



8

Operational and Budget Planning

Learning Objectives

By the time you have completed this chapter, you should be able to do the following:

- Understand the differences between operational and budget planning.
- Learn what this planning entails and why it must be done.
- Appreciate broader operational issues such as systems and systems thinking, information systems, building consensus, and the role of policies.
- Understand who is involved in operational planning and issues involved in getting it done before the start of the new fiscal year.

Chapter Outline

- 8.1 Some Broad Operational Issues
- 8.2 Operational Planning
- 8.3 Budget Planning
- 8.4 Participation in Operational Planning
- 8.5 Getting It Done in Time

No strategy is useful unless it can be implemented, and no strategy can be implemented with any degree of success without doing operational and budget planning. This chapter explains how to do such planning, why it's important, and other important process issues.

8.1 Some Broad Operational Issues

Some aspects of operational planning are more encompassing than just planning programs, projects, and tasks for people to do. These include systems and systems thinking, management-information systems, ensuring participation in the operational-planning process, and the need for consensus in decision making. Not only are they more encompassing but also are determinants of effective strategy execution and should therefore be taken into account.



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The world is made up of systems. A system is a set of interacting or independent components forming an integrated whole. Corporations are complex social systems.

Systems and Systems Thinking

For the most part, our world is made up of systems—from the galactic solar system of which we are a part, to the human body, which has many subsystems of its own, such as the immune, reproductive, digestive, and cardiovascular systems. A system is a set of interacting or interdependent components forming an integrated whole. Corporations are complex social systems, consisting of individuals and units that work together (or not) to produce products or services for their customers that ensure their survival. Complex systems are self-regulating systems; that is, they are self-correcting through feedback. In other words, systems must be responsive to feedback such as the company's sales figures, turnover, and other metrics in order to ensure their competitive edge and survival.

Moreover, the systems approach to understanding organizations addresses the relationship between the operation and its environment. It does so by examining

the nature of the boundaries between the organization and the outside world. The more permeable are an organization's boundaries, the more the organization is able to place its finger on the pulse of the competition, the marketplace, and industry trends. Boundaries may be created, for instance, by employer apathy toward employee development and small travel budgets; an organization that does not send employees to conferences and training, for instance, establishes a less permeable boundary between the organization and the industry. Systems with permeable boundaries are known as open systems and are preferred to closed systems for their greater functionality and innovativeness. Viewing an organization as an open system requires strategic thinkers to consider the complex interactions the system has with its environment, as well as the ways in which the different units within the organization (known as subsystems) import and export ideas, products, and other resources.

Additionally, systems are characterized by subsystem interdependence. For example, to market a product, the marketing department must interact with the research and development team to learn what it needs to know about the product, as well as the sales team to provide the sales strategy. In too many organizations, functional units act as if they were isolated from the others. For example, purchasing may order parts without knowledge of production rates and inventory levels. In both strategic and operational planning, systems managers must be cognizant that affecting one part of the system affects other parts and furthermore that decisions must benefit the whole company and not just a particular functional area to the detriment of others. The performance of any system, including a company, is thus never equal to the sum of the performance of its parts considered separately, but rather the product of their interactions (Ackoff, 1986).

In operational planning, plans should be coordinated between functional units of the organization, especially those between which there is an output-input relationship. The higher one's position in the organizational hierarchy, the more emphasis must be placed on having a system-wide perspective and maintaining awareness of the purposes and goals of the entire organization. Even at a basic operational level, tremendous coordination is needed. As Russell Ackoff (1986), one of the most influential management thinkers of our time, says, understanding how one unit's activities affect and are affected by other corporate activities is a benefit that "cannot be realized unless the planning is comprehensive, coordinated, and participative" (pp. 202–203).

There is a class of system models called system dynamics, a detailed discussion of which is beyond the scope of this text. In simple terms, however, dynamic systems specifically take into account how an organization as a complex social system behaves and changes. They are used predictively and can be used to support strategic decisions.

Not many companies employ such models, which take time to develop, calibrate, and learn to use. More important than the actual models is the thinking they require in terms of feedback loops; that is, these are positive if self-reinforcing in a positive direction or negative if self-reinforcing the other way. For example, make more product, sell more product, get more money, make more product, and so on is a positive feedback loop. When positive and negative feedback loops interact, depending on the data and kind of model created, results are often counterintuitive.

Management-Information Systems (MIS)

Every day, at every level in the organization, decisions are made. Earlier chapters focused on strategic decisions, while this chapter and the next focus on operational decisions. Simple decisions

require a person's knowledge and experience or, in some organizations, an established policy may govern decisions in routine situations. Startup firms operate with the entrepreneur making all the decisions seemingly "off the cuff," as speed is of the essence and the entrepreneur knows what he or she is doing.

The more complex decisions become, the less one person or even a group is able to act independently. Should special promotions in the Southern United States be continued for another month? That would depend on how effective the promotions had been in increasing sales, and without those data the right decision could not be made. Can production throughput be increased by 20% next year? Without knowing the plant capacity, production costs, and sales forecasts, that question also couldn't be answered. And these are operational decisions. We already know that strategic decisions need a lot of data to be analyzed and processed before they are made, and even then no one will know if the right decision was made until a couple of years later when one can see how the company performed.

With the exception of startups, no company can afford to be without a management-information system (MIS). By definition, it must supply the basic information needed by managers for making decisions. The extent to which it succeeds in doing this determines the quality of decisions made (Mason & Hofflander, 1972). Even before the advent of computers, there were information systems, usually in the form of reams of paper and information stored in people's minds.

A management information system is more than a stream of unprocessed data that people can access. If it is just this, it is a databank, not an MIS. An accounting system is an example of a databank. Likewise, financial statements display data—the user determines what meaning they have.

A management-information system must be tailored to the needs of the decision-makers it serves. Cloud computing has made management-information systems easy to create and maintain. These networked platforms make the MIS mobile, and data accessible from laptops, smartphones, and tablets. The usefulness of the information depends on its quality, timeliness, completeness, and relevance (Jones & George, 2007). What data are needed? In what form? Collected how often? Can anyone input data into the system? Can it be trusted? Can anyone use the system? In fact, it cannot be designed properly without first defining the kinds of decisions people make and the information that would best serve those decision-makers. Unfortunately, the reverse is often the case, where the MIS is built on data that can be easily collected and stored that people think will be useful for various decision-makers (Mason & Hofflander, 1972).

Predictive information systems permit decision-makers to draw inferences and make predictions from the data. Asking the system "what if" questions given certain



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An information management system must be tailored to the needs of the decision makers it serves. The usefulness of the data depends on its timeliness, quality, completeness, and relevance.



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Federal Express uses a communication system that allows it to coordinate handling an average of 5.2 million packages and delivering them with nearly 60,000 vehicles.

ERP is actually a process that attempts to consolidate all of a company's departments and functions into a single computer system that serves each department's specific needs (see Figure 8.2). The dream of ERP is to have a single software solution integrating the different functions and activities into a seamless whole where information needed for decision making is shared across departments, and the action taken by one department results in appropriate follow-up action up and down the line. ERP is used primarily in large corporations that can afford the substantial initial investment. The most often-cited example of an ERP software is cus-

tomers-ordering and delivery. A customer's order moves smoothly from sales, where the deal is consummated, to inventory and warehousing, which retrieves and packages the order for delivery, to finance, where invoicing, billing, and payments are handled, and on to manufacturing, where replacement of the bought-and-paid-for product is done. Most of these operations, however, involve recording and updating data, not making decisions involving judgment or prediction.

In companies with such integrated information systems, operational planning can be facilitated using data from the system and updated in real time as conditions change. For example, integrated systems in supermarkets typically include supply-chain, inventory, and finance/accounting management based on Figure 8.2, but not human-resource management (HRM) or customer-relationship management (CRM) systems. The emphasis is squarely on cost-control, which includes not stocking items in small demand and not being stocked out of any item in demand. Used for that limited but important purpose, the system is useful since margins are quite thin overall.

Larger companies find they cannot operate without some sort of sophisticated information system. Federal Express (FedEx) has communication systems that allow it to coordinate nearly 60,000 vehicles handling an average of 5.2 million packages a day. Its own controllers can override the flight plans of over 650 aircraft should bad weather or other emergencies arise. Its series of e-business tools allows customers to ship and track packages online either on their own or the company's website, create address books, generate custom reports, reduce internal warehousing and inventory-management costs, purchase goods from suppliers, and respond quickly to customer demands (Thompson, Gamble, & Strickland, 2004).

Information systems often extend beyond the company to suppliers, also. Walmart is unrivaled in terms of managing its supply chain. For example, its computers transmit daily sales to Wrangler, a supplier of blue jeans. From the information transmitted and "married" to Wrangler's own systems, the clothing manufacturer can ship specific quantities of specific sizes and colors to specific

Figure 8.2: Overview of ERP

Source: Enterprise Resource Planning, from SoftWeb Solutions. Reprinted by permission.

stores from specific warehouses—lowering logistics and inventory costs for both supplier and customer and leading to fewer stockouts (Thompson, Gamble, & Strickland, 2004).

Building Consensus

Operational planning is, in essence, a string of decisions that have to be made quickly at whatever level that planning is done. Unless there is consensus, that is, complete agreement, on a decision by a group of people, majority rule takes over. There's nothing intrinsically wrong with that, except that it introduces the possibility that a minority is *not* committed to the decision. So how can consensus be built when there is a difference of opinion?

If time allows, it pays to get more data on the alternatives to aid in the decision-making process; however, that is not always possible. It may be that the lack of consensus is due not just to different opinions, but also to different positions and political ploys. It is frequently easier to get managers and people to agree first that consensus is desirable (as well as possible) than it is to obtain it (Ackoff, 1986). The additional time and effort it takes to achieve consensus is more than compensated for by the surge in motivation after agreement has been reached.

Spotlight on Group Decision Support Systems

Operational planning requires the kind of consensus and buy-in that challenges even the most competent and cooperative human communicators. One solution that many organizations use to streamline this process is the Group Decision Support System (GDSS). GDSS has a long history of development and applications in team-related tasks. Although the sophistication of the interface and the platforms for these technologies have improved over the years, the documented outcomes of GDSS implementation on decision making and group communication have remained stable over close to 30 years of research. Today, most GDSS are supported by a web-based platform that collects, organizes, and interprets the thoughts and reactions of individuals participating in a group decision-making effort (Roszkiewicz, 2007). GDSS replaces whiteboards and flipcharts with a projected image, and can tabulate rankings and evaluations (offering anonymity when desired by meeting leaders and participants) that individuals input through their keyboards, laptops, tablets, smartphones, or specialized handheld “clickers” compatible with the system.

In many ways, the GDSS helps level the playing field among meeting participants—the shy individual hesitant to disagree or advocate for an alternative position; the dominant, outspoken opinion leader; the fault-finder; the devil’s advocate; and so forth. Although all these roles are important to group decision making, their individual communication styles often steer meetings down the wrong course and lead to outcomes that are unrelated to the best interest of the organization. These problems and other human-communication problems, such as groupthink, interpersonal conflict, and retaliation/retribution may be magnified by the popularity of web conferencing, where participants contend with apprehension about using technology, distractions, and lowered personal cues, which research has shown to be important communication outcomes (Walther, Loh, & Granka, 2005).

GDSS introduces discipline and structure into discussions that can go wrong due to human differences—without turning human participants into androids. Participants have equal opportunities to express themselves in brainstorming sessions by posting comments and thoughts to the projection screen, and vote via automated polling. But meetings supported by GDSS are far from silent; the meeting facilitator is now freed from the tasks of recording notes and votes and can facilitate more meaningful conversation. Research indicates that variables such as trust, group synergy, participation, openness, truthfulness, listening, and perceptions of cooperation are enhanced in GDSS-supported group environments (Aiken & Martin, 1994).

Further, the accuracy and efficiency of decision making improve when GDSS is implemented (Poole & Holmes, 1995). As agreements and consensus are reached, the facilitator can encourage the group to continue the dialogue with the sophisticated graphs and other visuals that GDSS produces quickly and seamlessly as people participate. Some studies indicate that strategic decision-making time can be cut in half when GDSS is employed. GDSS-supported meetings yield results that are reliably defensible through the patterns identified and statistics compiled by the system. And, because GDSS also serves as a cloud repository for meeting communication, participants can retrieve the ideas later.

In summary, research indicates that the implementation of online GDSS decreases negative interpersonal communication dynamics and enhances the efficacy and quality of decision making and information gathering. GDSS has applications for a wide range of organizational decision-making tasks, but can play a critical role in accurate and efficient strategic and operational planning where consensus is important.

Questions for Critical Thinking and Engagement

1. You may already have experience with GDSS; even the clicker-based response systems used in some classrooms represent a form of this type of technology. If you have experience with some type of GDSS, what is your reaction to it? Describe how the technology was utilized by your group, and with what outcomes.

2. Describe a group decision-making experience you have had which might have been enhanced by the use of GDSS. Describe the challenges your group encountered, and explain how GDSS might have mitigated or prevented them.
3. Although there are many benefits to GDSS implementation, these technologies are not a panacea. What barriers to their use might exist? What unintended problems might they introduce into the group decision-making process?

The Role of Policies

A policy is a company directive designed to guide the thinking, decisions, and actions of managers and their subordinates (Pearce & Robinson, 2005). Policies play several roles and serve several purposes. First, it saves higher management from wasting time making decisions that could be as well handled lower down the hierarchy. Second, it empowers people lower in the organization to make those decisions, often where they should be made. Third, they address issues that crop up frequently, so the amount of time saved is considerable. Finally, the decisions themselves could save the company money by, for example, limiting the kinds of services offered ("Sorry, sir, our policy is to . . .").

In addition, policies

- establish indirect control over independent action immediately;
- promote uniform handling of similar activities;
- ensure quicker decisions through using standardized answers;
- institutionalize basic aspects of organizational behavior;
- clarify what is expected and facilitate smooth execution of strategy;
- provide predetermined answers to routine problems (Pearce & Robinson, 2005).

Examples of policies include Wendy's purchasing policy that allows local store managers to buy fresh meat and produce locally rather than from company-owned sources. IBM has a strict marketing policy of not giving free IBM PCs to any person or organization. Packaging-materials giant Crown, Cork, & Seal's R&D policy is not to do any basic research. Polaroid Corporation has long-standing financial policies of never taking on any debt and never making an acquisition. Electronic Data Systems (EDS) for many years had a customer-service policy of empowering any employee to drop whatever that person was doing to answer a customer's call and take care of the problem, at least by passing it to a more qualified person for help (Pearce & Robinson, 2005).

Policies should be developed in written form, widely distributed throughout the company, and discussed at all meetings once finalized. In written form, employees can constantly refer to them



AP Images/Terry Gilliam

Wendy's Hamburgers' purchasing policy allows managers to buy locally produced fresh meat and produce from local producers rather than from company-owned sources.

as an authoritative source until they become second nature. Finally, policies are as useful for what they don't cover as for what they do. For instance, many banks have policies that state that a loan will not be given to a customer who is already overextended.

Discussion Questions

1. Corporations and all organizations are systems; yet they themselves contain many systems. Is this possible? Explain.
2. Following on from (1), how might one manage the smaller systems to improve the functioning of the larger one?
3. How can "systems thinking" improve operational decision making?
4. If some management-information systems are simply databanks, are they really systems? Explain.
5. Many manufacturing companies have realized significant savings from using MRP II or similar systems. What would you tell them about investing to upgrade those systems into ERP or more comprehensively integrated systems? How might the additional costs be justified?
6. In a public company, why is the accounting-information system the only system that must be audited? Would it make sense to audit other parts of the system? Why or why not?
7. Can an information system provide a company with a competitive advantage? If so, how?
8. The point was made that consensus in decision making means total buy-in to the decision and smoother implementation. How might you tell the difference between real consensus and several people just "going along" with the majority?
9. If consensus is desirable to achieve, whatever happened to dissent? Isn't dissent also considered a spur to better decision making? Discuss.
10. A bank has a policy of not validating a customer's parking receipt unless a transaction has been completed. One day, a customer wanted to see a bank officer who happened to be out of the office. When he asked to have his parking permit validated, the teller refused. What should the teller do—stick to the policy and risk losing a customer or make an exception?

8.2 Operational Planning

Operational planning involves preparing detailed organizational plans for the coming fiscal year. It includes programs, projects, and activities that the company is already doing as well as new ones required by any change in strategy. Detailed plans by organizational unit are part of operational plans. Finally, it includes coordinating all these activities to make sure they support stated strategies.

The iterative nature of the operational-planning process means that, in practice, draft versions of plans could go up and down the hierarchical chain more than twice (Figure 8.3). The model depicted also combines operational and budget planning into the same process, which is what happens in most companies; however, because the two are significantly different, they shall be discussed separately.

At the conclusion of the strategic-planning process, the vice presidents of the different functions, in functionally organized companies, take the strategic decisions to their department and, with their key managers, draft functional objectives to be achieved by the end of the next fiscal year. In other types of organizations, key operational units get to do the same thing. For example, in marketing, examples of operational objectives (with the addition of the quantitative element) might be to improve salespersons' "hit rate" of converting sales visits into orders, increase advertising effectiveness, increase the effectiveness of each distribution channel, and improve the effectiveness of



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Operational planning concerns detailed organizational plans for the upcoming year, including programs, activities, and projects the company is already doing or will start to do in the future.

market research. Production objectives could be built around issues of throughput, quality, cost-reduction, and even outsourcing.

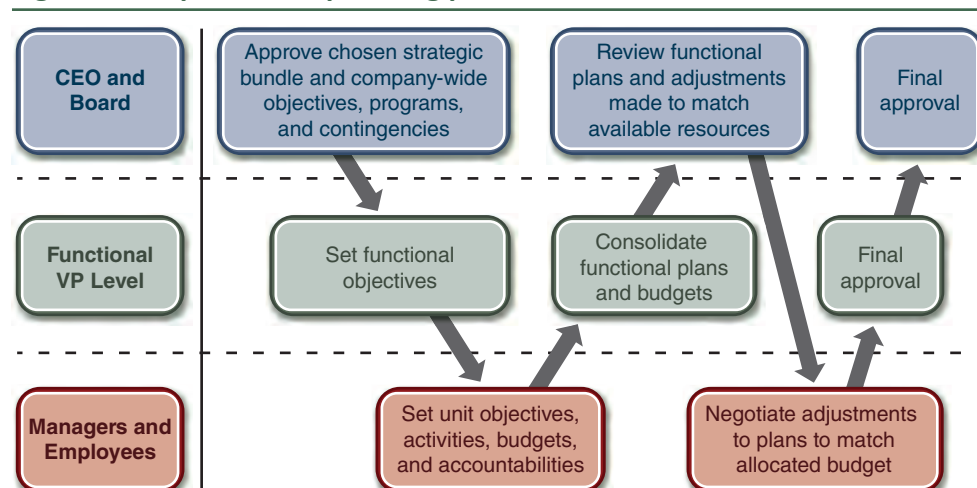
The directives then go to the actual operating units that must meet those objectives—the sales supervisors or actual sales force for a smaller company, the advertising department, market research, production or plant operations, quality control, and so on. Their challenge is to decide what must be done to meet that objective by the end of the fiscal year. This may mean continuing to do what they have already been doing, changing what they have been doing, or even changing

the objective if it appears to be impossible. They must develop a series of tasks and specify who will be accountable to do what, when, and for how much, with a clear output; and a summary of their efforts.

The operating units then submit their draft plan to their managers, who coordinate with other plans in the functional area, and modify if necessary the objectives and budgets. These then go to top management, who reviews them with knowledge of other plans from the other functional areas. Because no first draft is ever perfect and usually goes over budget, the plans are sent back down for revision. In practice, the revision process takes place in a succession of meetings, at the end of which planning documents are revised. After one or two more iterations, top management approves and finalizes the operational objectives, budgets, and tasks before the fiscal year begins. Only if they have changed significantly might the board get involved again.

For smaller companies, project-management software exists to help in planning projects, especially ones with lots of smaller tasks that must be done both sequentially and in parallel. Project

Figure 8.3: Operational-planning process



Source: From Stanley C. Abraham, *Strategic Planning: A Practical Guide for Competitive Success*, p. 162. Copyright © Emerald Group Publishing Limited. Reprinted by permission.

Evaluation and Review Technique (PERT) has been around for a long time, and is an operational tool useful in planning, scheduling, costing, coordinating, and controlling complex projects such as constructing buildings, assembling a machine, and R&D projects (Siegel, Shim, & Hartman, 1992). Its most valuable use is helping project managers determine when a project will be finished and the likelihood that it will be completed on time. Each task is mapped on a network diagram clarifying which tasks must be completed before it can be completed, and which other tasks require its completion first. With this information, PERT calculates and identifies a critical path through the network which is the path that takes the longest time to complete (Siegel, Shim, & Hartman, 1992). To avoid missing a deadline, changes could be made, and PERT would keep recalculating a new critical path until the project could be finished on time.

Online project-management solutions are widely available. Most web-based project-management tools offer the same basic options, including task-allocation and tracking, resource-allocation and management, risk management, scheduling timelines and deadlines, document archives, and communication. Online project-management solutions offer users transparent, easy access to files and communications, which in turn enables improved teamwork, enhanced time-management, and improved task efficiency.

Reward Systems

One more thing that must be done and that can't be done until the detailed departmental plans are finally approved is to put in place a reward system that will be sure to motivate the achievement of operational, and hence strategic, objectives. This is a system of rewards that incentivizes people to excel and achieve beyond expectations, often mis-termed a "reward and incentive system."

Rewards are primarily (but not exclusively) financial and vary by hierarchical position. The following are typical, although specific company experiences can vary:

- For CEOs and top executives, rewards are typically tied to companywide objectives such as growth in revenues and earnings, profitability ratios such as NPM, ROA, and ROE, and stock-price performance. They may include performance bonuses, stock options, increases in base pay, profit-sharing, and perks such as mortgage loans, use of a private jet or first-class travel, contribution to retirement plans, and so forth. Some incentives such as restricted stock may include provisions called golden handcuffs because they tie the executive to the company by prohibiting the sale of shares for a specified time period; if the executive leaves before that period is up, the shares are forfeited (Pearce & Robinson, 2005).
- The rewards given to middle managers are typically tied to functional or operational objectives such as sales of product lines or in a particular region, quality, throughput, cost savings, new product development, weighted average cost of capital, and myriad others. These include performance bonuses, promotions, raises, profit sharing, and possibly stock options.
- Employees' and supervisors' rewards are generally tied to contributing to the achievement of functional or operational objectives as team players, and may include some combination of profit sharing, bonuses for exceptional and timely work, and raises.



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After detailed departmental plans are approved, an incentive and rewards program will help motivate employees to achieve operational objectives.

Other rewards, while nonfinancial, are nonetheless important. Intangible rewards range from frequent words of praise (or constructive criticism), to special recognition at company gatherings or in its newsletter, increased autonomy, and more challenging assignments.

The financial rewards are based on accurate measurements of company performance that, in turn, typically depend on a reliable and up-to-date MIS. Some companies pay out rewards quarterly, but most do so annually. In creating the system, executives have to guard against the temptation of functional departments to set their functional and operational objectives too low in order to increase their rewards for achieving those objectives. Some experts maintain that companies should never offer a promotion as a reward for two reasons: It destroys the company's carefully constructed compensation system, and promotions should be given only to individuals that are ready to assume the greater responsibility of the higher position.

The following is a useful checklist for designing an incentive-compensation (reward) system:

- The performance payoff should be significant—perhaps 10%–12% of base pay, while 20% will command the attention of the potential recipient.
- Incentives should extend to all workers, not just the top executives.
- The reward system should be administered with scrupulous care and fairness.
- All individuals should know what the reward system is at the beginning of the year or else they won't be appropriately motivated.
- Incentives and the performance targets on which they are based should not be impossible to achieve.
- Payoffs should occur as soon as possible after results have been acknowledged.
- Confine payoffs only to results achieved. Payoffs should not be made for behaviors such as putting in long hours for a long period, or even going the extra mile but coming up short. Once an exception is made for one person, they will be made for more, and the reward system will quickly get out of hand (Thompson, Gamble, & Strickland, 2004).

Payoffs should *never* be made when the company's profits are below a level to make them possible or for average or below-average performance.

Discussion Questions

1. Some organizations (like some universities, for example) are content to keep doing what they have always done. In fact, the strategy and companywide objectives eventually comprise their operational plans added together. How would you persuade such organizations to do planning the other way round?
2. How does an organization specifically benefit from doing operational planning? (Contrast with an organization that might do no operational planning.)
3. Some smaller organizations operate "on the edge" and are forever "putting out fires." Operational planning isn't even in their lexicon. If you had an opportunity to talk to the president of such a company, what would you say? How might the conversation go?
4. Restricted stock or "golden handcuff" awards designed to keep executives from leaving also have the effect of fostering risk-averse decision making because of the downside risk borne by the affected executives. Can you see any way of countering this effect?
5. Restricted-stock deals always benefit executives that have them whether or not the firm performs well. Does this way of discouraging an executive from leaving make sense to you? Why or why not?

8.3 Budget Planning

Budget planning is the process of matching available organizational financial resources (cash on hand, a line of credit or loan, and any investment) with what the organization needs to spend to implement its strategies. It includes revising requests for money from organizational units until their requests and available resources match. What each organizational unit is finally approved to spend constitutes its budget.



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In corporations, the finance department begins the process of estimating the company's financial resources and arriving at a budget that upper management can implement.

The finance department begins the process by coming up with a comfortable estimate of financial resources that is the sum of what the company has and could obtain (through additional borrowing or equity investment). Given knowledge of each department's current spending and the spending implied by the new strategic initiatives, it further arrives at a tentative budget total for each department or cost/profit center.

That budget figure is given to each departmental vice president, who makes it available to departmental managers as they do their planning for the year. When they come up

with their initial plan to meet the functional objectives, they itemize every dollar it might cost to do so. If their estimate equals or comes in under the budget figure, there is no problem. If their estimate exceeds the budget figure, they try to adjust as much as they can, but more often will say that the job can't be done for the budgeted amount.

As Figure 8.3 shows, the department may get their plans back from an upper-management review with a mandate to reduce spending in some way to match the budget. Either departmental members become creative and find a way to deliver the mandated reductions or they respond that the only way to get the two numbers to match is to modify the objectives. Of course, the latter reply must include their reasoning for the position, and their supervisor then becomes their advocate.

The revised plans are resubmitted where the CEO and top management have the benefit of looking at all the departmental plans and budgets. At this point, they can be persuaded that implementing the strategy will indeed take more money than they thought and see whether they can raise the additional capital. If they can, then higher budgets are approved that match the estimated spending from all departments, and the budget-planning process ends. If they can't, then some or all departments are told that they must meet their objectives with the available budget. For example, if adding 10 salespeople was in the marketing plan to help marketing reach its sales objectives, then it might have to get the same objective accomplished with fewer salespeople. The process ends when departmental budgets finally match available financial resources together with their commitment to achieve their functional objectives.

Normally, operational and budget planning should be enough to enable each organizational unit and, by extension, everyone in the organization, to know what they have to do and accomplish during the coming fiscal year. However, some organizations also engage in profit planning, which is the process of arriving at an estimate, month by month, of the profit (NIBT) the whole organization intends to achieve. For each month, the total company budget is subtracted from estimated revenues; the sum of the monthly profits equals the overall NIBT objective for the coming year. Profit planning is not widely used and is considered unnecessary by some strategic planners.

Reducing Costs

The budget-planning process can also be thought of as a process for reducing costs. Not only does it ensure that spending will be covered by real financial resources but also is a forcing function for reducing costs. It's human nature to take the easy route or continue doing what you have always done. That will happen unless someone requires it to be done for less. The very requirement forces the consideration of alternatives.

Entrepreneurs are often faced with this problem when writing their business plan and trying to seek startup capital. Their first pass at a cash-flow projection often shows that the business might not make enough money, or even make any money at all, which is certainly not what the entrepreneurs or potential investors want to hear. All the assumptions must be reexamined and, with more research and thought, revised figures are produced of both the revenue model and the expenses. If the revised business plan looks better but still doesn't come close to achieving the 20%–40% ROI required by typical investors, the entrepreneur considers any and all alternatives to achieving the targeted revenues for less cost. More attractive margins, at least on paper, won't be possible until he or she is forced to consider lower-cost alternatives. Having had to put so much thought into the revised estimates also makes defending them easier.

For this reason, top management's first instinct in this process is to force functional and operational units to try to reduce costs. The budget-planning process is so valuable because it forces people to try to lower costs, which wouldn't happen any other way.

Discussion Questions

1. What risk is the organization running when it approves expenses that exceed available financial resources?
2. Departments of a city or other public entity are well known for trying to spend their entire budget allocations so that they will be funded again the following year at least at the same level. If they don't, they might be viewed as not "needing" their budget allocation and so be allocated a lesser amount. What is wrong with this process?
3. What do you think might happen when, midway through the year, expected financial resources fail to appear (for example, when some funding from a government agency is slashed)? What options might an organization in this position have?
4. Whose responsibility is it in the organization to reduce costs?
5. How does an individual or departmental unit know that something that person or group is doing can, indeed, be done at lower cost?
6. Following on from (5), if there is a way of knowing, why don't all corporations avail themselves of it all the time?

8.4 Participation in Operational Planning

Just as it's a mistake to do strategic planning only with the participation of the top-management group, so also is it a mistake to do operational planning with just middle managers. To be sure, middle managers bear the brunt of the responsibility for operational planning because they will be called upon later in the year to implement the plans. But make no mistake, *everyone* in the company is and ought to be involved, not only in operational planning but also in carrying out the plans.

By virtue of their size, small companies have no option but to involve everyone. Yet exceptions abound. The production manager for a small garment manufacturer complained of being left out of the planning process entirely. The company was being squeezed by its large customers who were forcing the price down to maintain their own profitability. The customers used the approach that if this firm could not supply at the desired price there would be lots of other suppliers that would. The president and co-owner of the company was the one who made the bids to these large clients for future business. Time and again, he bid at a price point that was below cost, because he was convinced that he wouldn't get the business otherwise, and he never checked first with the production manager who could have advised him of current costs and margins. The result was that it put enormous additional pressure on reducing manufacturing costs while margins all but eroded. This scenario was repeated many times, and this was a management team of only two people.

In large companies, it is all too common not to involve the rank and file in operational planning. In many companies, information is only divulged or passed down on a "need to know" basis, much as in the military or police departments. People at the bottom just do what they are told; it's part of the job.

As the discussion of organizational change in Section 2.10 made clear, however, smooth and enthusiastic implementation of any task is not possible unless those who are to do the work are involved in the planning. This is much easier said than done. It depends to a large extent on the kind of culture that exists in the company. Cultures that are command-and-control or bureaucratic are by their very nature not inclined to involve everyone as they should, mainly because, as befits those cultures, they have been able to do what they do without such involvement. Open, adaptive, innovative, nimble organizational cultures as discussed in Section 2.9 would not be able to progress without involving everyone and seeking their input, especially in planning and



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Involving all employees in the organization makes it easier to avoid things that block new initiatives or are no longer useful in helping the company be more efficient and productive.

suggesting new ideas. This culture of openness requires the implementation of participative leader-member behavior, which encourages supportive-relationship behavior and the open sharing of ideas during decision-making and strategic and operational planning.

Another reason to involve everyone in the organization is to make it easier to get people to *stop* doing things that either get in the way of new initiatives or are no longer useful in helping the company be more efficient and productive. Change involves “forgetting” about and dropping old habits if new ones are to take their place. Change will stall or not take hold to the extent that people cannot or won’t forget what they used to do. It is therefore wise to involve everyone; make sure they understand what they have to do and why; how their job, role, and expectations are changing; how and why they will benefit from the changes; and have a mechanism for repeating the new imperatives often until force of habit takes over, and the changes and improvements become second nature.

Discussion Questions

1. The ease with which everyone in the organization can be involved depends on its culture. Might involving everyone actually change the culture? Comment.
2. This section advocated involving everyone. Surely not everyone? Would this include the people loading boxes in the shipping dock? The janitors? The mailroom clerk? The secretaries? Comment.
3. Following on from (2), if you don’t agree that everyone should be involved, where might your cutoff be? Give reasons for your answer.
4. Following on from (3), if you advocate a cutoff, explain why that might be superior to involving everyone.
5. “Muscle memory” is unquestionably valuable when a new habit must be learned. But how can one get rid of an old habit that has also been engrained in the organization’s “muscles”?

8.5 Getting It Done in Time

The operational-planning process should be timed so that by the time the new fiscal year starts, all the strategic decisions, operational plans, and budgets have been completed. Final approval of the plans and budgets should be completed within a couple of weeks of the start of the fiscal year. Bear in mind that both strategic and operational planning take place in addition to people’s regular daily activities. But how long should the strategic- and operational-planning processes take?

There is no simple answer. Consider four scenarios—among many—beginning with the best or ideal situation:

- The company is used to doing strategic planning, and much of the required research is done throughout the year. It is performing well and is used to transforming strategic decisions into operational plans and can get those plans approved in one iteration. The two processes together, especially for small to mid-size companies, take no more than two months.

- Like the scenario just described, but for a well-performing larger company with more divisions and vertical layers, coordinating operational and budget planning takes longer but still gets done within 2-1/2 months.
- For a company that is not performing very well, has financial problems, but has some experience with strategic and operational planning.
- This company is constantly putting out fires, lurching from crisis to crisis; strategic and operational planning take back seats, if done at all. If anything is done, it will probably be done badly, with changes continuing to be made after “approvals” have been given. The time frame needed for planning is impossible to estimate.

There are companies, of course, that are run autocratically, with the CEO telling everybody what to do and being the only one to approve anything. In this situation, the combined processes shouldn't take long at all, perhaps two to four weeks. This was not included as a scenario in the preceding list because, although it might take the least amount of time, it doesn't qualify as a “best” or “ideal” scenario. However, it often works in that kind of organization.



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Budget preparation should take two to four weeks, depending on the size of the company.

Sometimes, the process takes longer than anticipated, and the deadline of the new fiscal year is missed. What usually happens is that the full operational-planning process is aborted, and whatever stage it has reached is hurriedly approved. After all, the start of the new fiscal year can't be changed. One way around this dilemma is to shorten the approval cycle. Instead of going all the way up the hierarchy for every approval cycle, as shown in Figure 8.3, plans should only go to a higher level when they are refined much further. This will shorten the operational-planning cycle.

For an organization that has not previously done operational planning, two months is a reasonable

allowance for the first time. In each successive year, familiarity with the process and everyone's ability to produce better plans should enable the company to be more accurate in scheduling the process without any drop in quality. It is best to start strategic planning as late in the fiscal year as possible while leaving enough time for decent operational and budget planning. The time frame of three months, mentioned earlier, is a whole quarter and really, too long to devote to planning, mainly because conditions will have changed during such a long planning process. For a large organization that has many layers and planning units, operational planning does take more time than anyone would like.

Should a company ever abandon the operational-planning process if time is running out? The short answer is no. As long as management approves what should be allocated and achieved during the first month of the fiscal year, there will be that additional month to finish the process

properly. In the next chapter we shall consider some tools that large organizations can use to speed up both strategic and operational planning and keep the “intrusion” of planning in people’s busy lives to a minimum.

Discussion Questions

1. Suggest one way in which operational and budget planning could suffer if the process were rushed.
2. Imagine that the operational-planning process was well into its third month and already extant conditions had changed. What should the company do? For example, should plans at the lowest levels be changed first or only those plans most affected by the changed conditions?
3. Following from (2), should just the plans be changed or budgets as well?
4. With more experience in operational and budget planning, it should be possible to get it done in less time each year. Exactly how important is getting it done quicker?

Summary

This chapter explained the context and importance of operational and budget planning. Operational planning focuses on planning the projects, programs, tasks, and activities the company needs to implement its strategies, and includes both what it already does as well as additional programs it must do the next year. Budget planning focuses on getting all operating units to spend what they need to spend to do what they must do without exceeding the total financial resources that the company has or may have at its disposal for the coming year. As plans take shape for each operational or functional unit, they inevitably undergo changes until their estimated costs match the estimated financial resources allocated to that operational unit.

Operational planning is carried out more effectively when everyone involved in the process understands that everything is part of a larger system, that anything they do affects other parts of the system, and vice versa. That understanding, called systems thinking, is critical in operational planning. In the same vein, having access to the right information for management decision making and action is vital—companies couldn’t operate without such information. Many such systems are nothing more than databanks, forcing the user to make sense of and interpret the data. Transforming them into systems such as MRP II (materials resource planning II) for manufacturing companies or the more encompassing ERP (enterprise resource planning) make such data far more useful, but they require considerable investment, not only in capital, but also in transforming the way people work and learn.

Operational decisions should be based on consensus at each decision-making level, which means complete agreement. Getting a majority vote, for example, means there is a minority that disagrees with the decision, which in turn means that implementation will be that much more difficult.

The chapter also discussed the role of policies in an organization. These are in effect rules that guide behavior in often-encountered situations. That way, in such situations people will make the correct decision all the time. Having the policies in writing allows people to refer to them at any time and gives them the force of law (which, in the company, they are). Policies can cover, for example, how customers and the environment and suppliers are treated, as well as mundane subjects like what can and can’t be included in an expense report. Operational planning must take into account the company’s current policies.

Operational planning itself is the process by which objectives are translated into projects, programs, tasks, and activities that get progressively more detailed the further down in the organization the process goes. Budget planning is done at the same time. Operational units must develop their plans while staying within the budget allocated to each one, requiring first drafts to undergo several revisions in order to balance these two requirements and as they go up and down the organizational hierarchy. One of the unheralded benefits of budget planning is the creativity unleashed in order to reduce costs.

Finally, everyone in the company should be involved in operational and budget planning, not just the managers and supervisors. When this happens, new ideas have a chance to surface, consensus is more likely, and implementation goes more smoothly. Operational and budget planning have to be done fairly quickly just before the start of the new fiscal year. Doing this is difficult without compromising the process and because involvement is an additional burden on top of day-to-day responsibilities. The risk with taking up to three months to do operational and budget planning is that conditions will change during the process, requiring plans to be further changed as a result. Experience helps, as does revising plans first before submitting them up the ladder for approval.

Key Terms

action information systems Automatically make (the right) decisions that are acted upon immediately.

budget planning The process of matching available organizational financial resources (cash on hand, a line of credit or loan, and any investment) with what the organization needs to spend to implement its chosen strategies. It includes revising requests for money from organizational units until their requests and available resources match. What each organizational unit is finally approved to spend constitutes its budget.

consensus Complete agreement.

critical path The path through the network that takes the longest time to complete.

databank A stream of unprocessed data that people can access.

decision-making system Embodies the organization's criteria for choice and actually makes decisions on which the organization can rely and act.

ERP (enterprise resource planning) A process that attempts to consolidate all of a company's departments and functions into a single computer system that serves each department's specific needs.

management-information system (MIS) A system that must supply the basic information needed by managers for making decisions.

MRPII (material resource planning II) A detailed production schedule that accounts for machine and labor capacity and scheduling the production runs according to the arrival of materials. An MRPII output is a final labor and machine schedule. Data about the cost of production, including machine time, labor time, and materials used, as well as final production numbers, is given by the MRPII system to accounting and finance.

muscle memory Repeating something often enough so that muscles learn what needs to be done and it becomes second nature (they can perform the activity without conscious thought). The concept is applicable to organizations.

operational planning Involves preparing detailed organizational plans for the coming fiscal year. It includes programs, projects, and activities that the company is already doing as well as new ones required by any change in strategy. It includes detailed plans by organizational unit. Finally, it includes coordinating all these activities to make sure they support stated strategies.

policy A company directive designed to guide the thinking, decisions, and actions of managers and their subordinates.

predictive information systems Permit decision-makers to draw inferences and make predictions from the data.

PERT (project evaluation and review technique) An operational tool useful in planning, scheduling, costing, coordinating, and controlling complex projects.

reward system A system of rewards that incentivizes people to excel and achieve beyond stated objectives.

system A set of interacting or interdependent components forming an integrated whole.

systems thinking The realization that affecting one part of the system affects other parts and that what is done must benefit the whole and not just a particular part at the expense of other parts.

