feature article

What Exactly Is a Best Practice?

A Best Practice is strictly defined as a methodology or approach that consistently—almost always—delivers improved performance. The performance improvement needs to be clearly defined and measurable to meet these criteria. For a tightly defined process like account payable, this is fairly straightforward. The process itself is highly comparable company to company, and performance measures are well established. When a new, innovative practice emerges, it can quickly and accurately be assessed as a best practice—or not.

Planning is a little different. For one thing, the process itself is often defined differently across companies. One company might think of planning as encompassing everything from strategy development to operational planning and quarterly forecasting, to management reporting and performance scorecards. For another company, planning might mean nothing more than developing departmental budgets once a year. A declared "best practice" for this company may simply mean than it's able to consolidate its departmental budgets faster. While that's a good thing, it may not mean as much to another company that's looking for a way to link strategic planning with concrete operational plans—its goal for a best practice.

That brings us to another point. The performance measures for the planning process vary far and wide. Of course, cycle time and FTEs (Full Time Equivalents) are often used, but once again these measures may not be very comparable across companies, given the many different ways companies define the process. Obviously, a company that defines the start of the planning process with the initiation of strategic planning, and ends it with the final approval of next year's budget, will define their cycle as being longer than a company that doesn't consider strategy as a part of planning.

Are these efficiency measures, like cycle time and FTEs, all that meaningful? Improved efficiency implies reduced costs, and that's always welcomed. But is that the only goal? If it is, then seriously consider halting planning, and you'll be able to realize 100 percent of your goal overnight. Unlike Accounts Payable or Accounts Receivable, there is no absolute necessity for the process, is there? The real purpose of planning—which companies can easily lose sight of—is to improve decision making. Better planning also provides powerful foresight, more focused execution, and improved operational results. Are these benefits captured in measures like cycle time and FTEs? Obviously not, and that's the reason why these measures—although helpful—are inadequate on their own.

The point here is that the term Best Practices as it applies to planning should be taken lightly and not absolutely. The five Best Practices that are described here are the most widely discussed solutions to better planning, and most likely are the ones you've heard of. Consider them as providing some degree of insight and innovation, and most certainly "food for thought".

Rolling Forecasts/Continuous Planning

The objective of Rolling Forecasts/Continuous Planning is to make planning more than a "once a year, one time" event, which can turn a plan into quickly forgotten and irrelevant credenza-ware. There is wide variability around exactly how this approach has been implemented. Some companies employ a rolling four quarter or six quarter forecast, which simply means that each quarter the company projects four or six quarters ahead. Other companies finalize an annual plan, then review it on a monthly basis and re-project the balance of the year expected results (while sticking to a more traditional calendar for planning the upcoming year).

Pros	Cons
Encourages managers to think about planning as an ongoing process, rather than a static event	Garbage in, garbage out. Asking for information more frequently does not necessarily mean that information will be well developed or useful.
Opportunity to provide more "real time" response to rapidly changing environment.	Changing templates doesn't necessarily change attitudes. If planning isn't taken seriously today, new quarterly templates won't—on their own—change that.
In theory, the annual planning process is eliminated. The projection for next year is simply the first rolling forecast that looks at all four quarters of the following year.	Many dot-com companies embraced "continuous planning", but found that perpetually changing direction and hyper-responsiveness created confusion, a lack of focus and priorities, and an inability to achieve goals.
Can create an awareness of the importance of accurate quarterly forecasts (which is important for publicly traded companies).	Marketing driven companies often need to build their marketing plans (i.e., advertising and promotion campaigns) on an annual basis, and a partial view—as you will get with a rolling four or six quarter forecast—into the following year lacks meaning and context.
Planning is not necessarily dictated by the calendar, but can be triggered by important changes.	Potential to undermine commitment to key plan targets. Constantly changing assumptions and the financial implications of those assumptions tends to invalidate targets, along with the commitment to achieve them.

Can this work for my company?

If a company completes an annual plan, then locks it away until the end of the year to see how they did, clearly that's a waste of time. If that describes your company, we suggest that you institute a process in which the organization reviews actual results against the plan, say on a quarterly or even monthly basis, and then adjusts the balance of year forecast to take into account any significant changes. This alone will save your plan from becoming credenza-ware, will greatly improve results, and falls into the loose definition of rolling forecast/continuous planning.

If your company is already doing this (producing an annual plan, reviewing it on a quarterly or monthly basis and updating the balance of year forecast accordingly) and are considering implementing the more text book version of Rolling Forecasts/Continuous Planning, you've got a few things to consider. The first is how often you want to produce a forecast and for what period of time.

For instance, a Rolling Four Quarter Forecast means that at the end of each quarter, a company projects four quarters out (regardless of whether any of those quarters fit into the current calendar year or the following year). From that definition, you can guess at what a six quarter or eight quarter rolling forecast consists of. A Continuous Planning process implies that a company is "continuously" planning—assessing and updating its plans based on any important changes. In the textbook definition of continuous planning, the planning calendar is thrown away, and there are no defined planning periods.

We recommend considering implementing rolling four or six quarter forecasts under certain circumstances (see below) but generally avoid the textbook version of continuous planning. While we believe that managers need to constantly be assessing their business and the implications of important changes, good managers will do this anyway; they don't have to be told. Official, scheduled plan updates or forecasts just formalizes this process; takes a snapshot if you will, and ensures coordination and communication. From a practical, real world perspective, if you throw away the planning calendar and announce that the company will "continually plan" you'll be left with whatever managers are doing today between official plan updates (be that good or bad).

You may want to consider implementing rolling four or six quarter forecasts if your company meets this criteria:

- There is little need for coordination between functions. Each area is somewhat "self contained".
- Marketing is NOT a driver.
- You're in a stable business; economic models can be back tested and prove highly reliable.
- Planning is taken seriously today, not just a fill in the numbers exercise.
- There is little to be gained from taking a more broad based, strategic view of the business.

Value Planning

Value Planning™ is a unique approach to planning, the only one that looks at the entire process—from strategy through execution—as part of a single, unified system to drive improved results. The goal of Value Planning is to seamlessly integrate Strategic and Operational Planning with Performance Scorecards, Management Reporting and Rewards. Value Planning employs coordinated mechanisms, processes and policies to make this common sense goal a reality.

Pros	Cons
A "meat & potatoes" approach. One of the easiest planning solutions to implement.	Managers who now operate with absolute autonomy and independence may resist being made part of a new, integrated effort.
Improved bottom line results as strategy is translated into measurable action. A company actually achieves what it says it will—the key to managing investor expectations.	If reducing the cycle time of the budget process is the only goal, this approach is inconsistent with meeting that objective, as the new planning process requires that managers take responsibility for developing and meeting their plans.
All the arrows get aligned; everyone is rowing in the same direction.	Technology systems need to be developed to track initiatives and non-financial metrics.
Complete implementation guide available in the bestseller *Value Planning* (John Wiley & Sons).	Care and attention needs to be paid to the selection of the drivers of success and their key measures.

Can this work for my company?

Value Planning is a simple, straightforward approach that can greatly improve the planning process. In fact, it's been dubbed the "meat & potatoes" approach to better planning. It's so straightforward that it can be easy to overlook its value. Here's an analogy. According to the American Automobile Association, the number one thing a car owner can to reduce repair bills and extend the life of her car is to change the oil every 3,000 miles. Since thirty-minute oil change garages have popped up like weeds, this shouldn't be a problem, right?

Wrong. Just ask yourself this. Will you, now knowing exactly what you need to do to reduce your repair bills and extend the life of your car, change your car's oil every three 3,000 miles? Chances are very high that if you're not doing it today, you won't in the future, in spite of the fact that "now you know better."

Other things will come up, or you'll simply forget to do it. Even if you've got good intentions, chances are you'll be pretty inconsistent. Instead of consistently going every 3,000 miles, you might first do an oil change after 5,000 miles, and then after 6,300 miles or 7,200 miles.

What's missing is a mechanism to get you to do it. Something as simple as putting a notepad in the glove box with the dates and mileage of each oil change can help. Other people put a desktop reminder on their PCs. The thirty-minute oil change garages try to help by putting a sticker on the inside of your windshield to remind you. Some automobile companies are even planning on installing voice reminders in the car's computer system.

The point is that *knowing* what you should do, and *actually doing it*, are two different things. You need a mechanism to connect *knowing* and *doing*.

That's what Value Planning is all about.

While it might seem obvious that all the components of planning should be integrated in order to be effective, few companies have actually achieved this end. It's no mystery that strategy should drive operational planning, or that consistent performance measures should be used in both and summarized in a performance scorecard. Most people would also agree that this performance scorecard should be integrated into ongoing management reporting. Of course nothing happens without people, so plan goals should be reflected in individual objectives and performance reviews.

Pretty straightforward, so why isn't everyone doing it?

Because many companies lack the mechanisms to fully integrate each aspect of the planning process. Value Planning provides those mechanisms.

The simple objective of Value Planning is to unite all the major components of planning into a single, unified system. To use another analogy, there are distinct components of the "Billing to Cash" cycle from preparing and sending out invoices, to dunning notices, to collecting and depositing checks. The traditional approach was to analyze each component on its own, and try to optimize it. But companies found when they examined the process in its entirety, a whole new picture emerged. They could see the fumbled hand offs, the opportunities for disconnects, how a problem in one area affected all the others. Armed with this information, they were then able to optimize the entire system and see far more dramatic results.

Value Planning takes a similar approach. It examines the entire "Strategy to Execution" planning cycle. And just as in the "Billing to Cash" cycle, the flows and connections from each component are examined and understood. Specifically, Value Planning looks at how the Strategy is developed, and examines the hand offs to operational planning. Value Planning assesses the existing performance measures, and how exactly they are integrated (or not) into strategic and operational planning. Management Reporting is examined as well, to assess if the measures used and targets set in the planning process are effectively being reported. Finally, the human resource policies on performance reviews, merit increases, bonus, and personal development plans are examined to see how they support the achievement of plan goals.

The result is a document that lays out the entire "Strategy to Execution" planning cycle, and highlights both the linkages and disconnects that exist. And as in the "Billing to Cash" cycle, the company can then make whatever improvements are necessary and beneficial.

In implementing a Value Planning approach, there are three basic alternatives:

- **Alternative #1:** Simply audit the existing "Strategy to Execution" planning cycle. Does every aspect pass the "Ten Foot Test"? Typically, each integration point in the planning process looks good until you get to within ten feet, then the opportunities for disconnects emerge. After the audit recommendations for improvement can be made. These improvements should focus on the nuts and bolts mechanisms, policies and procedures necessary to integrate all the components of the "Strategy to Execution" planning cycle.
- **Alternative #2:** Clean the slate. Erase the existing strategic and operational planning processes, performance measures, management reports and rewards systems, and fully implement the Value Planning blueprint as it exists in *Value Planning: The New Approach to Building Value Every Day* (John Wiley & Sons).
- **Alternative #3:** Customize the Value Planning™ blueprint to fit the existing needs of the organization, keeping the basic framework as a starting point.

While the Value Planning approach does not have the same "brand name" recognition as, say Rolling Forecast, it is among the most thorough and complete solutions offered, and is proprietary to The Buttonwood Group LLP.

Balanced Scorecard

The objective of a Balanced Scorecard is to measure key non-financial, forward looking or predictive metrics (while of course still providing more traditional financial measures). Some companies strictly adhere to defining measures for all four quadrants of the classic Kaplan & Norton model—Financial, Process, Customer, and Innovation/Learning. Other companies have loosened the definition, and created *performance scorecards* to capture non-financial or operational metrics. The real innovation with this approach is that it gets managers to think beyond purely financial measures.

Pros	Cons
Can increase the degree of foresight or predictiveness provided by the plan and the planning process.	Actual data for each metric can be difficult, sometimes even impossible to reasonably track.
Can make the plan, and planning, more operationally relevant.	Actual data is sometimes rejected as not being accurate. How many times have you heard "that's not my number" with financial data? It can happen with non-financial data as well.
Managers more likely to become willing participants in the planning process, more likely to embrace planning as a tool to help them run their business.	The performance card measures must be very carefully selected; otherwise positive movement in the selected metrics may not improve sought after results after all.
Planning not viewed as "just a finance thing."	The linkages between the performance scorecard measures and financial results must be made explicit; otherwise, improvement in these metrics may not translate into improved shareholder value.
Since operational metrics are tracked along with financial data, variance explanations are more meaningful, and insight into the business is increased.	The interrelationships of the selected measures need to be well understood—and the efforts to improve them well coordinated—otherwise the organization will be pulled in different or even competing directions.

Can this work for my company?

This might surprise you, but in some respects your company is *already* employing a Balanced Scorecard. Consider this: do operational managers look at productivity measures? Do human resource managers track retention rates? Do marketing managers try to understand if their customers are satisfied or not? Of course. In that respect, your company has a balanced scorecard (however informal, and poorly communicated it may be).

The trouble is that these measures have been largely left out of the formal planning and management reporting process. In fact, for most companies, the annual plan produces a projected income statement, and that's it.

The beauty of a Balanced Scorecard approach is that it integrates important non-financial measures into the planning process. Instead of merely negotiating a set of financial outcomes, the process focuses on what the drivers of success in the business are, and how they are measured. Targets can be established for these measures, and projects and initiatives developed to achieve them. The plan, or budget, then becomes an outgrowth of these discussions. Yes, an income statement is still produced at the end of the process, but now it's one that is grounded in operational reality, where every projection has a basis in action.

We don't necessarily recommend implementing the textbook version of Balanced Scorecard since the effort required is very high, and the results have been mixed. Instead, we often recommend a company relax the definition a bit and consider a Performance Scorecard that captures the key drivers of the business.

Our approach usually begins by facilitating a meeting with senior management in which they define the no-nonsense, half dozen things that drive success in the business. As an example from a recent engagement, one such driver was identified as "Innovation". Next, we define specific measures for each driver. Using the same example, the measure for "innovation" was defined as "The Percent of Sales Coming From Products Introduced in the Last Two Years."

Using a tree diagram, these measures are then broken down one or more levels based on a number of considerations. Different functional areas and departments can then take these measures and break them down even further based on their responsibilities. Next, both long term (strategic) and annual targets are established for each driver of success. Projects and initiatives are developed to achieve them, and resources are allocated during the budgeting process accordingly.

Keep in mind that there is a people side to all this. Every company has some pivotal operational numbers. What are your essential numbers? Operational numbers by definition vary from one industry to another. These days, plenty of companies make a point of posting some of these numbers. All of this is great, as far as it goes. Sure, employees will keep an eye on them, but the tabulations are as likely to be a source of resentment—Big Brother is watching us—as they are a source of inspiration. If people don't understand *why* they're supposed to lower the defect rate or take those calls faster, pretty soon they'll stop caring. Like traditional employees, they'll do just what they have to to get by. So you'll need to build some business literacy in your organization, so people understand the connections between operational figures and the financial measures that are critical to your business.

You may want to consider implementing a performance scorecard if your company meets these criteria:

- You've got the management reporting systems to handle it.
- You can integrate the performance measures into the planning process.
- Senior management commits to reviewing actual results.
- You can develop the measures with line people (rather than HQ staff only)

Value Based Management/EVA

Value Based Management (VBM) or Stern Stewart's EVA is used to determine the "real" shareholder value creation (or destruction) contributed by each business unit or division. Rather than simply taking a profit or earnings number, VBM/EVA assigns a capital charge. The intent is to move managers away from fixating on market share or revenue growth and other traditional measures, and instead focus managers on creating shareholder value as the "ultimate" objective. In terms of planning then, the question becomes "How much shareholder value can this division contribute over the planning horizon, and how will it achieve that goal?

Pros	Cons
Can focus the organization on creating shareholder value, and thereby greatly increase the likelihood of achieving that goal.	Calculations VBM/EVA can be very complex and difficult to explain to managers. Lack of commitment and buy-in can result.
Stock analysts generally view the adoption of a VBM/EVA program very positively.	Without a whole host of supporting factors (detailed below in "Can this work for my company?"), it's likely to be ignored by the organization and fall into disuse.
Can create an understanding among all managers of how they contribute to creating shareholder value and focus their efforts accordingly.	Management reporting systems often need considerable reconfiguration in order to report monthly VBM/EVA results.
Creates one defining, overriding priority—creating shareholder value. All projects, goals and initiatives can be evaluated in this light.	Business Unit heads often reject allocations, and since allocations are often part of VBM/EVA calculations, bottom line results are frequently contested.

Can this work for my company?

Value Based Management/EVA, in theory, is the best thing that ever happened to shareholders. Why? Because shareholders often underwrite a whole host of money losing propositions—like throwing good money after bad chasing market share. VBM/EVA can change all that by focusing on and reporting on shareholder value creation (it gets very complicated very quickly, but you can think of it as earnings after a capital charge). So rather than focus on revenue growth, or "being #1 in the market", or any one of a number of common goals, VBM/EVA companies will pursue those goals only if they will result in increased shareholder value. In fact, all proposed projects, initiatives and programs are judged by this yardstick. Want to build an on-site daycare center? Fine, as long as you can build a compelling case that it will increase shareholder value (lets say by reducing turnover and recruiting fees).

The problem is that VBM/EVA tends to get stuck at the senior management level. The reason why that's a problem is that it's the decisions that workers make on the front lines every day that really drive shareholder value. Sure, senior management can make a "big bang" decision to sell a division or enter into a strategic alliance. But the fact is that line employees and frontline supervisors make dozens of business decisions every day: whether to throw out or remachine a problem part; how hard to pursue that new prospect; whether to get maintenance to investigate the funny noise the truck motor is making or just wait till it breaks; whether the irate customer on the phone is entitled to a refund; and not to mention those little decisions like what hotel to stay in.

If managers don't understand the VBM/EVA measure, or what they do every day that influences it, they'll stop caring about it. They'll do what they need to get by and no more.

That's why the successful implementation of VBM/EVA requires a lot of support; in the form of across the board business literacy, robust management reporting systems, and integration with the compensation and bonus policies.

In light of this, you may want to consider implementing VBM/EVA if your company meets these criteria:

- You have a data warehouse, or have implemented an Enterprise Application System (such as SAP or Peoplesoft)
- You are prepared to undertake an organization wide business literacy program to teach VBM/EVA
- Your senior management is prepared to make difficult, even unpopular decisions given the shareholder value implications (if not, don't waste your time)
- Compensation and bonus polices can be updated to support shareholder value creation goals

Activity Based Budgeting

Activity Based Budgeting is an outgrowth of Activity Based Costing; which defines the "real" cost of providing a product or service (internal to the company or external to the customer) by capturing and analyzing how workers spend their time. Activity Based Costing is often thought of as a highly rigorous approach to allocating costs, and can be used to refine pricing models (especially when price is set based on underlying costs), improve profitability analysis, and so on.

Pros	Cons
Detailed understanding of an organizations costs	Results can be ignored or dismissed. Allocated costs tend to be hotly debated, even if they have been rigorously developed (as they are with ABB).
Increased control over expenditures	Difficult to implement, as Activity Based Budgeting first requires an Activity Based Costing (ABC) system.
Improved understanding of the linkages between a company's processes and activities and their related costs	Time consuming—a solid Activity Based Costing system (a requirement for ABB) requires workers to record how they spend their time.
Increases the level of the dialog during departmental budget review sessions, encourages a healthy discussion of issues and cost drivers.	Garbage in, garbage out. If workers don't record their time accurately, the value of an ABC system or Activity Based Budgeting can be undermined.

Activity Based Budgeting uses these same models, and given projections for volume, provides projected costs.

Can this work for my company?

For cost minded companies, Activity Based Budgeting, supported by an Activity Based Costing system can appear to be very attractive. If implemented well, it will help to control costs and help a management team tighten their grasp on the business. But the ultimate success of ABB depends heavily on two factors: management's commitment to act on the data, and worker's commitment to accurately record their time.

There will be some resistance to the allocated costs derived from ABC models, and projected using Activity Based Budgeting. That's to be expected. But if this approach is to be successful, management must support the results. Of course, it can't do that without a thorough and complete understanding of how it works (which requires an investment of their time).

If the management team does not understand how the budgets and allocations were developed, and fails to support the results, then the entire process can be undermined.

Likewise, if individual workers fail to accurately account for their time, or if their superiors take too many shortcuts in estimating their time, then the resulting allocations and budgets will not prove very useful.

In light of this, you may want to consider implementing ABB if your company meets these criteria:

- You have a data warehouse, or have implemented an Enterprise Application System (such as SAP or Peoplesoft)
- Management is committed to acting on the information provided by ABB
- There is an incentive system for workers recording their time in an ABC system
- Allocated costs today, without an ABC system, are sometimes thoughtfully challenged but rarely dismissed out of hand.

Zero Based Budgeting

The objective of Zero Based Budgeting is to "reset the clock" each year. While a traditional budgeting process allows managers to start with last year's expenditures and add a percent for inflation to come up with next year's budget, Zero Based Budgeting implies that managers need to build a budget from the ground up, building a case for their spending as if no baseline existed—to start at zero.

Pros	Cons
Can eliminate a sense of "entitlement" to costs increases.	May be overkill in some situations to request that managers justify every existing expenditure. Can meet with significant active and passive resistance.
Improved cost containment.	Unless management takes the process seriously, budget holders will figure out they don't need to really build a budget from the ground up after all.
Increased discipline in developing budgets.	If reducing the cycle time of the budget process is a goal, this approach is inconsistent with meeting that objective.
More meaningful budget discussions during plan review sessions.	There is a significant educational element to this approach that if ignored, will result in confusion and user backlash.

Can this work for my company?

Zero Based Budgeting (ZBB) can be a highly effective way to "shake things up". When management announces that budgeting as usual will be replaced with a process that requires individuals to justify all of their current and projected spending levels, that nothing is taken as a given, people get the message that things have really changed. It puts them on notice that not only are increases in spending going to be scrutinized, but even current expenditure levels will need to be justified. This can be highly effective in special circumstances like a merger, or severe industry turndown, to name but two. If implemented effectively, this can produce some dramatic results.

Success requires that management follow through on the message, that in fact they assess and evaluate all material expenditures and take nothing for granted. If they don't then people will catch on that Zero Based Budgeting amounted to lip service.

In addition, success also requires a fair amount of education for budget holders. Often, people are promoted into a responsibility that includes developing a budget, but are not given any training. Many times these people fall back on the simplest approach, which is to take last year's spending and add something for inflation or other known increases. Zero Based Budgeting requires a much more rigorous understanding of expenditures and what drives them, and many managers are simply not prepared for this.

You may want to consider implementing Zero Based Budgeting if:

- You are in a situation, such as a merger, that requires senior management to understand every functional area's expenditures and justification
- You are prepared to hold workshops or other educational forum to teach budget holders how to create a Zero Based Budget
- You have the full, enthusiastic support of senior management (there will be pushback)
- You have the technology tools to support development of zero based budgets

The Buttonwood Group LLP is a research and consulting firm specializing in performance management and organizational effectiveness. They can be reached by calling 203.328.3056 or visit www.buttonwoodllp.com.