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PREDICTIVE INTELLIGENCE

Management Education

Best Practices in Planning and Performance Management

How broken is your performance management process?

Improvements in transaction processes can be measured in terms of lower cost, higher productivity, and reduced error rates. The results are tangible and incontrovertible. Measuring the value of planning and performance management best practices is more subjective. How do you place a value on good information or a better decision? Many diagnostic tools have been developed to help organizations identify and size the improvement opportunities. This diagnostic comprises three elements which progressively allow you to:

- **Identify the magnitude of pain inflicted by a defective performance management process.**
- **Isolate the underlying causes.**
- **Understand the metrics that help define a best practice performance management process.**

Step One: Sizing the Gap

Isolating pain within a performance management process does not need an exhaustive analysis of the current process. Fifteen simple statements can allow any organization to determine whether a case for change can be made. How many of these statements do you agree with? If the answer is five or fewer, your performance management processes need serious rework.
How do you rate? Add up the total number of "No" answers and compare your score with the table in **Exhibit 1**, on the following page.

So why are so many organizations still wrestling with such fundamental problems?

Step Two: Understanding the Causes of Dissatisfaction

Digging into the causes of traditional performance management process failure, it is apparent that many problems are deep-rooted, but soluble. It is not necessary to rely on conjecture, perception, and anecdote to make the case for change—the data are compelling. Most performance management reporting processes not only fall far short of best practice, but are broken. By every measure, the gap between actual and desired performance is significant.

Circle Yes or No		
1. The planning and budgeting process is viewed as one of the most valuable management processes.	YES	NO
2. Senior management has confidence in the outputs of both the planning and forecasting processes.	YES	NO
3. It takes fewer than 60 days to complete the planning process from issuance of corporate targets/guidelines to management approval.	YES	NO
4. Plans specifically identify tactics, resource requirements, and expected results in each of these areas:	YES	NO
Attracting new customers	YES	NO
Retaining existing customers	YES	NO
Attracting and retaining talented associates	YES	NO
Developing innovative new products or services	YES	NO
5. Plans clearly identify the expected impact on key measures of all major initiatives that are included in the plan.	YES	NO
6. Sandbagging of plans and forecasts is virtually nonexistent.	YES	NO
7. Incentive compensation is not directly tied to meeting plan or budget.	YES	NO
8. Technology has been fully leveraged to improve both the efficiency and the value of the planning and performance management processes.	YES	NO
9. Analysts spend less than one-third of their time assembling data, developing and maintaining spreadsheet models, and creating reports.	YES	NO
10. Business risks are clearly identified, and appropriate contingency plans developed.	YES	NO
11. A new forecast can be developed on demand within 24 hours.	YES	NO
12. Managers rarely complain that they are unable to get the information they need to make important business decisions.	YES	NO
13. Management reports contain a balance of leading and lagging information and clearly show the linkage between key business drivers and financial results.	YES	NO
14. Analysts are able to analyze the impact of alternative decisions on future performance without the need to create new models or spreadsheets	YES	NO
15. Analytical support costs have been reduced by at least 10 percent a year (relative to business growth) for each of the last three years while the level of internal customer satisfaction has simultaneously increased. (Answer "No" if you do not even measure these two things!)	YES	NO

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Exhibit One

Source: Sonax Group

Number of "No" Answers	Assessment	Percent of Organizations that fall in this Category
Fewer than 3	Read no further. You are world-class	5%
4 to 7	On the right track / close to standard of today's best companies.	20%
8 to 13	A good foundation upon which to build; lots of potential to deliver more value	30%
More than 13	Major improvement opportunities; start selling the need for change	45%

Research data reveal a common theme that challenges the basic foundation on which traditional processes for planning, forecasting, and management reporting have been built. The data show that most organizations are trying to manage increasingly volatile and complex processes with management practices that are more than half-a-century old. Detailed five-year strategic plans, static annual budgets, calendar-driven reporting, and mind-numbingly detailed financial forecasts are largely ineffective tools for managing change, uncertainty, and complexity, yet for many organizations, they remain the foundation of the management process. So what are the drivers of such inadequacy?

Exhibit Two

Source: Sonax Group

Planning and Reporting the Wrong Stuff

Perhaps the most damaging attribute of many performance management processes is that they focus on the wrong things. Operating plans fail to describe the major initiatives that will be undertaken; financial plans do not show the expected costs and benefits of each initiative, nor do they identify the total investment being made in critical areas of the business. Obvious? Perhaps, but the reality is that many organizations plan and report the things they can rather than the things they need. Barely 60 percent of all companies develop plans that describe the tactics and investments to be made in key areas, such as attracting new customers or retaining existing customers; only 20 percent consider the retention of talented employees to merit specific focus in their plans (see **Exhibit 2**).

Poor Ownership and Accountability

Unclear ownership and accountability underlie many performance problems. Often, the two elements are mismatched so that the individual or organization being held accountable has little or no real ownership. This can be a problem, but it is nowhere near as damaging as the reverse situation, where ownership of an activity, asset, or resource is not matched by some clear accountability for performance—a sure recipe for creating performance shortfalls. For many organizations, defining appropriate ownership and accountability is the single most important factor in driving successful execution of strategy. A number of leading indicators should raise the red flag that potential ownership and accountability issues may exist:

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Exhibit Three — Source: Sonax Group

To what degree is incentive compensation tied to meeting plan or budget?

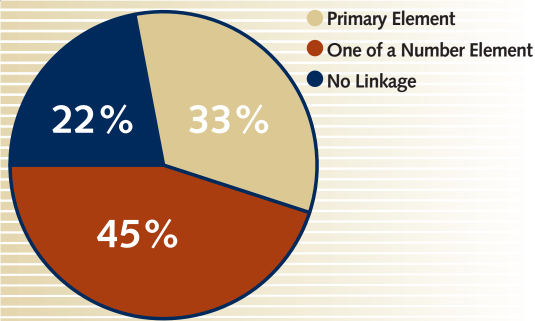
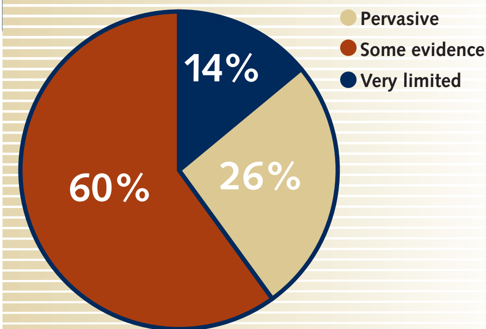


Exhibit Four — Source: Sonax Group

Level of sandbagging in plans and budgets



- **Highly complex organizations characterized by matrix structures**
- **Shared ownership of activities, assets, or resources**
- **Numerous allocation or internal transfer pricing mechanisms required to create business unit, functional, or departmental financial statements**
- **Redundant management of common processes, such as procurement, human resources, or information technology.**

Tying Plan Achievement to Compensation

Everyone agrees that the way people are rewarded influences the way they behave. The basis upon which an individual is rewarded is critical to an effective management process. Given the overtly financial focus of most business plans, it is not surprising that for one-third of all companies, incentives are completely tied to performance relative to the annual financial plan (see **Exhibit 3**). At a further 45 percent of companies, plan achievement is a major determinant of bonuses.

Although it seems very logical, this linkage can result in a number of unintended consequences. The primary purpose of developing plans is to decide on tactics and allocate resources in an optimal manner to achieve agreed-on objectives. If compensation is tied directly to meeting the numbers in the financial plan, there will be an inevitable tendency to be conservative—some call it sandbagging—to maximize the chance of achieving the plan. Instead of motivating exceptional performance, results may be the exact opposite, as people seek to maximize the chance of earning incentives. The data clearly support this assertion: 86 percent of companies struggle with some degree of sandbagging in their plans and budgets (see **Exhibit 4**)

Given the frequent disconnect between strategic plans and financial plans noted above, linking compensation to financial plans can lead to a very short-term focus at the expense of strategy and long-term value creation.

Overall, the lack of alignment and integration between strategy and tactics leaves many organizations dangerously exposed when things do not turn out exactly as projected—which is most of the time. Without a clear understanding of the cause-and-effect relationships between tactics and objectives, one can have little confidence that today's actions will produce tomorrow's desired results. Best-practice organizations do not necessarily develop better predictions or plans; however, they are far better equipped to quickly identify changes or problems, diagnose root causes, and take corrective action.

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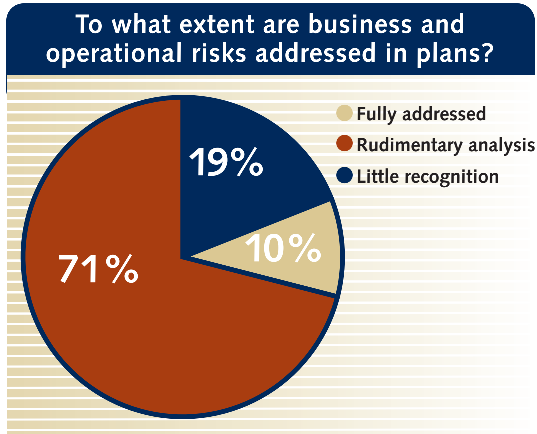
Exhibit Five Source: Sonax Group



Inadequate Risk Recognition

Effective performance management requires that managers explicitly address risk and uncertainty in order to make rational decisions. In addition to formal scenario planning, a number of internal and external risk factors need to be considered in plan development. Nearly 90 percent of companies pay no more than token attention to risk in their plans (see **Exhibit 5**)— a truly frightening statistic.

Few companies follow a rigorous risk assessment process. More disturbing is the fact that fewer than one in five organizations systematically addresses major external risk factors related to reputation, labor relations, special interest groups, or community impact. The planned acquisition of Honeywell by General Electric in 2001 thwarted by regulatory concerns, the Chapter 11 filing by United Airlines in 2002, and the negative publicity associated with the use of child labor by several multinational companies all illustrate the potential magnitude of such issues.

Mistaking Detail for Accuracy

There must be something in the DNA of finance professionals that creates an insatiable thirst for detail. Starting with the earliest experiments in scientific management in the 1920s, the volume of data generated within organizations has grown at a phenomenal rate. Widespread deployment of computers has only added fuel to the data explosion. As the data volume has increased, so has the potential to plan, budget, and report at ever increasing levels of detail, leading an unfortunate number of companies to create performance management processes so detailed that really important items become obscured. It is not unusual for a company to develop a budget item for spending on office supplies in the third quarter of next year, but have little or no idea how much business it expects to generate with its 20 best customers.

There is no evidence that developing more detail in a financial plan results in either greater accuracy or—more importantly—better performance. Organizations that insist on excruciating detail often fail to appreciate likely consequences:

- **People will have less time to plan each line item. To get the job done, they are more likely simply to plug in a number than to develop a rationale and set of tactics to support each item.**
- **Given that plans by definition deal with the future, there is no guarantee that more detail will result in greater accuracy. In fact, the reverse is more likely to be true.**
- **The more detailed the plan, the more complex and time-consuming the processes for tracking performance against that plan, reporting and analyzing variances, developing forecasts, and restating plans to reflect the impact of major business events.**

The net effect is to slow down decision-making, precisely the opposite of the effect most companies desire. Not only does excessive detail hamper the planning process, it also leads to painfully detailed management reporting. We have all seen or had to use management reports that were more suitable as doorstops than as insightful decision- support tools. Inundating managers with flood of metrics can make their job harder. Managing performance against a multitude of measures not only creates a complex equation that cannot easily be solved, but also increases the risk that a material trend in one key measure may be overlooked.

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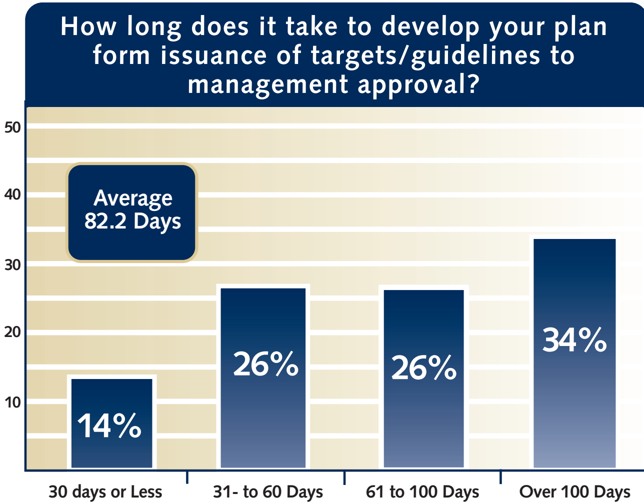

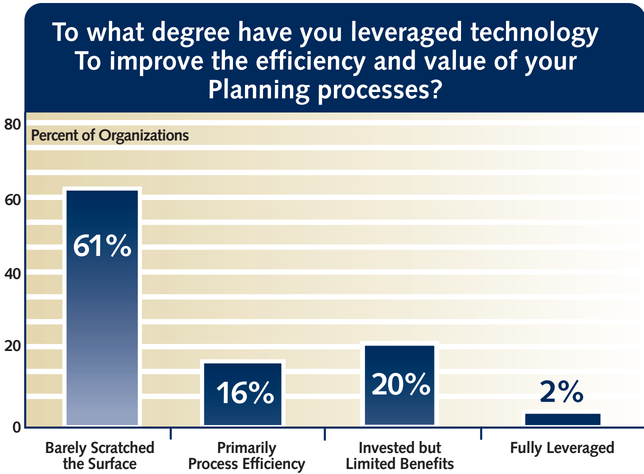

Extended Cycle Times

Not only is performance management expensive, it is also time-consuming. In an era of cycle time compression in nearly every other aspect of business, the planning and management reporting process has been left behind. **Exhibit 6** shows that the average time required to develop a tactical plan is 89 days.

Automating Inefficiency

Contributing to management's frustration has been the comparative failure in recent years of the vast technology investments made to provide the much-promised improvements in visibility, control, and information. Many bought the promise of technology, but now feel cheated. Far from liberating management from the constraints of untimely, useless information, computers have—if anything—exacerbated the problem. Organizations wrestle with long, tortuous accounting close cycles, which Sarbanes-Oxley has in many cases served to extend still further. Last-minute year-end events invalidate budgets prepared in excruciating detail over many months. A basic question like, "How much do we sell to our biggest customers?" still triggers days, sometimes weeks, of frenzied activity. Managers and analysts had become slaves to their PC-based spreadsheets. Technology was supposed to solve such problems, but despite massive investments in data warehousing, executive information systems, and other reporting and decision support tools, most organizations are frustrated at their lack of progress.

Their frustration is not due to a lack of investment, but rather to poor implementation. Organizations have failed to leverage their investments in enterprise resource planning (ERP), data warehousing, and online analytical processing (OLAP) systems. **Exhibit** 7 shows that only 2 percent of companies believe they have fully leveraged technology in their performance management processes. Six out of 10 companies believe they have barely scratched the surface.

Understanding the relative impact of each of these symptoms on your current performance management processes lays a sound foundation for identifying those best practices that:

- **Are most applicable to your organization**
- **Will have the biggest beneficial impact**

Step Three: Best-Practice Metrics

A consequence of the explosion in the amount of data available to most companies, combined with increasing numbers of competing benchmarks, is that it is all too easy to suffer from "metrics overload." The risk of relying on too many metrics is that it becomes increasingly difficult to identify

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the metrics that really matter. The table below shows seven metrics that provide a quick snapshot of the relative health of your performance management processes.

Best Practice Process Metrics

Source: Sonax Group

Metric	Acceptable	Best Practice Standard
Plan Achievement[1]	Within 5% of Target Range	Within Target Range
Forecast Accuracy[2]	+/- 3%	+/- 1%
Staff Leverage Ratio[3]	0.5	0.25
Value Added Ratio[4]	>1	>1.5
Forecast Completion Time[5]	< 3 Days	< 1 Days
Annual Plan Completion Time[6]	8 to 12 Weeks	8 Weeks
Management Satisfaction[7]	50% "Top 2 Box" Score	75% "Top 2 Box" Score

Metric definitions

1 Achievement of revenue and net income goals assuming a target range is defined. Ranges should not exceed 5 percent of the midpoint.
2 Achievement of revenue and net income forecasts for the next quarter.
3 Ratio of professional staff time spent on value-added tasks versus lower-value tasks.
4 Ratio of managerial and professional finance staff engaged in transaction processing as opposed to business risk management and decision support.
5 From request or trigger of a forecast activity to executive management approval.
6 From the issuance of targets to board approval
7 Percentage of managers rating the performance management process a "9" or "10" on a 10-point scale

Conclusion

It is rare that a company is shocked by the results of an evaluation of its performance management process. Managers generally know if their management processes are cumbersome, inaccurate, and of limited value. The key is to get beyond identifying the problems to fixing them by instituting more effective processes.
Spend less time sizing up the problem; spend more time architecting and selling the solution.
In summary, best practice companies:

- **Have simpler, faster, more focused processes**
- **Deliver information that is tailored to the needs of the individual**
- **Spend twice as much time planning and analyzing as they do collecting and validating data**
- **Spend less money supporting more effective performance management processes**
- **Attract, retain, and leverage more talented staff**
- **Make better decisions, faster.**

About The Author

David Axson is an author and consultant. A former co-founder of The Hackett Group and Head of Corporate Planning at Bank of America he is a highly regarded public speaker. His most recent book is Best Practices in Planning and Performance Management (Wiley 2007). For more information visit DavidAxson.com.

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