to take you thirty years to do it.

Goals must be consistent. Expansion into a new market may require large investments that would make it impossible to reach a goal of increased profits at the same time. If they are not in line with your goals or targets, then you may have to change your plans in order to reach the required goal, or perhaps, even change the goal to reflect the realities of the situation.



LINKING OBJECTIVES

3. STRATEGY DEVELOPMENT

Strategy describes how the organisation intends to achieve its objectives. This is a critical step in planning, for selection of strategies will also dictate how resources are to be allocated. Strategy formulation also offers the greatest opportunity for creativity.

3.1 Marketing

Marketing strategies are designed to guide planning in getting products or services to reach customers and getting customers to buy.

3.2 Growth

Growth strategies give direction to such questions as "how much growth?" Where? How will it be financed? Every business and, for that matter, every non-business enterprise must have a clear strategy for financing its operations. There are various ways of doing this and usually many serious limitations. I will discuss this later.

3.3 Organisational

This kind of strategy has to do with the type of organisational pattern. It answers such practical questions as how centralised or decentralised should decision-making authorities be, what kind of departmental patterns are most suitable, whether to develop integrated profit response divisions, what kind of matrix organisational structures and so forth.

3.4 Personnel

Major strategies in the area of human resources and relationships may be of a wide variety. They'll deal with union relations, compensation, selection, recruitment, training and appraisal, as well as strategy for such matters as job enrichment.

3.5 Public Relations

Strategies in this area can hardly be independent, but must support other major strategies and efforts. They must be designed in the light of the company's type of business, its closeness to the public, its assessibility to regulation by Government agencies and other factors.

3.6 Information Technology

Strategies in this area depend on the whole thrust of the management information system. What hardware/software do we require? Can it be done in-house? What will the cost be to go through a bureau, and so forth. All these are questions which must be dealt with before an effective information technology strategy can be developed. Information technology is dependent on all of the other strategies as it will be instrumental in developing data bases, forecasts and so forth.

One of the most important requirements of effective strategic planning is to make sure that strategies are consistent, that they fit each other.

It is also important to recognise that because every strategy must operate in the future, and because the future is always subject to uncertainty, the need for contingency strategies cannot be overlooked. Contingent strategy should be based on a different set of premises. These "what if" kinds of strategies can be put into effect quickly to avoid much of the crisis management that is seen so often.

A strategic planning system cannot achieve its full potential until it is integrated with other control systems, such as budgets, information systems and human resource systems.

4. THE LIMITS OF PLANNING

It would be naive of me to state that planning is the panacea for all business organisations. It's not, as there are a number of limits to planning. The first and most obvious limitation is inherent in the forecasting process. There is little to be gained from establishing an extensive framework of premises, plans and policies, based on forecasts that have little likelihood of coming true or staying true for any extended period of time. Contingency planning may overcome a number of these problems. Similarly, change may be so rapid that even correct forecasts do not stay true long enough to give the plans based on them a chance to operate at more than marginal levels of effectiveness.

Planning is further limited in its effectiveness by the degree of implementation. For planning to be of real value, planning and implementation must operate in close parallel, "hand in glove". However, it may not be possible to mobilise time, financial resources and human resources in the right combination to plan with maximum effectiveness.

4.1 Pitfalls to avoid

There are a number of reasons why planning systems may be ineffective. The ten most common pitfalls are:

1. Top management assumes that it can delegate planning to a planning specialist and thus does not need to be directly involved.

2. Top management becomes so engrossed in current operating problems that it devotes insufficient time to planning. As a result it becomes discredited at lower levels.

3. There is a failure to develop and specify organisational goals that are suitable as a basis for formulating long range plans.

4. There is a failure to create a positive value towards planning and thus a congenial climate for it.

5. Top management fails to review with departmental and division heads the long range plans they have developed.

6. There is a failure to assure needed involvement of major line management in the planning process.

7. An assumption develops that corporate comprehensive planning is somehow separate and distinct from all other aspects of the management process.

8. Top management and major line managers really do not understand the nature of long range planning and what it can accomplish.

9. The corporate planning specialist does not report at a high enough level in the management hierarchy.

10. Plans are not actually used as standards in measuring and evaluating managerial performance.

In summary it does not receive management commitment.

5. FINANCIAL PLANNING

Given the broad explanation of corporate planning, what then is financial planning. Financial planning is concerned with seeking improvement in the business within the financial objective. This has three aspects:

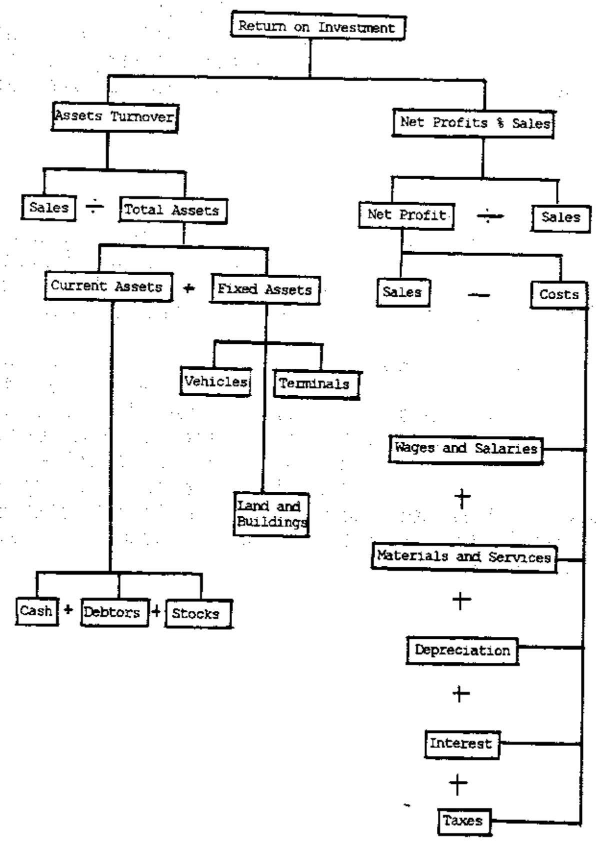
1. Long term - demand, availability of capital, government policy and controls, etc.

2. Short term - current gearing, structure, return on investment, share yields, labour, material availability, etc.

3. Seasonal - recurring trends, sales in rural areas, etc.

Financial planning is an element of corporate planning. Generally, many organisations pursue financial objectives only and their financial planning is therefore their entire corporate plan. This is probably the most important area of confusion. The corporate plan must be concerned with non-financial as well as financial objectives and is thus broader in outlook than the financial plan. Indeed, in many organisations the main purpose of planning is the achievement of a financial outcome.

FINANCIAL PLANNING



5.1 Trade-offs in Financial Planning

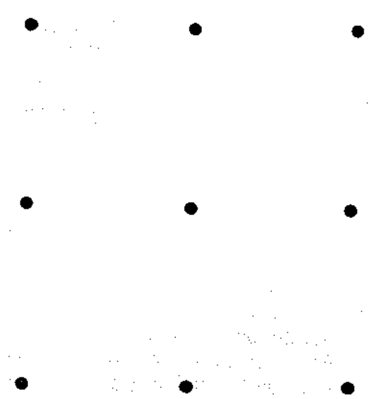
Setting financial objectives, or objectives generally, is not a simple matter of determining one's wishes and announcing them because numerous factors must be taken into consideration. An increase in market share may require an expansion of plant and equipment. Every organisation of course has other uses for capital, so this expansion would have to be made at the expense of something else. An increase in research and development to get a new product on the market may reduce current profits, but enhance long range profits, so there may be a reduction of dividends today with a likelihood of higher dividends in the future and so on.

These illustrations make it clear that it is more than likely that most important financial objectives set by an organisation will necessitate trade-off analysis in which top management and lower level management will be involved. Objectives are finally set after trying different combinations and permutations of objectives, strategies and tactical plans.

5.2 Forecasting

In a financial planning sense forecasting means the prediction of future financial results in a form suitable for decision-making. This will generally include forecasting profit and loss, cash flows, products, balance sheets, plus a number of financial and operational performance measures.

Given a number of possible scenarios, the purpose of forecasting is clear. It is to unravel some of the complexity that surrounds each business decision so that data available becomes pertinent information to the situation being studied. Forecasting then can be described as an attempt to create a bridge that links data. The importance of forecasting does not necessarily lie in its statistical accuracy, but in its contribution to the managerial decision and learning process.



THE NINE DOT PROBLEM

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In preparation of financial plans any planner must ask himself the following questions:

1. Does the organisation regularly collect and analyse information about population, price level, labour and other important trends affecting the general future of the business.

2. If it does, are such analyses reported to management in a manner that permits utilisation in the planning process.

3. Does the organisation regularly collect and analyse significant information about competitors.

4. Is this information effectively used in the planning process.

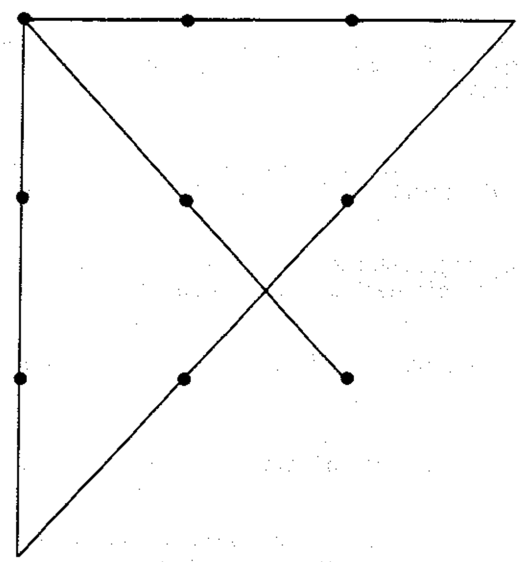
5. How good is the internal data for planning purposes.

6. Does the organisation know what products and in what geographic areas profits are being made.

7. Does the organisation know how costs behave in response to volume changes.

8. Are the factors that condition success in the organisation explicitly stated and widely communicated within the management group.

9. Has the company's organisational structure remained unchanged say, over the last fifteen to twenty years.



A SOLUTION TO THE NINE DOT PROBLEM

Within the Department of Transport we have developed a number of financial models which are used in the evaluation of capital expenditure proposals and to test a number of sensitivities such as inflation, cost of capital, depreciation, wages, cost of energy, effect on profit and loss, capital efficiency and so forth.

The thrust of the Government in Western Australia is that trading organisations such as port authorities will be required to earn a certain return on investment, and as a consequence make a dividend payment to the Government.

Again, financial models utilised by the Department of Transport allow this exercise to be undertaken with ease and flexibility. Determination of a rate of return on investment has only recently been accepted in Western Australia but has not yet been implemented due to a number of complexities which require consideration.

5.3 Interactive Planning

It is important to recognise that a financial plan is the culmination of the marketing plan, the production and manufacturing plan, selling and administrative expenses, research and development plan, and the capital works plan.

In a marketing plan which forms the basis of financial planning, items which would be considered would be forecasts, analysis of past performance such as long term trends, cyclical, seasonal and random, need for our products, product analysis, use of business indices, market analysis, field estimates such as sales management and salesmen.

In a production and manufacturing plan, items which would be considered would be production volume, what, when, how much, current capacity, labour requirements, material requirements and purchase of raw materials.

Selling and administrative costs would include advertising, sales promotion, direct selling, sales administration, fixed costs, warehousing and shipping, transport, financial and other clerical costs.

Research and development would include considerations for development of new products, what percentage of sales will be spent on research and development, and so forth.

Capital expenditure - this would require current capacity and forecast requirements to determine what capital expenditure would be required, when and where. This would then have other financial implications such as method of financing expansion. Would it be through internal funds. Borrowings, leasing and so forth. What will the return on the project be?

It readily becomes apparent that development of the financial plan is not a single exercise which can be undertaken by a single person, such as the financial controller, but requires input from all sections of the organisation because, as I have stated earlier, it transcends all organisational boundaries and input must be obtained from all levels within the organisation.

5.4 Capital Expenditure

In deciding on capital expenditure within the Department of Transport, all organisations have to justify capital expenditure in either financial or socio-economic terms, using discounted cash flow techniques, such as net present value methods upon which sensitivity testing is also undertaken. Capital efficiency is also an important consideration and decisions are often based on a number of these parameters.

When evaluating capital expenditure, a number of decisions have to be made, such as replacement decisions, expansion decisions, new plant, cost reductions, decide at what level a project is acceptable and decision between alternative methods of finance. What discounting rate do we use? Is it the cost of borrowing funds, interest rate forgone, will we use a marginal cost of funds or a weighted average cost of funds? The real cost of the choice is the loss of the benefits that would have accrued from the next best alternative. Capital evaluations should be undertaken for a number of reasons.

1. The outlay of funds for capital expenditure is often large. Once a decision has been made it is difficult to reverse it without a large loss.

2. The future prosperity of the organisation depends on these capital expenditure decisions.

3. The decisions often have a wide impact on the organisation, its employees, managers and competitors.

4. Until the important strategic decisions are made, the operating decisions such as pricing and cost recovery cannot be made.

5. There is usually more risk and uncertainty with capital expenditure decisions than other types of business decisions.

6. Special techniques are required, since the data is not normally found in many of the management information records. It is the cash flows which are important, not the profits or losses derived from conventional accounting principles.

It is important to appreciate that any capital expenditure proposal which involves expansion, or meeting market demand, is based on the marketing or sales plan. It is therefore important that forecasts are as accurate as possible, with a number of sensitivities being undertaken. This analysis is undertaken with great detail within the transport portfolio, and a number of models have been developed to assist in this regard.

6. TRANSLATING STRATEGIC PLANS INTO CURRENT DECISIONS

No organisation has ever made a cent of profit by making plans. Profit flows from the implementation of plans. Budgets are the first step in translating plans into decisions. They are the primary technique used in the financial planning process and are the culmination of all other planning activities. They translate strategic plans into current actions such as pricing policy, cost of production and so on. Budgets provide a basis for controlling performance to see that it is in conformance with plans.

6.1 Budgets Defined

Implicit in budgets are three overlapping functions: planning, co-ordinating and control. Some budgets may cover an entire year, whereas others may be made for three months, one month, or weekly periods. Generally budgets improve planning by forcing managers to direct attention to the formulation of financial goals and the way in which they are to be implemented. Once the ends are quantified, budgets necessitate the specification of the means to achieve them.

The first year of a medium range plan should establish a solid base for the development of current budgets, but generally does not provide all that is needed for annual budgeting, as annual budgeting involves much more detail than is developed in the medium or long range planning process.

Budgets are a means to help managers co-ordinate operations, such as production, raw material purchases, direct labour requirements are co-ordinated with anticipated sales, advertising, cash flows and so on. Finally, budgets facilitate managerial control over performance. Budgets themselves do not control anything. They do, however, set standards for performance against which actions can be measured. The essence of budgeting is to put a dollar sign on an activity and freeze it. However, as environmental conditions change, budgets should also change, they must be flexible to reflect changing circumstances. Probably the most appropriate of flexible budgeting is to use a variable expense budget.

This ensures that proper co-ordination of activities and costs take place in accordance with the provision of services and activities. Time does not permit me to go into the details on fixed, semi-variable, and variable, nor to elaborate on zero base budgeting, incremental budgeting, or programme budgeting.

7. PLANNING CONTROL

It is important that once the financial plan has been finalised, it is not put on the shelf and just brought out occasionally for review and assessment.

7.1 Performance Analysis

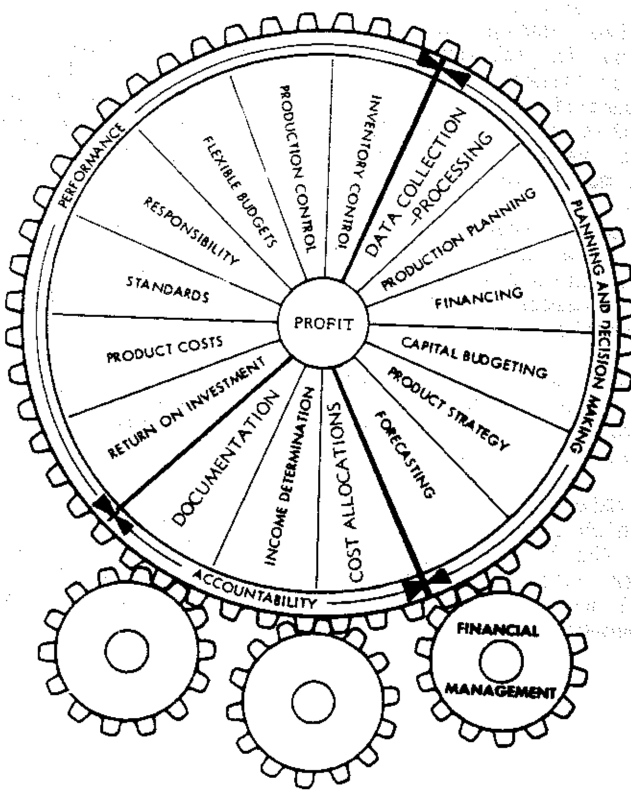
One method of financial control is by performance analysis. Performance analysis must be an ongoing process, and must include both operational and financial analysis, together with appropriate balance sheet ratios.

Only through the analysis of these various ratios can management satisfactorily develop and implement "what if" strategies.

To facilitate the control and implementation process, questions should be asked such as the nature of the task to be carried out, the relevant goal or objective, who is responsible for carrying it out, the steps to be taken, who is responsible for each step, the timing of each step, the money allocated to each step (if any), the critical assumptions on which the schedule is based, the expected performance and when it is expected, the assumptions on which this expectation is based.

Explanations of, and comments on, significant deviations of actual from planned performance should be critically analysed and corrective action taken. Information on the corrective action taken should then be communicated to all relevant personnel.

FINANCE PLANNING



6. CONCLUSION

The planning process requires the identification of the mission or purpose of the organisation. When this task is done it becomes possible to develop long range objectives and to plan specific strategies to achieve objectives and purposes. The assessment of past performance and current and future environmental factors, both internal and external, is an important step in the planning process. The range of data that might be collected in this area is very wide, and organisations must choose what is to be studied and how deeply each factor is to be analysed.

From this information an identification of strengths, weaknesses, opportunities and threats can be formulated and considered in the overall planning process.

Objectives should be suitable, measurable over time, feasible, acceptable, flexible, motivating and understandable. They should also receive managerial commitment, be based on people participating in setting them, be limited in number and be integrated or linked. Theoretically, objectives should be set for every element in an enterprise of importance to management. Actually, this can be unwieldy and many organisations generally limit long range objectives to sales, profits, return on investment, margin and market share.

One of the prime reasons for continuous dialogue is that objective setting is done only after consideration of many combinations of elements in an organisation. There are trade-offs among such factors as investment, market share, employment and product price, which are settled when objectives are set.

It is also necessary to ensure that actual results are in accordance with stated plans. It is therefore important to maintain control and analysis of the financial and operating results.

Corporate objectives and constraints are combined into performance criteria which enable measurement of whether the objective is being achieved. The final step in corporate planning is the development of decision rules which translate the performance criteria into unequivocal measurable standards, whose application will result in the achievement of the corporate objective.

ACKNOWLEDGEMENTS

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