

CHAPTER NINE

9

A Lean Annual Planning Process - Ten Working Days or Less!

OVERVIEW

Annual planning can be completed in two weeks provide we take a fresh look at the process. The only thing certain about annual planning is that it is wrong as soon as the ink has dried, so we need to get it wrong quicker. This chapter explores why annual planning needs to change radically. It discusses the foundation stones and better practices behind a lean annual planning cycle, and how to sell the change to management.

This sounds impossible, yet annual planning can be completed in two weeks. It takes good organization, plenty of abandonment and awareness that the annual planning process is not adding much value to the organization as the numbers are wrong as soon as the ink has dried. Annual planning is undermining an efficient allocation of resources, encouraging



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dysfunctional budget holder behavior, negating the value of monthly variance reporting, and consuming huge swathes of time from all those involved.

When was the last time you were thanked for the annual planning process? You have a situation where, at best, budget holders have been antagonized; at worst, budget holders now flatly refuse to cooperate.

The future for planning in any lean organization is quarterly rolling planning, which is covered in Chapter 16 in this book and is developed from the *Beyond Budgeting* movement, which I fully endorse. However, it will take upwards of nine months to implement quarterly rolling planning, and thus your annual planning cycle may be just around the corner.

This chapter is a summary of the content in my white paper “Timely Annual Planning Process in Two Weeks or Less.”¹

LEADING AND SELLING THE CHANGE

It is important to sell to management why a quick annual plan is a good annual plan. This is not particularly difficult, because it is rare to find a manager who enjoys the process or finds it rewarding and worthwhile. The difficulty is that while managers will concur with the concept, getting them to change old and embedded bad practices requires a culture change.

As mentioned in Chapter 2, *Selling and Leading Change*, it is important to start off the process by getting management to see that the default future is not what they want. We need to sell the change using emotional drivers rather than selling by logic, as already discussed.

Some Emotional Drivers

“It’s no secret that annual budgeting processes are time consuming, add little value, and prevent managers from responding quickly to changes in today’s business environment.”

— *Jeremy Hope of Beyond Budgeting fame*²

The following points are some of the emotional drivers you would use to sell the need to streamline the annual planning process to the SMT:

Annual planning is wasteful. There is a huge cost associated with the annual plan—ensuring you estimate on the high side, as costs motivate the SMT and the board.

Finance team members lose months and work many late nights and weekends, producing an annual plan that is wrong.

The board, the SMT, and all levels of management are tied up in endless arguments discussing a period no one can predict.

Poor allocation of resources. Rational budget holders become dysfunctional requesting funds they do not need, but feel they should have them just in case. Resources are thus locked away in budget holder slush funds.

Many new opportunities that become available are not taken up, as they were not funded in the budget. The funding is thus not adaptable to the changing conditions.

The finance team and budget holders are skilled staff that could be doing more meaningful activities.

Undermines reporting. The monthly budgets, if set from the annual plan, create meaningless month-end targets. The June budget turning out to be closer to September's numbers and September's budget more relevant to November and so on. The corrupted budgets lead to meaningless variance commentary (e.g., "it is a timing difference" "it was not meant to happen this month").

I always say to attendees, at my workshops, if you set your month-end budgets from the planning round you have committed one of the greatest mistakes since Luca Pacioli invented double entry bookkeeping.

Costing the Annual Planning Process

In order to create a change in the way the SMT, board, and management address the annual planning process, you need to establish what is the full cost of the annual planning process, including CEO, CFO, SMT, the budget holders, and the accounting and planning staff masterminding the process.

Based on a costing for a 500 FTE organization, I have estimated that the annual cost is between \$1.2 million and \$1.7 million a year. As I like to say to senior management, "If you do nothing about this, you will be investing \$12 million to \$17 million over the next 10 years." Exhibit 9.1 illustrates how the sum was calculated. The times are estimates and show what a 500 FTE organization may be investing in its annual plan preparation.

As used in earlier costings, I use 42 productive weeks a year for the finance team and budget holders, having removed holidays, training, and sick leave. I take off another 10 weeks for the CFO, SMT, and CEO to account for time spent traveling and in numerous meetings.

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	General Managers	CEO	CFO	Accounting & Planning	Budget Holders
Staff involved	4 to 6	1	1	3 to 5	50 to 70
Estimated total number of weeks worked					
Budget Process (incl rework)	4 to 6	3 to 4	3 to 4	10 to 25	100 to 140
Re-Budget Process (if done)	1 to 2	0.5 to 1	0.5 to 1	5 to 10	50 to 70
Reporting Against Budget	2 to 4	0.5 to 1	0.5 to 1	5 to 10	150 to 210
Re-Forecasting Y/E Result (>6 Times a Year)	1 to 2	0.5 to 1	0.5 to 1	3 to 5	100 to 140
No. of Weeks Worked	8 to 14	4.5 to 7	4.5 to 7	23 to 50	400 to 560
Average Salary Cost	\$250,000	\$400,000	\$250,000	\$120,000	\$100,000
Average productive weeks	32	32	32	42	42
Personnel costs only	\$50-90k	\$60-90k	\$30-40k	\$60-150k	\$1.0m-1.3m
Annual cost	\$1.2m to \$1.7m				
Over next ten years	\$12m to \$17m				

EXHIBIT 9.1 Cost of the Annual Planning Process

FOUNDATION STONES OF A LEAN ANNUAL PLANNING PROCESS

When discussing better practices, I separate out those practices (foundation stones) that you have to adopt to progress forward from those practices you can choose to adopt or not without adversely affecting the process.

A number of foundation stones must be laid before we can commence a project on reducing the annual plan to two weeks. When building a house, you need to ensure that all of the structure is built on a sound foundation. Lean annual planning has a number of essential foundation stones:

1. Separate targets from the annual plan.
2. Bolt down your strategy beforehand.
3. Avoid monthly phasing of the annual budget.
4. The annual plan does not give an annual entitlement to spend.
5. Commit the budget committee to a lock-up.
6. Budget at category level rather than account code level.
7. Get it wrong quicker.
8. Build in a planning tool—not in a spreadsheets.
9. Plan with months that consist of 4 or 5 weeks.



Separation of Targets from the Annual Plan

It is so important to tell management the truth rather than what they want to hear. Boards and the senior management team have often been confused between setting stretch targets and a planning process. Planning should always be related to reality. The board may want a 20 percent growth in net profit, yet management may see that only 10 percent is achievable with existing capacity constraints.

The key is to remove any deliberate manipulation related to performance bonuses. In Chapter 20 on Performance Bonus Schemes, I point out that any performance bonuses should be paid on performance compared to the market rather than to an annual plan. We want management to be extracted from the annual charade of making a target easy so their bonus is secured.

DIALOGUE WITH THE BOARD

You can say to the board, "Setting a stretch target is desirable, but you must accept that we might not be able to achieve this. We understand that the bonuses might well be pegged against the goal and we are not trying to lower the threshold to get the bonus, but merely informing you of the performance gap so you can think strategically about how we are to close the gap up."

By reporting a gap, we are saying to the board that based on expected customer demand, the existing products/ services and the relevant prices there is a shortfall. "Please help us find the missing profit." The board then might need to acquire some profit by purchasing a new subsidiary or bring forward the development of a new product, increase prices etc.

Exhibit 9.2 shows where management have forced the plan prepared in March to meet the target set by the board. Each subsequent reforecast continues the charade until in the final quarter reforecast, performed in March the following year, the truth is revealed. In reality, the truth was always a shortfall, as the dark line in Exhibit 9.2 illustrates.

Bolt Down Your Strategy Beforehand

Leading organizations always have a strategic workshop out of town. This session should be anticipated with a positive attitude. Normally, board members

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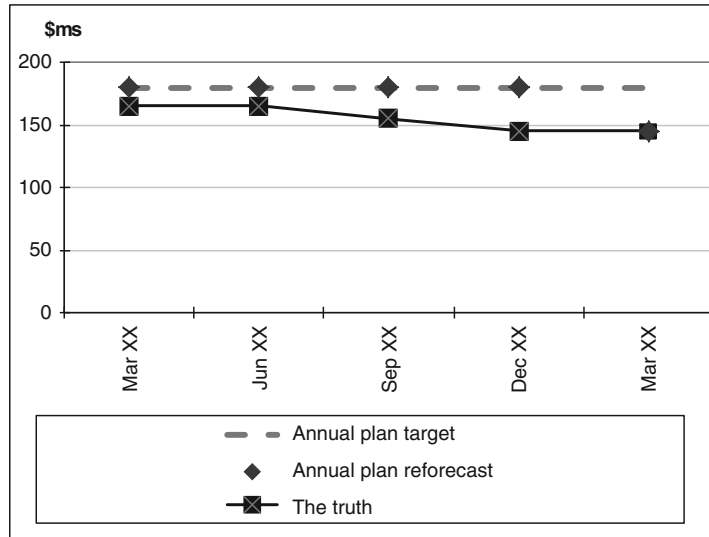


EXHIBIT 9.2 Reporting What the Board Want to Hear

will be involved, as their strategic vision is a valuable asset. These retreats are run by an experienced external facilitator. The key strategic assumptions thus are set before the annual planning round starts, and board members also can set out what they are expecting to see.

Great management writers, such as Jim Collins, Tom Peters, Robert Waterman, and Jack Welch, have all indicated that prominent organizations are not great because they have the largest strategic plan. In fact, it is quite the reverse; the poor-performing organizations are the ones that spend the most time in strategy and the dreaded annual planning process.

Jack Welch, in his book *Winning*,³ talks about how he stopped business units writing large strategic documents and delivering drawn-out presentations. He forced all strategy plans to fit on to five slides. I have set out my interpretation of his slides and also include the thoughts from Jim Collins (see Exhibit 9.3).

Q1

Avoid Monthly Phasing of the Annual Budget

As accountants, we like things to balance. It is neat and tidy. Thus, it appeared logical to break the annual plan down into 12 monthly breaks before the

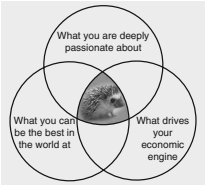
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EXHIBIT 9.3 A Strategy Slide Deck Based on Welch and Collins



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year started. Since we planned monthly, it seemed logical that July's column was July's number. In reality, July's numbers represented November's actuals and the November budget was closed to February's actuals. In other words, although the 12 columns added up to a year that maybe proved to be a reasonable guess, the monthly splits are radically wrong. If you can get your monthly splits right, you are in the wrong job, as you should be making money out of your knack of seeing into the future.

In the annual plan, we should only present quarterly indicative splits concealing the month columns. See Exhibit 9.4 for a suggested one-page summary format.

The monthly targets should be set a quarter ahead using a quarterly rolling forecasting process, which is discussed in Chapter 16. This change has a major impact on reporting. We no longer will be reporting against a monthly budget that was set, in some cases, over 12 months before the period being reviewed.

If you get the monthly budgets approved in the annual planning process, you will have created a reporting yardstick that undermines your value to the organization. Every month in the organization you will make management write variance analyzes that I could do just as well from my office. "It is a timing difference," "We were not expecting this to happen," "The market conditions have changed radically since the plan," and so forth.

The Annual Plan Does Not Give an Annual Entitlement to Spend

The annual plan should not create an entitlement; it should be merely an indication, with the funding based being allocated on a quarterly rolling forecasting and planning regime, a quarter ahead each time (see Chapter 16). Asking budget holders what they want and then, after many arguments, giving them an "annual entitlement" to funding is the worst form of management we have ever presided over.

Organizations are recognizing the folly of giving a budget holder the right to spend an annual sum, while at the same time saying that if you get it wrong, there will be no more money. By forcing budget holders to second-guess their needs in this inflexible regime, you enforce a defensive behavior, a stockpiling mentality. In other words you guarantee dysfunctional behavior from day one!

Annual plan for the year ending _____

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Y/E plan	Forecast for Y/E
	Apr - Jun	Jul - Sep	Oct - Dec	Jan - Mar	31/03/	31/03/
	20__	20__	20__	20__	20__	20__
Income	\$Ms					
Income 1	13.0	12.5	12.1	12.3	50.0	46.5
Income 2	12.5	13.5	14.5	15.0	60.0	55.8
Income 3	10.5	10.0	9.5	9.0	40.0	37.2
Total Revenue	36.0	36.0	36.1	36.3	150.0	139.5
EXPENDITURE						
Personnel costs	15.1	15.7	15.3	15.5	61.6	57.3
Cost category 2	5.3	5.9	5.7	5.9	22.8	21.2
Cost category 3	3.4	4.0	3.6	3.8	14.8	13.8
Cost category 4	1.7	2.3	2.1	2.3	8.4	7.8
Cost category 5	1.6	2.2	1.8	2.0	7.6	7.1
Cost category 6	1.4	2.0	1.8	2.0	7.2	6.7
Other operational costs	2.8	3.4	3.0	3.2	12.4	11.5
Total Expenditure	31.3	35.5	33.3	34.7	134.8	125.4
Management overview					(0.2)	(0.1)
Net Result	4.7	0.5	2.8	1.6	15.0	14.1
Key Ratios						
FTEs	Average over last 4 qtrs 350	355	360	365	370	370
Revenue per FTE	\$98,000	\$101,000	\$100,000	\$99,000	\$98,000	\$405,000
Personnel costs to total revenue	40%	42%	44%	42%	43%	41%

Notes:

- XX
- XX
- XX
- XX

EXHIBIT 9.4 Example of an A3 (US fanfold) Annual Plan

THE NINE-YEAR-OLD'S BIRTHDAY CAKE

The annual planning process has a lot in common with the handling of a nine-year-old's birthday cake. A clever parent says to Johnny, "Here is the first slice, if you finish that slice, and are not going "green around the gills" and want more, I will give you a second slice." Instead, what we do in the annual planning process is divide the cake up and portion all of it to the budget holders. Like nine-year-olds, budget holders lick the edges of their cake so even if they do not need all of it, nobody else can have it. Why not, like the clever parent, give the manager what they need for the first three months, and then say, "What do you need for the next three months?" and so on. Each time, we can apportion the amount that is appropriate for the conditions at that time.

The key is to fund budget holders on a rolling quarter-by-quarter basis. In this process, the management asks, "Yes, we know you need \$1 million and we can fund it, but how much do you need in the next three months?" At first the budget holder will reply, "I need \$250,000 this quarter," to which is replied, "Pat, how is this? Your expenditure in the last five quarterly has ranged between \$180,000 and \$225,000." "Pat, you are two team members short and your recruiting is not yet underway; be realistic. You will only need \$225,000 tops."

It will come as no surprise that when a budget holder is funded only three months ahead that the funding estimates are much more precise and there is little or nowhere to hide those slush funds.

Commit the Budget Committee Commits to a "Lock-Up"

It is best to have a small "budget committee," comprising the CEO, two GMs, and the CFO. Rotate the GMs each year so that all are involved over time. The GMs will, of course, be part of their relevant annual plan submission.

This committee, sits in a lock-up for between three and five days. It is important to book, well forward, in the diaries of the budgeting committee the key dates when they need to be in committee to interview budget holders.

You need to ask the budget committee whether it would rather have three days or three months of pain. I cannot conceive of any CEO, who is a modern thinker, who would not take up the offer.

The role of the committee is to interview all budget holders about their annual plans for their team next year, including justifying their annual plan forecast, and the nonfinancials (e.g., staff succession, staff rotation).



During the three-day lock-up, each budget holder has a set time, up to about 45 minutes, to do the following:

- Discuss their financial and nonfinancial goals for the next year
- Justify their annual plan forecast
- Raise key issues (e.g., the revenue forecast is contingent on the release to market and commissioning of products __ and __)

Budgeting at Category Level Rather Than Account Code Level

It is far better to budget at category level rather than account code level. A forecast is rarely right. Looking at detail does not help you see the future better. In fact, I would argue that it screens you from the obvious. Planning at a detailed level does not lead to a better prediction of the future. A forecast is a view of the future; it will never, can never, be right. As Harry Mills⁴ says, “It is better to be nearly right than precisely wrong.” Planning a full final year in detail, in the dynamic world we live in, has always been, at best, naïve, and at worst, stupid.



COUNTING THE TREES IN A FOREST

Imagine that you have been asked to count the trees in a state forest that consists of 100 square miles of trees. You have two choices, the detailed way and the “helicopter” way.

For the detailed way, you could set up 10 teams of seven people. Each team is assigned 10 square miles and is given satellite navigation equipment, a different color of spray paint, safety gear, camping equipment, and provisions for three weeks or so. The teams update their count each night on a spreadsheet. At the end, the tree counts are consolidated. Some data are left out because the counters in some teams forgot to load every spreadsheet into the workbook. The final count, therefore, is wrong, although no one knows that.

For the helicopter way, satellite imaging is used to select five sample areas that are 1/1000 of the forest. The staff are assigned to five bigger teams, and each counts their area in a day. The count of the five areas is averaged and then multiplied by 1000. The answer is wrong. But it was wrong quickly and is still a good approximation. For forecasting, the helicopter way is usually the better option, unless you are forecasting payroll where managers can forecast by their staffs’ actual salaries.



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Although precision is paramount when building a bridge, an annual plan need only concentrate on the key drivers and large numbers.

Following this logic, it is now clear that as accountants, we never needed to set budgets at account code level. We simply do it because we did it in the previous year. You can control costs at an account code level by monitoring trend analysis of actual costs over 15 to 18 months.

We therefore apply Pareto's 80/20 principle and establish a category heading that includes a number of general ledger codes, as shown on Exhibit 9.5.

Helpful rules that can be used to apply this foundation stone include:

- Budget for an account code if the account is over 10 percent of total expenditure or revenue—for example, show revenue line if revenue category is over 10 percent of total revenue. If account code is under 10 percent, amalgamate it with others until you get it over 10 percent. See Exhibit 9.5 for an example.
- Only break this rule for those account codes that have a political sensitivity.
- Limit the categories that budget holder's need to forecast to no more than 12.
- Select the categories that can be automated, and provide these numbers.
- Map the G/L account codes to these categories—a planning tool can easily cope with this issue without the need to revisit the chart of accounts.

Getting It Wrong Quicker

The only thing certain about an annual target is that it is certainly wrong; it is either too soft or too hard for the actual trading conditions. If we all agree that we spend months of effort getting a number wrong, then you should agree with me that we need to get it wrong quicker, but we still need a reasonable estimate.

In the past, we have given budget holders three weeks to produce their annual plan—yet they have done it all in the last day or so. They have proved to us it can be done quickly.

If we apply the foundations stones described earlier, you will have taken the politics out of annual planning—why would budget holders spend a long time fighting for an annual plan allocation if you have told them it is not an entitlement to spend?

Forecasting at Account Code Level		Forecasting at Category Level		Notes
Stationery	40,556	Consumables	110,000	Estimated to the nearest \$10K.
Uniforms	23,325			
Cleaning	11,245			
Miscellaneous	17,654			
Consumables	12,367			
Kitchen supplies	2,134			
	<u>107,281</u>		<u>110,000</u>	
Salaries and Wages	25,567,678	Salaries and Wages	27,400,000	Computed by business unit expected staff, rounded to the nearest \$100k.
Taxes Levied on Gross Wages	2,488,888	Taxes Levied on Gross Wages	2,900,000	Taxes are automatically calculated by model.
Temporary Staff	2,456,532	Other Employment Costs	4,200,000	This number is the balancing item.
Contract Workers	2,342,345			
Students	234,567			
	<u>33,090,010</u>	Employment Costs	<u>34,500,000</u>	Budget holder estimates costs to the nearest \$0.5m.

EXHIBIT 9.5 How a Forecasting Model Consolidates Account Codes

One way to reduce the time spent in this area is to start the annual planning cycle off later. I recommend the second week of the ninth month—that is, for a December year-end, start the annual planning in week 2 in September.

The CEO needs to make a fast time frame nonnegotiable in all communication with staff. As long as the foundations stones are in place and the CEO has agreed to get behind a fast annual planning process, the program, as set out in Exhibit 9.6, will work.

From the memo that goes out to invite budget holders to the annual planning workshop, the address of the attendees at the workshop, and the daily chasing up of the laggards during the three days budget holders have to complete their annual plan, the message is clear: We want a fast, light-touch annual plan. *Fast* ensures the annual plan is completed in less than two weeks, and *light touch* avoids unnecessary detail.

As part of this foundation stone, common templates are established to replace the myriad of spreadsheets. One such common template is the payroll worksheet that shows budget holders all their staff and their salaries, start date, leaving date if known, and so on (see Exhibit 9.76). This tool is discussed later on.

			Week													
			Pre-work			1	2	3	4	5	Week End	6	7	8	9	10
Process =>	Budget prework	Meeting with divisional heads (DHs)	Present budget workshop	Budget holders prepare and load their forecast	First look at numbers	Rework some budgets					Submissions by BHs to budget committee	Completion of final draft budget for board approval	Final alterations and finishing off documentation			
Activities by team =>																
Strategic planning			Attend							Review to ensure linkage to plan, and advise on any discrepancies				Attend		
Senior management team (SMT)	Set assumptions	One-to-one with the finance team				First look at numbers					Budget committee review submissions in a "lock-up" session	Hear presentation and give instructions for final changes				
Finance team	Prepare system, the presentation, calculate known costs overheads, personnel costs etc.	One-to-one with DHs	Give presentation to BHs	Help BHs with budget plans (extended team)	Quality assurance	Help BHs					Further quality assurance	Complete preparation and deliver annual plan presentation	Complete documentation			
Budget holders (BHs)			Attend	Prepare budget	Alter numbers after feedback	Rework numbers if necessary					Present plan to SMT when called	Attend or see presentation slides later	Document all calculations			

EXHIBIT 9.6 Two-Week Annual Planning Outline

Employee Name	Position Grade	Department	Current Salary	New Salary	Start Month	End Month
Jump, John	Junior Sales	Sales team 1	35,000	40,000	June *	
Host, Chris	Senior Sales	Sales team 1	70,000			
Big, Terry	Senior Sales	Sales team 1	68,000			August *
A. N. Other #1	Senior Sales	Sales team 1	70,000		August *	
A.N.Other #2	Senior Sales	Sales team 1	60,000		May *	

EXHIBIT 9.7 Payroll Calculation Worksheet

Built in a Planning Tool—Not In A Spreadsheets

As stated in Chapter 4 *Technologies You Must Have Before You Upgrade the G/L*, there is no place for a spreadsheet in forecasting, budgeting, and in any other core financial routine.

Acquiring a planning tool is the first main step forward, and one that needs to be pursued not only for the organization's future but also for the finance team members' future careers.

It has never been a better or easier time to do this. Planning tools are more affordable, many are cloud based, and they can work with any general ledger. I consider it unprofessional for qualified staff to be working with spreadsheets over 100 rows. If not convinced please reread the first section of Chapter 4.

Plan with Months That Consist of 4 Or 5 Weeks

The calendar in use today can be a major hindrance in forecasting. With the weekdays and number of weekend days, in any given month, being different from the next month, forecasting and reporting can be unnecessarily compromised. Closing off the month on a weekend can make a big positive impact in all sectors.

Forecasting models should be based on a "4, 4, 5 quarter"; that is, two four-week months and one five-week month are in each quarter, regardless of whether the monthly reporting has moved over to this regime. Calculating and forecasting the following items then becomes easier:

- Revenues. For retail, you either have four or five complete weekends (the high revenue days)
- Payroll. You either have four weeks of salary or five weeks of salary
- Power, telecommunications and property related costs. These can be automated and be much more accurate than a monthly allocation



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- Monthly targets. You can simply adjust back based on calendar or working days.

Simply design the model so that smoothing back to the regular calendar can be removed easily when you decided to migrate reporting to 4, or 5 week months.

To make progress in this area, I recommend that you contact your general ledger supplier and ask, “Who is a very sophisticated user of this general ledger and who uses 4, 4, 5 reporting months?” Arrange to visit them and see how it works for them. Ask them, “Would you go back regular calendar reporting?” Most are likely to give you a look that says, “Are you crazy?”

EFFICIENT ANNUAL PLANNING PROCESSES

I have included a checklist on “performing an efficient annual planning process” in the attached PDF files. This will help with the quality assurance process.

Hold a Focus Group Workshop

As explained in the section *The Power of the Focus Group* in Chapter 2, a focus group needs to be formed as part of the selling change process. We need the oracles in the business units to discuss what the annual planning default future looks like and agree that they do not want it. The focus group workshop is important for a number of reasons:

- Many people will doubt the organization’s ability to move from three to four months to two weeks, and we need to ensure that all likely objections are aired in the focus group workshop.
- We need to reengineer the annual plan process using Post-it Notes, as discussed in Chapter 10.
- The foundation stones need to be understood, agreed on, and put in place early in the project.
- A green light from the focus group will help sell this concept to the SMT.
- The focus group will give valuable input as to how the implementation should best be done to maximize its impact.

The proposed agenda for the focus group is set out in Exhibit 9.8. The suggested attendees would include: Budget committee, selection of business unit

heads, all management accountants, and a selection of budget holders. You will need an event secretary to document agreements, two laptops, a data show projector, and two whiteboards.

EXHIBIT 9.8 Draft Agenda for a Planning Focus Group

Location: _____

Date and Time: _____

Prework: Attendees to document forecasting procedures on Post-it stickers. One procedure per Post-it. Each team to have a different color Post-it.

8:30 a.m. Welcome by CFO, a summary of progress to date at _____, an outline of the issues and establishing the outcome for the workshop.

8:40 **Setting The Scene**—topics covered include:

- The default future, the cost, and the major flaws
- The alternative—the proposed foundation stones, how a two-week process can work
- The proposed new annual planning foundation stones

9:40 **Workshop 1: Analyzing the foundation stones.** Separate teams look at the proposed new rules, and comment on changes required.

10:15 Morning break.

10:30 **Workshop 2: Workshop on “Post-it” Reengineering of the Annual Planning Process.** During the workshop, we analyze the bottlenecks of the forecasting process. In this workshop, we use these sticky notes to schedule the steps (e.g., yellow for budget holder activities, red for forecasting team activities, blue for budget committee activities).

12:00 p.m. Feedback from work groups on both workshops and action plan agreed (document deadline date and who is responsible). Individuals will be encouraged to take responsibility for implementing the steps.

12:30 Lunch at venue.

1:30 Delivery the proposed “selling” presentation.”

2:00 **Workshop 3: Feedback on the presentation.** Separate work groups look at different parts of the presentation.

3:00 The team presents, to an invited audience, the changes they would like to implement and when. They can also raise any issues they still have. Suggested audience includes all those who attended the setting the scene morning session.

4:00 Wrap-up of workshop.



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The Post-it reengineering exercise is the same as the month-end process reengineering. Please see the Chapter 10 Working Smarter, Not Harder on how to run a Post-it reengineering session.

Forecasting Demand by Major Customers by Major Products

If you have 200 products and 2,000 customers, how do you get to a reasonably accurate forecast? The answer lies in applying Pareto’s 80/20 rule to the sales forecasting process. Sales need to be forecast by major customers and major products. The rest of the customers and rest of the products should be put into meaningful groups and modeled based on the historic relationship to the major customers’ buying patterns. See Exhibit 9.9 for a suggested format.

Many organizations liaise with customers to get demand forecasts, only to find them as error prone as the forecasts done in-house. The reason is that you

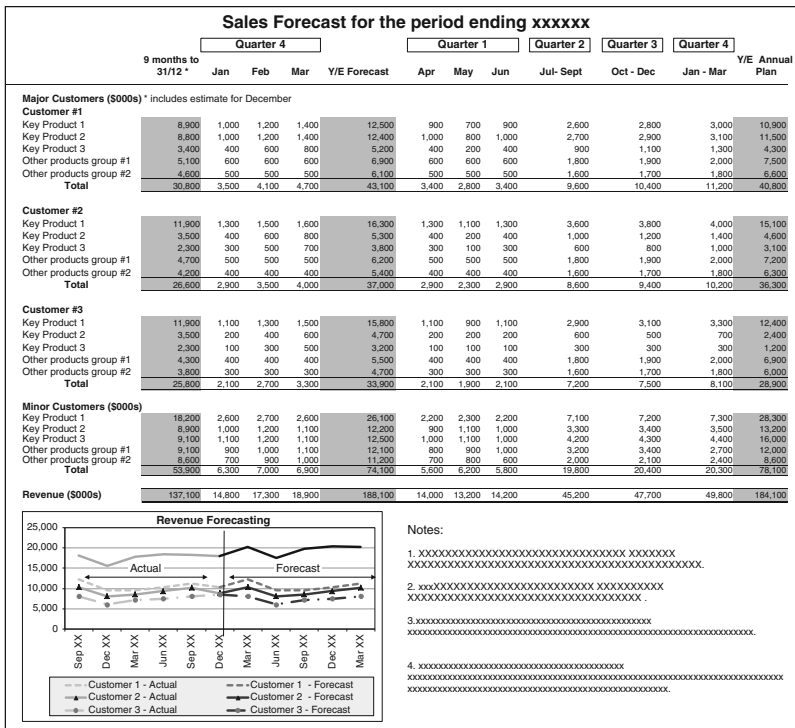


EXHIBIT 9.9 Suggested Level of Detail in a Sales Forecast Model

have asked the wrong people. You need to get permission to meet with the staff who are responsible for ordering your products and services.

One financial team decided to contact its major customers to help with demand forecasting. Naturally, the team was holding discussions with the major customers' "headquarters" staff. On reflection, the financial team found it better but still error prone, so its members went back and asked, "How come these forecasts you supplied are so error prone?" "If you want accurate numbers, you need to speak to the procurement managers for our projects," was the reply. "Can we speak to them?" "Of course, here are the contact details of the people you need to meet." Several meetings were then held around the country. The team found that these managers could provide very accurate information and were even prepared to provide it in an electronic format. The sales forecast accuracy increased sevenfold due to focusing on getting the demand right for the main customers.

The lesson here is that if you want to forecast revenue more accurately, you can do this by delving into your main customers' business, by asking them, on a quarterly basis, "Whom should we speak to in order to get a better understanding of your likely demand for our products in the next three months and the next five quarters?"

James Surowiecki wrote that "a large group of people are often smarter than the smartest people in them." Hence the term *wisdom of the crowd* was born. In other words, a group's aggregated answers to questions that involve quantity estimation have generally been found to be as good as, and often better than, the answer given by any of the individuals in the group. Involving a "crowd" in planning and forecasting can have a major positive impact on the process because:

- A great deal of trend information is being noted by those at the workplace, such as unsold products that are piling up, products that are being returned, and customer comments.
- Groups are less motivated to forecast what management wants to see.
- A small group of forecasters can only process a tiny fraction of the information available, whereas a crowd can take in an almost unlimited "harvest of data."
- Experts tend to have a bias of optimism, especially if they are looking at sales from inside the company, rather than from the customer perspective. A very interesting paper has been written about this, called "Delusions of Success—How Optimism Undermines Executives' Decisions."

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This theory was tested by Best Buy, a large US consumer electronics retailer who found the monthly sales forecast for the gift card business: the marketing department was 95 percent accurate, whereas the “wisdom of the crowd was 99.5 percent accurate. The holiday season sales showed a similar improvement (93 percent / 99.9 percent).

In Best Buy, the annual plan and subsequent forecasts updates are now prepared by invited staff who provide anonymous forecasts directly into a system. They are provided with some basic trend information, with the incentive of the recognition and a prize if their forecast is the nearest to the actual figure.

Resistance from “experts” is likely when you suggest using the wisdom of the crowd in place of their forecast. To convince them, you can take a page from Best Buy’s book. Suggest two forecasts: theirs and one by selected sages from around your business. Ask the sages to forecast sales for the whole organization based on what they are seeing in their areas. You can tell them, “We have prepared some historic data for you and limited the forecast to some key lines and the rest is summarized in groups. Please place your forecast in the system. If your forecast turns out to be the most accurate, you will win a weekend for two at ___ resort.”

Each quarter, you then disclose the experts’ forecast versus actual and the wisdom of the crowd versus actual. I predict that the experts will want to duck for cover after a couple of forecasts highlight their inaccuracies. They will ask, even plead, “Please put our forecast in with the wisdom of the crowd.”

The wisdom of the crowd has implications on the design of the planning tool. You can expect to accommodate possibly 20 versions of the revenue forecast and then average them. This, however, should not be a problem because you are not forecasting revenue by each line and by each branch.

Required Pework

Before the two-week lean planning cycle starts, much prework has to be performed by the management accountants responsible for overseeing the planning model. The prework, includes:

- Amending the existing model to incorporate the changes in this paper
- Ensuring that the sales forecast, using the practices already discussed, appears reasonable

- Inserting the current personnel details (name, title, salary) into the payroll section of the model
- Calculating all categories that are to be based on historic trends

Accurately Forecasting Personnel Costs

Payroll often represents 30 to 60 percent of total costs, depending what sector your organization is in; thus, it is worth some extra effort to get a reasonable forecast.

Accurate forecasting of personnel costs requires analysis of all current staff (their end date if known, their salary, the likely salary review, and bonus); and all proposed new staff (their starting salary, their likely start date). This is done by each manager, who reviews a prepared schedule of current staff with the salary field populated by personnel from the most recent payroll records.

Budget holders put in a leaving date if known, their likely salary review with start date, and any possible bonus. For new staff, budget holders enter starting salary and their likely start date. No one needs to show managers the monthly and quarterly figures. The model can get it right. They simply have to get the best estimate of who will be working that year and the likely salary. Exhibit 9.7 shows an example of personnel cost forecasts.

Too many errors occur when budget holders are simply given last month's payroll total to use as a basis for annual planning. By using this number, you have multiplied the long service leave paid to employee _____ last month by 12. At the same time, you have not recognized that two staff positions were not included. Many of us have made this error.

After you have the correct salaries and wages, you can model any employment taxes paid by your organization. Then, forecast the total likely employment costs because you will have an idea about what total costs are permissible, and you can deduce the temporary, contract and interns costs (see Exhibit 9.10). Exact numbers for these costs are not possible, no matter how much time is spent on them. In fact, the amount flexes all the time: if recruiting costs related to contract workers are late, these costs go up and the salaries and wages total is lower, and vice-versa.

Automate the Calculation for Some Expense Categories

A number of categories can be pre-populated, as the budget holder will look only at historic numbers and may even misinterpret this data. The finance team

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Taxes Levied on Gross Wages	2,488,888	Taxes Levied on Gross Wages	2,900,000	
Temporary Staff	2,456,532	Other Employment Costs	4,200,000	This number is the balancing item.
Contract Workers	2,342,345			
Students	234,567			
	<u>33,090,010</u>	Employment Costs	<u>34,500,000</u>	Budget holder estimates costs to the nearest \$0.5m.

EXHIBIT 9.10 Forecasting Employment Costs (the Helicopter Way)

is best equipped to do provide these numbers as the budgets will be calculated based on historic trend information. The obvious categories to populate and lock down include:

- Communication costs (landlines, Internet, mobile)
- Property costs (power, lighting, property repairs, security, cleaning)
- Consumables
- Fleet costs
- Depreciation
- Miscellaneous costs

Provide Automated Calculations for Travel and Accommodation

When budget holders calculate travel and accommodation costs, they can spend hours searching the web for special deals. They then use these deals for their annual plan. I recommend that you set up a simple calculator. See Exhibit 9.11 with standard costs so all staff have to do is state the date, object of trip, select a return or one-way journey, number of staff, such as “three people going from Houston to Boston for two nights on a roundtrip.”

The model then uses standard estimates to automatically calculate the airfares, accommodation, transfers, overnight allowances and other costs. For example, you might schedule the top 10 routes with standard pricing and have an eleventh flight called “Flights—other” and set a \$300 return airfare. Although the forecast won’t be exactly right, it is likely to be approximately right because it is based on an average calculated from the last three months of actuals.

Month of trip	Object of trip	From	To	Return trip	Nights	Number of staff traveling	Cost
Oct xx	QRP project	Houston	Toronto	Yes	2	2	1,600
Nov xx	QRP project	Houston	Seattle	Yes	2	2	1,400
Nov xx	QRP project	Houston	Boston	Yes	3	2	1,900

Cost is calculated based on standard flight, accommodation and overnight allowance costs.

EXHIBIT 9.11 Example of a Travel and Accommodation Calculator

Prepare a Simple Reporting Template for the Annual Plan

Annual plans often end up in elaborate reports. The feeling is “Since we spent so much time on it, we better make a great job of the write-up.” In reality, nobody reads these documents. It is far better to have the documentation left mostly in presentation format along with a key summary page for each business and one for the consolidation. We do not need to report the annual plan to the board in monthly splits. A quarterly analysis of the annual plan will suffice, as shown in Exhibit 9.4.

Have Trend Graphs for Every Category Forecasted

Better quality can be achieved through analysis of the trends. There is no place to hide surplus funding when a budget holder has to explain why the forecast trend is so different from the past trend. The graph shown in Exhibit 9.12, if made available for all the categories budget holders are required to forecast, will increase forecast accuracy. Budget holders will want to ensure their forecasts make sense against the historic trend.

If Using a Spreadsheet, Simplify the Model to Make It More Robust

As explained, forecasting requires a good robust tool, not a spreadsheet built by some innovative accountant that no one can understand now. However, you may not have the time to replace the existing Excel model. A new planning tool will take at least six months for researching, acquiring, and implementing for organizations with over, say, 500 full-time staff. In this case, you can:

- Improve the revenue predictions by focusing in on major customers' demand for the major products. You can automate the rest of the sales based on historic relationships between sales of minor products and major products and sales to minor customer's to those made to major customers.

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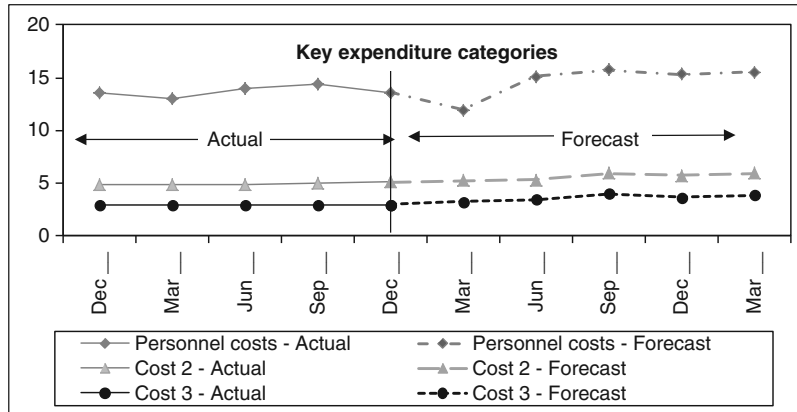


EXHIBIT 9.12 Expenditure Trend Graph

- Budget at category rather than account code level, hiding the rows not required.
- Forecast the annual plan using quarterly figures rather than monthly (hiding two of the monthly columns for each quarter).
- Consolidate via the G/L instead of the spreadsheet (if you can add the category headings easily into the G/L).

Expand Your Team, as Budget Holders Will Need One-to-One Support

Many budget holders will need one-to-one support. Yet, as seen in Exhibit 9.6, we are to do this all in three working days. We thus need to expand the support team. Some suggestions to expand your team are:

- Get all the qualified accountants involved, even those not working in the finance team (e.g., get the CFO involved as well).
- Ask the auditors to loan some audit seniors from their local offices to cover those remote locations—the audit seniors will be happy to be involved in an interesting task (those who have been auditors will know what I mean).
- Bring in some temporary staff with budget experience.
- For smaller budget holders, the senior accounts payable staff would be ideal.
- Offer remote budget holders one-on-one training with Skype-based virtual meeting technologies.

Thus, all budget holders who need help, wherever they are located, can be supported during the three-day window for data entry.

Hold a Briefing Workshop for all Budget Holders

Never issue budget instructions, for you already know they are never read. Follow the lesson of a leading accounting team that always holds a briefing workshop at which attendance is compulsory. With today's technology, you also can hold the workshop simultaneously as a webcast so budget holders in remote locations can attend, albeit electronically. (Attend a webcast to see what I mean.)

Hold a "budget preparation" workshop (see Exhibit 9.13 for an agenda example) covering how to complete the input form and explaining why budget holders do not need to forecast monthly numbers, only quarterly; the three-day window; the daily update to the CEO; and the fact that late returns will be career limiting. Stress that the bigger items should have much more detail. Explain why you have automated some of the categories and the help they will receive, and so forth.

Make sure that at the workshop, the CEO makes it clear that:

- **Fast light touch**
 - Everybody has to cooperate to achieve the three-day window to enter data.
 - Late forecasting will be a career-limiting activity.
- **Help at hand**
 - Help will be provided on a one-to-one basis.
 - How to use the planning tool (attendees will already have some training on this).
 - Forecasting by the categories, and why some categories are now automated.
- **Level of detail required**
 - What they should prepare for their presentation to the budget committee.
 - No monthly breakdown in annual plan, as the monthly numbers are to be set just before each quarter starts.
 - Stress the fact that only the more material categories will have more detail (e.g., payroll).
 - Sales forecast has been already made and is _____.

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EXHIBIT 9.13 Draft Agenda for the Annual Plan Briefing Workshop

Location: _____

Date and Time: _____

Suggested attendees: All budget committee, all business unit heads, all management accountants, and all budget holders

Requirements: event secretary, desk top for every seven attendees, data show, two whiteboards

8:30 a.m. Welcome by CEO and why this is a nonnegotiable event.

8:40 **Setting the scene**—topics covered include:

- Why we cannot afford the current annual planning process
- Better-practice stories and research we have done
- Some of the major flaws with the annual planning process
- The new rules that have been vetted by the focus group
- Proposed two-week annual planning process
- The setting on monthly targets, a quarter ahead, instead of annually

The senior management team may wish to leave after this session.

9:30 **Present the new planning tool.**10:00 **Workshop 1: Looking at the planning tool:** In small groups, no more than seven, each attendee gets a chance to play with the tool. Each group has a member from finance facilitating this process.

10:30 Morning break.

10:50 **Feedback on the package from the workgroups.**

11:20 Wrap-up of workshop by CFO, reminding about deadlines, help available, and to keep to the bigger picture.

 **PDF DOWNLOAD**


To assist the finance team on the journey, templates and checklists have been provided. The reader can access, free of charge, a PDF of the suggested worksheets, checklists and templates from www.davidparmenter.com/TheFinancialControllersandCFOsToolkit.

The PDF download for this chapter includes:

- Costing of the annual planning process
- Performing an efficient annual planning process checklist
- Planning focus group agenda
- Annual plan briefing workshop agenda

NOTES

1. David Parmenter, “Timely Annual Planning Process in Two Weeks or Less” www.davidparmenter.com, 2015.
2. Jeremy Hope, *Reinventing the CFO* (New York: Harvard Business Press, 2006).
3. Jack Welch with Suzy Welch, *Winning* (Cambridge, MA: HarperBusiness, 2005).
4. Harry Mills, *Artful Persuasion: How to Command Attention, Change Minds, and Influence People* (New York: AMACOM, 2000).
5. James Surowiecki, *The Wisdom of the Crowds* (New York: Anchor, 2005).





Queries in Chapter 9

Q1. Comp: There has been a change to two slides. Use the updated ones.

