Before You Tie a Bow Around Next Year's Operating Plan…

By Jack Alexander

Before you tie a bow around next year's Operating Plan, take some time to consider if you have created an effective "Operating Plan" or just a "Financial Budget." An effective operating plan will help to ensure that your organization achieves your objectives for the coming year and beyond. Since the finance organization is typically the process owner, many annual planning exercises place too much emphasis on the financial and budgetary aspects, and too little on the strategic, operational, process and project aspects. Consider the following questions to assess the use of best practices and overall effectiveness of your annual planning process:

1. Is your Plan just a document or is it a robust Management Process? President Eisenhower said: "In preparing for battle I have always found that plans are useless, but planning is indispensable." We all know that the future will be different than we project. The value lies in the thinking and discussion that goes into the plan, not the plan document itself. Identifying critical assumptions, actions and issues, thinking through various scenarios and alternative courses of action are among the "indispensable" aspects of planning. This critical thinking will better prepare the organization for the inevitable surprises that are inherent in business.

2. Where did we spend the bulk of our time in the planning Process? If you spend the bulk of your time in preparing multiple revisions of departmental budgets, detail projections and the like--- change your process. Many companies short circuit the planning process by jumping into the detailed budget phase without doing the critical thinking and "planning" in advance. The financial budgets should be prepared **after** completing a situational analysis, establishing goals and priorities, and "working" major issues and opportunities. In addition, there are many tools and techniques that minimize the time and effort in "quantifying the plan" into budgets and facilitate sensitivity analysis and scenario planning.

3. Is the Operating Plan an Installment of the Strategic Plan with a focus achieving our Long Term Goals? One of the most important objectives of the annual operating plan is to map out actions on key strategic initiatives in detail and to monitor the progress toward achieving those initiatives. A prerequisite for developing a meaningful operating plan is to have a well thought out and articulated ***strategic*** plan. The strategic plan should serve as the context for setting goals for the coming year, evaluating operating activities and allocating scarce human and financial resources. Managers should ensure that the operating plan represents substantial progress towards achieving the objectives in the strategic plan. Too often, short term priorities and current "issues" dominate the thinking in the operating plan, at the expense of strategic issues and initiatives.

4. Have we identified Critical Assumptions embedded in the plan? By definition, the operating plan for next year has hundreds of assumptions. These assumptions likely include everything from general economic conditions, to weather, to pricing, to the availability and cost of critical materials. In many plans, these assumptions are buried in the details and are not explicitly identified. Key assumptions should be identified and reviewed. Managers should understand how sensitive the planned results are to changes in critical assumptions. These assumptions should be tracked over the plan horizon, and any signals indicating the assumptions may not be valid should trigger a review, and response, if appropriate. Identifying and reacting to changes in significant assumptions early will allow you to minimize the impact of downside events and trends and to fully capitalize on the upsides.

5. Have we identified Critical Actions required to achieve the planned results? Successful plans place significant attention on the activities required to achieve the planned results. For example, sales growth arising from the introduction of a new product in the next year requires a number of activities related to the development, production, marketing and selling of the product. Each of these activities must be thoroughly planned out and adequately resourced to ensure the planned sales are achieved. In addition, each of the responsible managers must be committed to the completion dates to support the product introduction and revenue plan.

6. Do we have a management system in place to track critical assumptions, Leading Performance Indicators and progress on critical programs included in the plan? In many companies, performance tracking and monitoring is focused on financial results. By definition, financial results are "lagging" measures of business activities and processes. If you wait until trends or problems are visible in the financials, it is already too late to correct for that period. Many problems are easily addressed at an early stage, but grow and compound as time passes. Dashboards should be developed to track performance on leading indicators which will alert managers to unfavorable trends in near real time so that corrective action can be taken.

7. Does the projected performance in the operating plan represent appropriate Performance Targets for the organization? How did we arrive at the planned results for next year? Do they represent an improvement in key drivers over last year's performance? Do they represent progress towards our strategic goals? Consider benchmarking the performance of customers, competitors and best practice companies to set a context for evaluating recent performance and establishing targets for next year. How will the investment community react to the targets? Are they consistent with past guidance and will they be recognized as progress towards long term financial and strategic goals?

8. Have we established targets for Key Performance Indicators (KPI) consistent with the projected financial results? You can't manage financials; you can manage people, processes, transactions and projects. The financials are a result of these business activities and inputs. For example, if you want to improve Accounts Receivable Days Sales Outstanding from 75 to 60 days it won't happen unless you focus on the critical business processes that impact receivables. Create a plan which addresses the critical drivers of receivables: Revenue Hockey Sticks, improving quality and on time delivery, and resolving customer problems faster. Establish targets and then monitor KPI's covering revenue linearity, quality, past due orders and collections and problem resolution.

9. Do our Employees understand the key elements of the plan and their role in achieving the plan? Can our managers and employees list the five critical priorities for the coming year? Significant leverage is possible by communicating key objectives and activities included in the plan. For example, imagine the potential benefits to a critical project if all finance, human resource and procurement teams recognize and support the project as the number one priority for the company. Even more effective results can be achieved if the objective setting and performance management process for managers and employees is a part of the annual planning process, instead of an independent, subsequent drill.

Additional References: **Performance Dashboards and Analysis for Value Creation**, Alexander, 2006 Wiley, available from amazon.com

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