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Effective Planning During Uncertain Times

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Introduction

- The Global COVID-19 Pandemic has a had profound impact on all aspects of U.S. society.
- With the resulting uncertainty impacting nearly every aspect of manufacturing businesses, a comprehensive planning process is essential to achieving company goals.
- If a manufacturer “fails to plan,” it “plans to fail.”
- Business planning involves key management in a strategic process that focuses on defining company goals and objectives.

Introduction

- Manufacturers have been affected in many different ways.
  - Employee safety and other personnel matters.
  - Supply chain disruptions.
  - Changes in distribution channels.
  - Variability in customer demand and sales functions.
  - Inflation in costs of materials, labor and overhead.
- All of these areas should be addressed within the Company's normal planning process, and the effectiveness of that process is even more critical during uncertain times such as this.

Comprehensive Planning System

- Develop business goals (strategic planning).
- Quantify the financial impact of those goals (budgeting).
- Obtain commitment to achieve the goals (individual performance planning).
- Evaluate the success or failure of plan attainment (financial reporting and plan review).

Long-Term Outlook

- It is critical to assess the long-term outlook in order to make strategic business decisions.
- Some products may no longer be viable while there could be a stronger market for others.
- Changes may also be needed to the manufacturing process, including increased automation as discussed above.
- Major changes caused by the pandemic make this a great time to reevaluate things such as plant capacity, product offerings and employment levels.

Objectives of Long Range (Strategic) Planning

- Secure adequate financial resources, as required and on relatively acceptable terms, to meet corporate growth needs.
- Maintain financial health in a manner that will make owners comfortable over the longer term.
- Meet the requirements of various credit agreements without endangering its capital.
- Achieve its target ROE, return on assets (ROA), and other financial goals.

Phases of Strategic Planning

- Developing goals and strategies.
  - Intensive, highly analytical process of strategic or conceptual thinking about:
    - The company's mission or purpose.
    - The desired objectives.
    - The strategies to achieve these objectives.
  - The finest minds of the company, especially those executives who possess comprehensive and in-depth knowledge of markets and products and marketing techniques, should participate in this phase.

Phases of Strategic Planning

- Preparing the long-range plan.
  - Engage in long-range planning, which takes into account the sales, earnings, and financial health of the company over a long time horizon.
  - Evaluate the company's human, material, technological, and financial resources in terms of their capacity for supporting the selected strategies.
  - Financial know-how plays a more important role in the second, or long-range, planning phase of the total planning cycle.

Elements of Strategic Planning

Questions	Element
What kind of business should we be in? Where, geographically, should we operate	Corporate mission
What are the strengths and weaknesses of the company? Why do we think we can achieve our corporate mission?	Environmental analysis
By what path or technique will we achieve our purpose?	Strategy
What are our key objectives and when should they be accomplished?	Long-range goals
What specific plans and programs need to be untaken?	Coordinated programs
What are the possible results from the programs?	Budget and financial plan
How did we do versus plan?	Actual to Budget

Environmental Analysis - External

- Identify the strengths and weaknesses of the company relative to those of its competitors, the potential threats to its existence and growth, and the opportunities to be seized.
- External forces beyond the control of the firm exert a dominant influence on the activities and the condition of the company.
- The activities in the external environment that can affect the company may be categorized as follows:
  - Economic activity.
  - Technological activity.
  - Legal and/or political activity.
  - Societal activity.
- Each trend or factor in the external environment must be analyzed to determine whether it represents a threat or an opportunity.

Environmental Analysis - External

- Looking externally has never been more critical for a Manufacturer than it has been in the last two years!
- The pandemic has created possible opportunities and threats in areas such as sales, distribution channels, material purchasing, and availability of labor.
- An ongoing analysis of these external factors and a link to the company's operating plan will better allow a Manufacturer to adapt to changes and remain competitive.

Environmental Analysis - Internal

- A key ingredient in strategic planning is introspection - that is, the company's self-evaluation. It is often difficult to judge ourselves or our company.
- Objective, realistic answers to the firm's status or condition must be secured.
- The influences within the company that will have a material impact on its future well-being include the company's attributes, present momentum, and flexibility.

Environmental Analysis - Internal

- An understanding of the company's attributes is based on the knowledge and appreciation of:
  - The "critical success factors" or attributes of each business sector. Such factors include the true source of winning, superb research, quality products, sound engineering, and quick response time.
  - The present status of each of the company's business segments.
  - The company's strengths and weaknesses, including:
    - The areas in which the company performs well,
    - How the company's strengths compare to those of its competitors, and
    - Whether the company can maintain or improve its competitive strengths.

Environmental Analysis - Internal

- Evaluation of the company's momentum considers the current size of company operations and the rate of decline or growth, including:
  - Size of plant and percent utilized,
  - Number of employees,
  - Amount of product shipped, and
  - Qualitative indications of changes in the products and markets.
- The flexibility of the enterprise should be understood, including:
  - The extent to which a firm's existing plant, know-how, and marketing channels can be adapted to other uses, and
  - The extent to which the knowledge, skills, and judgment of the firm's management and other personnel can similarly be adapted.

Polling

Does your company have a strategic plan?

a. We have a detailed written strategic plan.
b. We have a high-level summary of a long-range plan.
c. We have long range goals and plans but they are party of a written document.
d. We have no plan beyond the next fiscal year.

The Business Purpose or Mission

- After the external and internal environment of a business has been assessed, then its purpose or mission can be determined or updated.
- Developing a mission statement (occasionally called the purpose or vision statement) is the first step in determining where the company wants to be.
- The mission statement may never change or it may evolve as the company evolves.
- The statement is a formal written expression of the company's basic intent and purpose.
  - To many owners or executives, this may appear to be unnecessary and overly formal because they believe they know their company's mission.
  - However, developing a mission statement is useful because it may identify misunderstandings among key individuals about the company's mission.

The Business Purpose or Mission

- The mission statement should be brief-perhaps just one sentence, but never more than one paragraph.
  - It forms the basic foundation for future planning, providing both direction and motivation.
  - A properly written mission statement also creates a charter for future operations by steering growth and resource utilization.
- An effective mission statement identifies company characteristics that set it apart, thus creating a competitive advantage. For example, the planning members might address questions such as:
  - Does the company want to be known for quality? For service? For meeting the needs of a certain market niche?
  - Is the company in business primarily to make a profit or is providing security and employment to the owners and others a priority?

The Business Purpose or Mission

- Mission statement development requires a thorough analysis of the products and services the company offers its customers.
  - Management planners should look beyond the obvious to determine what customer needs the company successfully fulfills.
  - Companies failing to strategically understand their customers' needs have overlooked many growth opportunities.
  - When considering growth for strategic purposes, controllers should be aware that real growth typically occurs in at least one of four ways:
    - Market penetration - current products sold in current markets.
    - Product development - new products sold in current markets.
    - Market development - current products sold in new markets.
    - Diversification - new products sold in new markets.

Long-Range Goals

- In the strategic planning process, once the corporate mission is determined, then the long-range objectives may be selected.
- Goals or objectives can be defined as:
  - A desired major result or condition.
  - To be achieved by a specific time.
- The process is again an iterative one, with much interplay between objectives and strategy until satisfactory objectives are established.

Long-Range Goals

- The adjectives that may be used to describe the attributes of a satisfactory long-term goal include:
  - Suitable,
  - Feasible,
  - Measurable,
  - Compatible,
  - Motivating, and
  - Flexible.

Long-Range Goals

- Goals are often financial in nature and relate to sales volume, profit level, return on assets, return on shareholders' equity, product margin, or share of market.
- Measures developed for other areas may include employment levels, facility expansion, labor, content of product, industry ranking, productivity, R&D expenditures, diversification, minority workforce levels, and R&D professionals employed.

Long-Range Goals

- The following are some typical corporate goals to be attained in five to ten years:

Goal	Achieve By	
	2025	**2030**
Aggregate sales (millions)	$15,000,000	$22,000,000
Operating profit (as percent of sales)	6.5%	8.0%
Rate of return		
On shareholders' equity	20%	22%
On assets employed	11%	12%
Earnings per share	$5.70	$9.00
Market share	35%	42%

Typical Contents of a Long-Range Plan

- Objectives selected for the company or SBU during the long-range planning horizon, and reasons for their selection.
- Expected financial results for each year of the long-term plan and related supporting analyses.
- An overview of the facilities (property, plant, and equipment) planning for the company/operating centers, human resources planning, indicating the expected head counts, professional skills required, and recruitment methods.
- A comparison of the current long-range plan for the company or operating center, or major functions with prior long-range plans, using selected factors or programs (such as sales) to explain progress made (or lack thereof) and other important changes between the present plan and prior plans.

How Far Ahead Should a Company Plan?

- Manufacturers should plan ahead as far as is useful!
  - If the industry environment changes so rapidly or if the company's circumstances are such that a plan would be largely useless after two years, then that company's strategic planning horizon should be set accordingly.
  - For example, a firm that designs and markets high-fashion clothing may find that it is useful to plan only one year or eighteen months into the future.
  - On the other hand, a forest products company may find it necessary to plan fifty years into the future.
  - The pandemic has resulted in more focus on more detailed planning for a shorter time period.

How Far Ahead Should a Company Plan?

- In selecting the time span for its long-range plan, a company should consider the following factors:
  - Time required for new product development,
  - The life of the product,
  - Time required to construct or acquire the necessary plant and equipment,
  - Time required to develop new markets, and
  - Development time for raw material sources and sources of other components.

Contrasting Long-Range and Short-Range Planning

- Detail
  - The strategic/long-range plan deals largely with significant matters of a broad nature. Extensive detail is simply unnecessary; overall ratios may be used.
  - By contrast, the short-term plan or budget requires monthly or quarterly detail of expenses by department and by type of expense.
- Uncertainty
  - The strategic/long-range plan contains a large element of uncertainty because it is affected by changing trends and other factors not controlled by the company over a longer time horizon.
  - This is one reason for preparing a more condensed plan that is reviewed less frequently than the annual plan.

Contrasting Long-Range and Short-Range Planning

- Information needs
  - The development of a strategic/long-range plan requires vast amounts of external information, such as industry data, competitors' actions, and changes in laws and regulations.
  - The short-term plan depends to a greater extent on internal information.
- Time horizons
  - A strategic plan may cover a period ranging from one to thirty years, depending on the company's market and product.
  - A short-term plan spans a shorter, more uniform period, usually no longer than one to two years.

Contrasting Long-Range and Short-Range Planning

- Alternatives
  - The range of alternatives to be considered in strategic planning is much greater than that in short-term planning.
- Regularity
  - Strategic planning (other than the annual review of the plan) occurs irregularly and may be triggered by events such as the emergence of a new threat or a new opportunity, an internal or external crisis, a scientific discovery, or a major technological breakthrough.
  - Short-term planning is performed on a fairly predictable schedule fixed by executive decision.

Contrasting Long-Range and Short-Range Planning

- Personnel involved
  - Strategic planning is usually done by top management.
  - Short-term planning engages vast numbers of lower-level managers and nonmanagerial employees in tasks ranging from securing detailed sales estimates from each salesperson to preparing detailed departmental budgets.
- Nature of problems
  - Problems encountered in strategic/long-range planning tend to be unstructured.
  - Problems encountered in short-term planning are usually structured, probably because they are more foreseeable and tend to recur over time.

Polling

Have you updated your long-range goals and plan as a result of the pandemic?

a. We have made significant revisions to our detailed long-range plan.
b. We have started to change long-range plans but more revisions will be needed as things continue to evolve.
c. We have adjusted our outlook for the near future but think that long-term will return our goals and plans will be similar to before the pandemic.
d. We are taking things month by month and have not considered long-term impacts.

The Operating Budget

- The operating budget is an integral part of the business planning process.
- Once a company defines its goals and objectives and the means for achieving them, the budget simply translates the strategic plan into numbers against which a company's future performance can be measured.
- Essentially, if a budgeted expenditure cannot be linked to a business strategy, the funds should not be spent.
- Remember that effective budgeting is part of a continuous planning process, not a once a year exercise.
- Budgets for 2020 certainly required updating based on the impact of the pandemic and 2021 budgets certainly looked very different than past years!

Critical Budgeting Areas for Manufacturers

- Critical elements of the operating budget basically following the areas of an income statement for manufacturers.
- Sales budget.
- Separate elements of costs of goods sold including material costs, labor costs and overhead, including usage and unit costs for each.
- Operating costs should be budgeted with some indication of which amounts are fixed and which are variable.
- The impact of other possible elements such as financing costs and items of other income such as those from government programs.

Benefits of Budgeting

- Improved decision-making.
- Involvement of the management team.
- Prompt performance analysis.
- Prevention of unplanned expenditures.
- Improved cost evaluation.

Approaches to Budgeting

- Top-down approach.
  - Initiated by top management after it has reviewed and assessed relevant information regarding past performance, industry trends, economic and market conditions, and management's effectiveness.
  - It integrates this assessment with the company's long-term goals and agrees on the objectives for the year ahead for the company and its business units.
  - Top management communicates the overall goals and objectives to managers at the next level. The individual managers then develop plans that will achieve the objectives established for their unit and communicate them to managers at the next level.
  - In this way, the goals established by top management are pushed down through the organization to the lowest level of management.
  - A benefit claimed for the top-down approach is that it provides operating managers with a clear understanding of the company's objectives and their roles in achieving them.

Approaches to Budgeting

- Bottom-up approach.
  - Starts with the lowest level of operating managers.
  - They develop budgets based on their perception of the company's objectives and their responsibilities for achieving them.
  - At each successive level, the budgets are summarized and integrated with operations in other departments and other functional areas.
  - Top management reviews the summary of all budgets and the combined results of operations. If it is not satisfied with the planned results, it sends the budget back to the appropriate managers, indicating the areas which need to be improved.
  - When the budget meets top management's approval, it is communicated to managers at all levels, and it becomes the blueprint for operations.
  - A major benefit claimed for the bottom-up approach is that it involves managers who are closest to the activities in setting goals and developing plans. Managers who participate in this way are more likely to set realistic and challenging goals for themselves, and they are more likely to work harder to achieve them.

General Principles of Budgeting

- Budgets as a tool for planning.
  - Preparing a comprehensive budget can force detailed planning at all levels.
  - Plans for better use of company resources such as facilities, material and labor.
- Budgets as a tool for control.
  - A carefully prepared budget is the ideal standard for measuring and evaluating performance.
  - The budget acts as a control point and serves as the benchmark against which to compare actual results.
  - For this purpose, the budget must be prepared on a month-by-month basis, and the monthly budgets are combined to form the annual profit plan.
  - Departmental budgets must be developed in adequate detail if they are to serve as the basis for meaningful performance reports.

General Principles of Budgeting

- **The budget period** – Monthly, Annual and Rolling Budgets should be considered.
- **The budget committee** - Even in small companies, there is a benefit to establishing a budget committee to oversee and guide the preparation and use of the budget.
- **The budget manual** - Essential for the smooth and timely functioning of the budget process. It provides all managers a set of the company's budgeting policies and procedures.
- **The realistic budget** - Budgeting should not be viewed as an opportunity to improve performance by setting high goals that cannot be achieved.

Using Budgeting and Forecasting Software

- Many accounting software packages come with budgeting and forecasting add-on modules, which is the obvious first place to look for budgeting software.
  - The appropriateness of these modules will depend on the software package and whether it can be tailored to meet your unique needs and situations.
  - However, generic spreadsheet software and commercial budgeting and forecasting software often meet any needs not satisfied by these add-on modules.
- Because fine-tuning and constant updating are necessary, budgeting and forecasting is an ideal application for specialized spreadsheet software.
- A critical security feature of budget software is its ability to limit access to update or view specific worksheets. For instance, department managers will need access to compensation information for their staff, but should be restricted from other department's confidential data.

Using Budgeting and Forecasting Software

- Other important features or functionality to consider in evaluating the best budgeting and forecasting software for your company's unique needs include:
  - The ability to produce individual department or business unit budgets as well as a consolidated company budget.
  - A system that supports bi-directional changes-both top-down (high-level budget criteria ripple down to lower levels) and bottom-up (numbers entered at lower levels roll up to higher levels) and quickly calculates new iterations.
  - Workflow automation that routes spreadsheets for approval and performs user-defined business rule checking to alert users (or reviewers) to exceptions in the budgeting data.
  - The ability to track and document submissions and report the status of individual budgets.
  - The ability to model and perform scenario evaluation using "what-if" commands for key assumptions.
  - The ability to perform variance calculations using the flexible budgets for performance measurements.

Polling

Does your company prepare an annual budget?

a. A detailed annual budget is prepared that remains static throughout the year.
b. A detailed annual budget is prepared that is updated periodically during the year.
c. Summary budgets and forecasts are used instead of a detailed annual budget.
d. We do not prepare any budgets or forecasts.

Budgeting the Balance Sheet

- A gross budget preparation approach essentially follows double-entry accounting when estimating the budget amounts.
- In other words, as budget amounts are estimated, the offsetting debit or credit amounts are also determined.
- A natural tendency for smaller manufacturing companies is to use the net budget approach, which generally includes an income statement and possibly a cash budget.

Budgeting the Balance Sheet

- The balance sheet budget allows controllers to monitor key balance sheet accounts, which often serve as red flags or early warning indicators to potential problems.
  - For example, if a purchasing manager is making excessive inventory purchases, this situation will quickly become apparent with a balance sheet budget.
  - Otherwise, it may not become apparent until cash flow is squeezed several months later.
- The balance sheet budget approach is useful to tie a firm's strategy and goals to the operating cash flow budget.
- The balance sheet also manages to assess the effects that the budget will have on working capital and other assets and liabilities.

Activity Based Budgeting

- When combined with standard costs, it facilitates the development of the annual profit plan and the preparation of meaningful performance reports.
- In each department, the budget for factory overhead is expressed in the form of rates per unit of activity for variable overhead and amounts per month for fixed overhead.
- While fixed budgets involve a plan that is unchanging, a flexible budget permits revision of estimates of operating costs and profits with changes in the sales or production volume. Budgets need to be flexible, coordinated, controlled, and have the ability to be forecasted.
- A flexible budget can be especially useful during times where costs inputs are changing significantly, such as the current situation with inflation in material costs, transportation, labor and overhead costs including utilities.

Using Rolling Budgets in Place of Traditional Budgeting

- There is a school of thought that traditional budgets are not effective.
  - They are prepared one-time per year, generally before the beginning of the year.
  - Preparation is extremely time consuming.
  - Budgets are static.
  - They are used as a guide throughout the following year even though they are out-of-date.

Using Rolling Budgets in Place of Traditional Budgeting

- Many companies are turning toward rolling budgets.
  - These forecasts are updated monthly or every few months.
  - They allow for a reassessment of the company's outlook a few times per year.
  - They consider changes in the economy and other current factors.
  - They are less exhaustive and more efficient than annual budgets.
  - They rely on projected activity levels to determine projected costs.

Using Rolling Budgets in Place of Traditional Budgeting

- European companies have been quicker to move toward more flexible “forecasts.”
- Goals for improved budgeting should include:
  - Reduce time and cost of budgeting,
  - Reduce gaming and improve behavior,
  - Become more strategy/value focused,
  - Make the company more responsive, and
  - Improve relative to your competitors.
- An effective budget must be tied to the company’s long-term strategic plan!

Linking Planning With Reporting

- An effective strategic plan must have measurable criteria to monitor achievement of goals and objectives.
- The budget converts the financial aspects and goals of the business plan into numbers.
- Most strategic plans include nonfinancial goals that also need to be monitored and reported to senior management.
- Strategic business planning, budgeting, and management reporting should be linked in a circular pattern.
  - Quantify performance measures.
  - Create key reports.
  - Evaluate results. Financial statements must include budget comparisons!

Polling

Is your annual budget linked to financial reporting?

a. Our annual budget is included in our regular financial reports allowing for easy comparison to accrual results.

b. Our annual budget does not appear on our financial reports but we regularly or periodically refer to it as part of our financial analysis.

c. We prepare budgets and forecasts but we do not use them much after that.

d. We do not prepare any budgets or forecasts.

Financial Results During the Pandemic

- Many manufacturers have experienced greater variability in sales and also higher costs to produce products.
  - For some manufacturers, this has just meant lower profits than in recent years.
  - However, other manufacturers operated at a loss during 2020 that has extended into 2021.
- Greater variability in operating results means that more scrutiny is needed in comparing results to plans before sharing statements with key financial statement users.
- Operating budgets and revised forecasts should also be used in helping to determine if there could be loan covenant violations based on interim and year-end results.

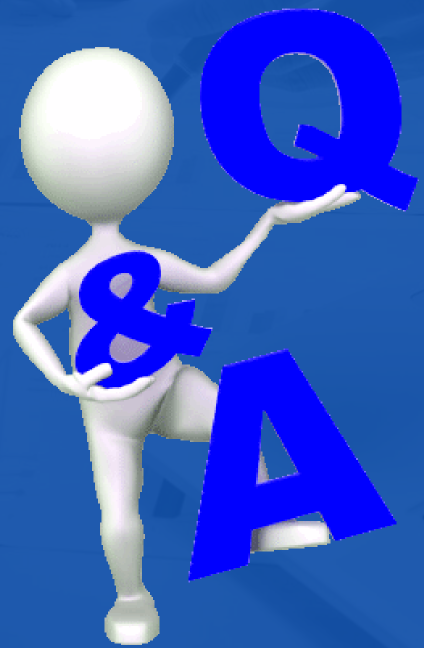
Budgeting for Government Assistance

- During the pandemic, the Federal government has provided assistance to businesses through various programs including the Paycheck Protection Program (PPP) and the Employee Retention Credit.
- These programs have changed frequently so it is difficult to project what benefits a manufacturer might receive.
- Still the benefits from these programs have been significant to most manufacturers and have dramatically impacted the results of operations and financial position.
- As result, based on the best information available the potential impact of these programs must be reflected in financial plans as it certainly will have an impact on decision making.

Conclusion

- Strategic planning is critical for all organizations!
  - A simple written plan is a useful management tool for a company of any size.
  - The strategic plan must be the basis for short-term planning including annual budgeting and forecasting.
- The budget is an essential management tool that manufacturers can use to gauge progress during the year and to highlight the need for changes before problems get out of hand.
- The budget should not be a once per year numeric exercise, but rather it should be one part of a continual planning process that begins with the strategic plan.
- To enhance the effectiveness of the planning and control process, management should consider linking the budget to financial reporting and other measures of performance based on short-term objectives.

Questions



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