

CPM Expert Series⁷
The Budget: A necessary
evil?

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THE BUDGET: A NECESSARY EVIL?

Few people enjoy the budgeting process. It can be one of the most problematic, complex and tedious aspects of the business planning cycle. Research has shown that over 50% of companies that use traditional budgeting tools and methods are unhappy with the process and the resulting plan. In most cases the reasons for this widespread discontent can be traced back to two key issues: A poor budgeting process and inappropriate tools.

Focusing on what you can measure rather than on what matters

To illustrate this let's examine a typical budgeting process. The first step is for the senior management team to meet to determine the direction of the enterprise for the coming twelve months, usually within the context of the strategic plan. Based on these discussions they will develop high level targets, often little more than sales and profit growth figures allied to a set of key objectives.

Once these high level targets are communicated to departmental heads, one of two things happens: Managers either blow the dust off of last year's plan and attempt to modify it to meet the new targets or they will open up their departmental spreadsheet models and start entering numbers.

Both approaches have serious consequences for the resulting budget: simply reusing last year's plan and applying changes based on "gut feel" takes no account of new macro-economic conditions or the underlying drivers of profitability. Departmental models,

on the other hand, are often too detailed and focused on the line-items that exist in the general ledger. Indeed, research by the Hackett Group has shown that it is not unusual for a company to have detailed monthly plans for photocopier costs, yet lack a realistic model of what it will sell to its top ten customers. This is because most budget models focus on what is easy to measure rather than on what is important to executing strategy.

Horse trading: where their budget becomes your problem

The path to completing the budget is strewn with obstacles. The data collection stage, for example, is a slow and often manual process. In most budget cycles it consumes the majority of resources and time. Budget holders struggle to collect the data that they can, consolidate it, tweak the figures and horse-trade with subordinates in an effort to come up with final numbers that they feel are achievable.

However, when the departmental figures are collated and they fall short of the original high level targets, CFO's often resort to issuing top-down directives: all revenue centres must increase turnover by a fixed percentage. Discretionary expenses are to be reduced. Margins must be adjusted. In order to meet these cost trimming requests budget holders may cancel projects and initiatives without a thorough analysis of their overall impact. Consequently, while the budget may meet its targets and be completed on time, the resulting plan is one that no-one feels committed towards delivering. It's no wonder then, that only 30% of budget holders feel that the

budgets they agree to are achievable.

Stitched up

This situation is exacerbated by the mixture of technologies used in the typical budget process. These days it is not unusual for businesses to attempt to complete their budget using the data capture module of their ERP or perhaps a bespoke spreadsheet solution. The problem with these approaches is that they use products that have not been designed with collaborative corporate budgeting in mind. Spreadsheet systems are cumbersome, single user and prone to error. ERP modules can be clumsy to use and may focus on capturing data at general ledger level. It is not uncommon for departments to use multiple or incompatible tools and collect data at different levels.

One effect of this is that budgets often resemble some sort of Frankenstein's monster; they are composed of incompatible parts sewn together for convenience and lack any real focus or coherence. Worse still, they fail to be linked in any meaningful way to the strategic plan.

Planned obsolescence

Perhaps the biggest single problem with the budgeting process is the amount of time that the process takes. By the time that two bottom-up phases have been completed and the final top-down adjustments have been put in place 4-5 months may have elapsed. In today's dynamic marketplace that means that the prevailing market conditions will have changed and the make-up of company itself may even have altered substantially.

Problems with the budgeting process

As the above example demonstrates, the typical budgeting process is deeply flawed:

- The budget is not integrated. Departments plan as operational fiefdoms with their own tools and to their own levels of detail. The result is a data integrity nightmare.
- Comparative reporting is difficult. Actual figures may be collected and reported at a detail level but the budget will be planned in a more consolidated way. These two types of data may even be stored in different data repositories. As a consequence, carrying out meaningful reporting against the budget is a task in itself.
- The budget is not linked to strategy. Most budgets focus on planning the items that exist in the general ledger. These do not accurately represent the operational tactics that the business must execute in order to achieve its strategy.
- The budget is not fact based. The horse-trading and negotiating which inevitably becomes part of the budgeting process mean that the final budget is not based upon the real drivers of business success; rather it is a reflection of the politics within the organisation.
- A lack of commitment. The number of iterations and excessive detail mean that managers do not feel that they own the plan.

- The budget is too slow to produce. The typical budgeting process last 4-5 months and multiple iterations. The sheer amount of time and effort involved make it out-of-date as soon as it is complete.
- "Thank goodness it's over!" Rather than being treated as the key to delivering the strategic plan, the budget is regarded as a necessary evil. Surviving the process is more important than the accuracy of the resulting plan.

"Budgeting is not pleasant. Too often referred to as a necessary evil, largely as a consequence of the time taken to collate and the likelihood that high level adjustments will be required as the results do not sit comfortably alongside corporate objectives. Done efficiently and effectively, a budget can be a critical piece of the strategic planning jigsaw - done less well and it becomes obsolete almost before its completion."

Paul Newton
VP Finance
Croda International Plc

How Corporate Performance Management can turn the budget into a competitive advantage

The budget provides the foundation for all other business planning processes. It should enable an organisation to align its resources and activities so that executing corporate strategy becomes everybody's every day job. Unfortunately, in many organisations the budget is actually an obstacle to this happening.

Corporate Performance Management (CPM) applications provide the best practice solution to these problems. They allow budget holders to plan at an appropriate level of detail, enable the budget to be linked to corporate strategy and, most importantly, reduce the time taken to complete the planning process. As a result CPM solutions allow organisations to transform the budget process from a necessary evil into the first point on a virtuous circle of strategic delivery.



Quality through Partnership

Rinedata specialise in the selection, development and support of corporate performance management solutions. For over ten years Rinedata has delivered successful CPM solutions to numerous blue chip organisations across a wide range of industries. Our portfolio of experience encompasses SAP BPC, Infor PM, Oracle Hyperion, IBM Cognos and a selection of independent vendor solutions including Tagetik CPM and KCI Control.

Mayfair House
14-18 Heddon Street
London
W1B 4DA
T: +44 (0) 207 043 8107
F: +44 (0) 207 043 8108
E: info@rinedata.com
W: www.rinedata.com

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