Integrated Planning, Forecasting, and Budgeting for Organizational Success

PLF4/23/V1

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Key to Profitability Is Proper Planning

Key to Profitability Is Proper Planning

Learning objectives

Upon completing this chapter, the reader will be able to:
- Recognize the need for proper planning;
- See the dysfunctional qualities of traditional budgeting;
- Understand the difference between planning and budgeting; and
- Describe the qualities of a good plan.

I. Course learning objectives

This course on planning will probably be different from what you might expect. It is not a course on traditional budgeting, but rather a course on the alternative to traditional budgeting. Most organizations spend huge amounts on planning, forecasting, and budgeting. This course will teach you how to save money by combining the disciplines. More importantly, using this system will ensure that the organization is far less subject to power-based politics and more apt to have executives, departments, and workers aligned with the central goals of the company.

II. Course structure

In this program we will move step by step through the entire planning cycle, from analyzing variances at the beginning of the year, through planning for the next year, and back to the review of how we have done. We will not allow strategic planning to be disintegrated from the annual plan but will show how it can be an important part of the annual process. Furthermore, we try and make a case that the organization completely does away with the annual budget. While there will be a document that looks very similar, its purpose will be completely different.

III. What we have learned from COVID-19

Did we plan for the pandemic? What could we have done differently with respect to our planning? Certainly the recent pandemic has altered many aspects of our organizations – but mostly, it has shown us the need to be nimble and change rapidly. That concept will be covered in many, if not most, chapters in this program.

A. Black swan or grey rhino?

A black swan is an occurrence for which you could not have planned. A grey rhino is an occurrence for which you should have planned but didn't.

B. The need to be nimble

Probably the most important thing COVID-19 taught us is that we need to be nimble, able to change many of our systems very quickly. The organizations that accomplished this came out of the experience better than others.

IV. Planning or budgeting?

One of the most important things that will be considered this entire day is the difference between the traditional organization and the new-style organization. Consequently, we will constantly be referring to the difference, and encouraging you to know and understand how the new-style organization works.

A. Why do we plan?

There are several answers to this question, but most of them revolve around the following reasons.

1. To know where we are going

Obviously, this is a great reason to have a plan. One of the most important things in a successful organization is for everyone to have a good idea where the organization is heading. It is this knowledge that keeps everyone on the same page and brings alignment to the company. Without a plan, and general agreement to the plan, there will be no alignment.

2. To allocate resources

Most organizations have limited resources. Therefore, a plan needs to be in place that allocates those limited resources to where they will do the most good. This is especially true when the organization decides on new projects, capital expenditures, and people assignments.

3. To give broad direction to the organization

This may be the most important reason for planning, and it is closely aligned to the first reason mentioned. Everyone in the organization, from the chief executive to the workers on the factory floor or those interfacing with the public, all need to be in agreement with the broad direction of the organization. If they are not, there is a tendency for them to pursue more selfish goals that may hurt the organization in the long run.

4. To control the outcome

Of the reasons mentioned, this may be the most controversial and the one that can’t be achieved. In economics for years, business owners have attempted to control the direction of the organization. In the businesses of old, that goal may have been more possible; however, with our fast-changing society, many other things exert control that make our attempts at control fruitless. So, we may conclude that directing the organization is more of a realistic goal than actually controlling it.

Key cliché: “If you fail to plan, you plan to fail.”

B. Why do we budget?

When we ask this question at seminars, we often get the same answers as those under the “why plan” question; however, with one additional answer.

1. To control spending

This reason goes directly to point 4 above. In the old-style organization, where we thought we could control the organization with more of a “command and control” structure, the budget became the primary way to attempt to control. The theory was that management didn’t really trust middle- and lower-level people to spend wisely, and therefore, we needed to control what they spent by giving them permission to spend only certain amounts and for only certain purposes. Thus, the budget was formed.

C. Traditional budgeting

Whereas planning tends to be more of a financial function, budgeting is more of a political function. Because its primary purpose is to control spending, individuals within the organization tend to figure out political ways to manipulate that control resulting in several dysfunctional aspects to the organization.

1. Suits do the planning, staff does the budgeting

One of the greatest problems with traditional planning is that senior management generally does the planning while they delegate the budgeting phase to the staff. This causes several problems, with one of the greatest being a lack of accountability. When people don't have a part in formulating the plan, they tend not to buy into the plan nor are they willing to be accountable to the plan.

With one group doing the planning and the other the budgeting, often the two disciplines do not meet causing severe confusion at best.

2. Use it or lose it syndrome

With budgeting being a method of controlling expenses, people quickly realize that the only way for them to get allocated money next year is to make sure to spend the allocated money this year. Consequently, hotels, training companies, and several other industries flourish during the last couple months of the year as these companies quickly spend money to make sure they will have it included in the budget next year.

3. Can't spend the money

The flip side to the "use it or lose it" syndrome is not allowing a good expenditure because it wasn't included in the budget. For example, a manager discovered a great way to save $100,000 per year in her department by spending only $10,000 on a particular machine or software program. But, because the $10,000 expenditure wasn't in the budget, she is not permitted to make what is obviously a good decision.

4. No one likes the budgeting process

We need to admit it—there is probably no other process within the organization that is less liked than budgeting. This is true for several reasons:

- It is time-consuming;
- It is often ignored, especially by management; and
- It is often seen as a waste of time.

D. Get rid of the budget

Making that suggestion to a group of CPAs may very well put me in the class of heretic; however, that is exactly what we are suggesting. And we will attempt to prove that eliminating budgeting in the traditional sense will not only improve the operations of the organization, but it will also increase productivity.

The above problems of traditional budgeting occur because the budget is primarily a political discipline driven from the budget really being a permission to spend money. That, in turn, is derived from the purpose of the budget being to control spending. While controlling spending is important, we will suggest that it can be accomplished in a better way. Some kind of system where people are rewarded for being more efficient will cause the employees to want to be productive. By using that kind of reward system to keep expenses in line, we can do away with the traditional budget, and concentrate on planning.

1. Planning not budgeting

For this reason, and for the duration of this program, we will not refer to budgeting any more. We will get rid of it. However, I did not say that we would get rid of planning. In fact, the rest of the program is all about planning; however, it is not about budgeting. Sure, at the end of the class, you will know how to construct an annual plan that looks much like a traditional budget, but it will be derived in a totally different way that will be more fun, more creative, have greater accountability, and lead to a more successful organization.

V. Qualities of a good plan

A. Process not an event

One of the greatest problems in the planning function is that it is often seen as an event rather than a process. Good planning happens throughout the year, and it is not a fall project to prepare the budget. As we will see, the process starts as soon as the books are closed and reviewed, and it continues until the various plans are put in the can for the next periods.

1. Enjoyable process

With this model, everyone in the organization has a part in the planning process. Planning is seen as an integral part of doing business rather than something that one has to do once a year and that is relatively fruitless. Planning should be a creative process and involve everyone in that process. People naturally want to be creative, and the process uses that natural creativity to form a good plan. When the plan is seen as a political chore, people don't like the process. When it is seen as an opportunity to be involved in the business, it is seen as an enjoyable part of work.

B. Create alignment

The opposite of alignment is silos. In the successful organization, teams run the company and they are all tied with each other through a series of teams. In a more bureaucratic environment, managers tend to create silos and don't work together. The result is a dysfunctional organization where company politics is the operating system and trust is very low. With proper alignment trust is high, and everyone is on the same page working toward the same goals. As we will see later, departments plan the same as senior management.

C. Culture of accountability

Because everyone had a part in formulating the plan, everyone feels accountable to the plan. Everyone wants the plan to succeed causing people to want to hold on to good decisions and good spending. There are far less instances where people purposely try and circumvent the plan through political tricks. The greatest problem with traditional budgeting is that people don't want to follow the plan because they had no part in its formulation. The budget is seen as an external control force that they have to obey and is enforced by the cops – the accounting and finance department.

VI. The integrated planning process

While many of the following steps in a completely integrated planning process are related and can be combined or be accomplished in a different order, generally the process is a step-by-step process. We generally want to go from the first through to the last step.

A. The business model or plan

Traditionally, business plans are developed to obtain financing, partners, or some other specific need. This plan is actually a type of marketing piece designed to convince someone else of the potential of the organization and why an investment is warranted. When the business plan is included as a part of integrated planning, the step is used to analyze the organization's business model and examine some of the reasons it might be working, not working, or changing.

B. The strategic plan

In this step, we start to examine the vision of where the organization is going, how it is going to reach that vision, and on what core values it will operate. The broadest strategies of the organization are planned at this point. As we will see in the section on strategic planning, it is not just done at the senior management level, but also each division and department has a strategic plan where the department sets its vision, mission, and core values. The strategic plan is an important part of creating alignment within the entire organization.

C. The sales/income plan

While this plan is actually discussed at the five-year and closer levels, it is most important when reading the annual plan. In this step we look at the various methods of sales forecasting and how the finance department helps the operating department with this step.

D. The people plan

In a more traditional budgeting environment, the people plan is a very political exercise since everyone seems to want the most people for their departments. Here we spend more time on what kinds of people we want and how to get them, as well as motivation and leadership in the new-style organization.

E. The marketing plan

As we get a little more detailed, we look at how we will market our goods and services. This is an important step because we want to look closely at changes in the marketplace and how we may need to adjust our traditional marketing efforts due to these changes.

F. The technology plan

This may be viewed as the first of the three parts of a resources plan. The resources available to most organizations would be technology, people, and capital, which will each have its own plan. Many companies consider technology as part of the operating plan; however, we strongly feel that it should be a specific plan taking a close look at our level of technology, what is changing in the market, and what changes we need to make to stay ahead of the curve.

G. The capital plan

An important part of the resources plan is the capital needed to reach our vision. Using traditional and non-traditional methods, we look at capital allocation. This part of the plan also takes in the issue of money and how we will be able to obtain the resources for the needed capital expenditures.
In this part of planning, we will also talk about flexible planning. As we complete the intermediate plans each year, we need to update them as we get more current information. We also develop the necessary metrics to follow as we both revise and establish the plans.

H. The short-term plan

We used to call this plan the budget; however, as can be seen from this progression, it is developed from the intermediate plan and not as a stand-alone document. We end up with the same kind of numbers-oriented plan; however, how it was arrived at and by who is the key to its success. In this section, we look at metrics, reward systems, seasonal variation, and finish up with the cash plan.

VII. The role of the finance department

In the old-fashioned command and control management system, the budget was the primary tool for control. Consequently, the finance or budget department, seen as the author of the document, was often seen as the enforcing department for the system.

In integrated planning, exactly the opposite is seen as the result. All departments are creating their own plans, so they feel ownership toward those plans. But, sometimes the individuals in those departments don't have the necessary skills to put together the best plan. So, it is the job of the finance or planning department to serve the operating departments by helping them put forth the best plan possible.

This is especially true with some of the more sophisticated statistical techniques that may be used in determining sales, capital needs, and even marketing plans. It is often the planning experts who have these skills, so it is their job to help those without.

A. Empowerment

While we will talk about it in other sections, we need to discuss the concept of empowerment at this point. One great definition of empowerment is:

"Sharing the ability to make critical decisions."

This becomes a key concept when considering planning.

1. Managers and teams build the plan

When we are properly empowering our people, they are the ones to build the plan from start to finish. They go through all 13 steps of the plan at the department level. They take the time to review and reflect, see how they fit into the overall business plan of the organization, and set a strategic plan for their department. Then, they do their marketing plan if it is warranted, look at their own technology needs, and formulate their own people plan. They assess their needs for capital equipment and go through the exercises of capital planning with the help of the planning department. Next, they formulate a five-year plan for their department, move it into an intermediate plan, and finally develop a one-year operating plan. The department will then break the yearly plan into months and may or may not look at how their department fits into the cash plan. With the exception of the cash plan, each department will go through all of the steps with the departmental plans being consolidated into the final organization plan.

2. Teams must have the ability to move money

One of the greatest dysfunctions of the old-style budget is the way it is enforced. We usually end up budgeting in detailed line items thus removing the flexibility for managers and teams to move money. For example, the problem mentioned before about the person who was not able to save $100,000 because $10,000 wasn't in the capital budget to purchase a machine. With the integrated planning system, the manager would have the right to move the $10,000 from one account to another or even borrow from future years if the decision made sense. Giving departments that kind of autonomy and empowerment is key to good management and the key to good planning.

3. Teams should be able to save unused money

Another type of flexibility that should be allowed to the team leaders is to be able to save unused money to future years if it is not needed. For example, let us say that the marketing department planned some training, and that was put into the plan. Due to some things happening to the department near the end of the year, the team leader decided to put off the training until next year. Under the old system, he or she might not want to do that since it will show a variance and the amount might not be allocated next year. With this flexibility, the manager should be able to save the money and push it forward to next year.

VIII. Group discussion

Divide into small groups and discuss the planning and/or budgeting system in your organizations.

In your discussions, consider how happy are the employees with the system; is it integrated or disintegrated with different people handling the strategic planning from the ones who do the operating planning or budgeting? How did your planning system work during the recent pandemic? Did that event expose any difficulties?

At this point, and without going further, do you think that an integrated planning system would work for your organization?

Business and Strategic Planning

Business and Strategic Planning

Learning objectives

Upon completing this chapter, the reader will be able to:

- Understand the risks of the business plan;
- Use two important models in formulating different plans;
- Identify some of the things that are changing business plans; and
- Recognize how strategic planning works.

I. Business plan basics

A. Traditional business plan

We often think of a business plan as something we write when we need something. The real purpose of the plan isn't really to plan, but to market the plan we already have in place and try and convince some person or company to give us something. We may be asking for partners, strategic relationships in the business, financing from a bank or other lender, or some other similar request. When we think of it, the plan is really a marketing piece and not really a plan.

The traditional use of the business plan is more for a start-up organization and provides a way to make sure we are planning everything before we really start.

B. Integrated-planning business plan

For our purposes in this program, we are looking at the business plan more as a way to analyze and understand the business model. We will ask questions such as, "What are we doing?" "What makes us different?" and "What are our key strengths and weaknesses?" In addition, we will look at the business model as an important factor of risk. While most companies have detailed risk plans, we often discover that most of those plans do not recognize possibly the greatest risk – the likelihood of a change in the industry's business model.

We need to determine if our business model is still valid. This model may have been what started the company, and the model was valid at that time, but is it still valid today? Could it be that our problems stem from the fact that the business model is changing around us, and we are not keeping up with that change?

C. Several business plans

While the traditional business plan seeking financing or partnerships will be a specific document for the organization, the integrated-planning model may easily have a different business model for each product or service. In a small company with only one product or service, it has only one business model; however, the larger organization with many different sources of revenue will have separate business plans for each product or service. After all, the business model of how we make money will be different depending on the product.

D. Uses of the business plan

1. Financing

As was mentioned before, the primary use of a business plan is to obtain financing or partnerships. Banks traditionally ask for a business plan as part of the application process. However, it also has several other important uses.

2. Recruiting

The business plan, or some parts of it, will often be used as a document to explain the organization to prospective employees, especially at the management level.

3. Alignment

Possibly one of the most important uses of the plan is to help align the employees of the company. Without the knowledge of how the business operates, often employees have no idea of how they fit into the entire scheme of the organization. People in one part often have no idea of what happens in another part, and they don't know actually what the company does to create value for the customer. Thus, the business plan, or some parts of it, becomes a great training aid informing the employees exactly how the business works.

II. Need for the business plan to be updated

Unfortunately, most companies produce a business plan for the specific purpose of obtaining financing, then put it in a drawer, and forget it. It is only taken out and revised as needed when the firm needs to either change lenders or obtain more financing.

A. The world is changing

The primary reason for a business plan in this rapidly changing business environment is to recognize that change, continuously evaluate the risk of the business model, and what can be done to keep it up with the changes in the economy.

B. Some key business changes

1. Moving from hierarchical to crowd-driven

Philosophically, this is one of the greatest changes and it is happening all over the world. When we look at history, it's also interesting that the change has happened before, but in different ways. Authoritative systems in governments and organizations have always been with us. Continuously, populations have rebelled against that authority, and change has occurred. We can go back literally thousands of years and see how people have wanted freedom and have fought, protested, and agitated for that freedom. We can analyze the Reformation, various revolutions, and several other movements in that way.

Today, it is more about changes occurring due to the Internet, but they actually have to do with the move for authority to the people.

A great example of this is the encyclopedia. Not many years ago, the knowledge of the "truth" was housed in the Encyclopedia Britannica. Needless to say, there was a lot of hierarchy in the process and a fact had to be vetted by many experts before it was deemed ok for the prestigious volume of books. Today, that kind of knowledge is stored in the online encyclopedia, Wikipedia.

When Wikipedia was started, the educational elite had a fit. Often schoolteachers and professors wouldn't allow it to be cited as a source in a term paper because the facts had not passed the hierarchical tests of the authority. Today, we recognize the value of the concept, and the Encyclopedia Britannica is virtually out of business. We will see this trend repeated in many things happening today, and it's important to recognize it as we consider our business model.

2. Changes in the location of knowledge

We have become accustomed to obtaining knowledge from traditional hierarchical sources. These may have been our bosses, books, libraries, and similar items. Now, knowledge is on the Internet and/or in groups. If we want to know how to do something we might "Google" the item or even search on YouTube to see if there is a video telling us how to do it.

Publishing has changed. Believe it or not, there are literally hundreds of millions of blogs presently on the Internet. Actually, no one knows the total number, but there are over 50 million just on WordPress alone. Some dismiss the blogs as illegitimate sources of knowledge, but all you have to do is subscribe to a few of them, and you will see how much information is available and how easy it is to get it. A couple of my favorites are: *Fast Company*, *Business Insider*, Seth Godin, and the Online Learning Update. I get these in my mailbox every morning, and they keep me up on a couple of the subjects in which I'm highly interested.

This huge trend affects (and will continue to affect) both our business models and our everyday work. When we want our employees to gather more knowledge, we will no longer send them to an expensive training program in another city where we have to pay travel and expenses. We will just encourage them to subscribe to a blog and get the training directly to their mobile device at no charge.

3. Hyper-competition

As we have said from the beginning of the program, the only two things an organization must do to be successful are to serve the customer better and do it efficiently. Well, the trend is that both of those are rapidly causing competition to grow at an exponential rate. We know that there is someone out there who will do a better job at one or the other of those two items unless we are constantly nimble and change first.

Great examples of these are education and book publishing. In both cases, they have experienced changes where others have come up with business models that both served customers better and also did it more efficiently. Now we have self-publishing at a fraction of the cost of going through a traditional publisher, and we have new education models where people are learning at a fraction of the cost.

Productivity is often the key to recognizing where changes will happen. When the productivity is low or the prices are increasing much faster than inflation, we can be relatively sure that someone or some company will exploit the opportunity and find a more efficient way to deliver the product or service. When that happens, the business model will change quickly.

4. Commoditization of knowledge

Knowledge used to be considered one of the most important competitive advantages of an organization. Consequently, the firm spent huge funds to recruit, train, and maintain the best and the brightest. Today, a firm can quickly outsource a job or find out information from China, India, or from many other places at a much lower cost.

Today, networks of knowledgeable people working across time and space can make informed decisions and solve complex problems in ways they couldn't even dream of only a few years ago.

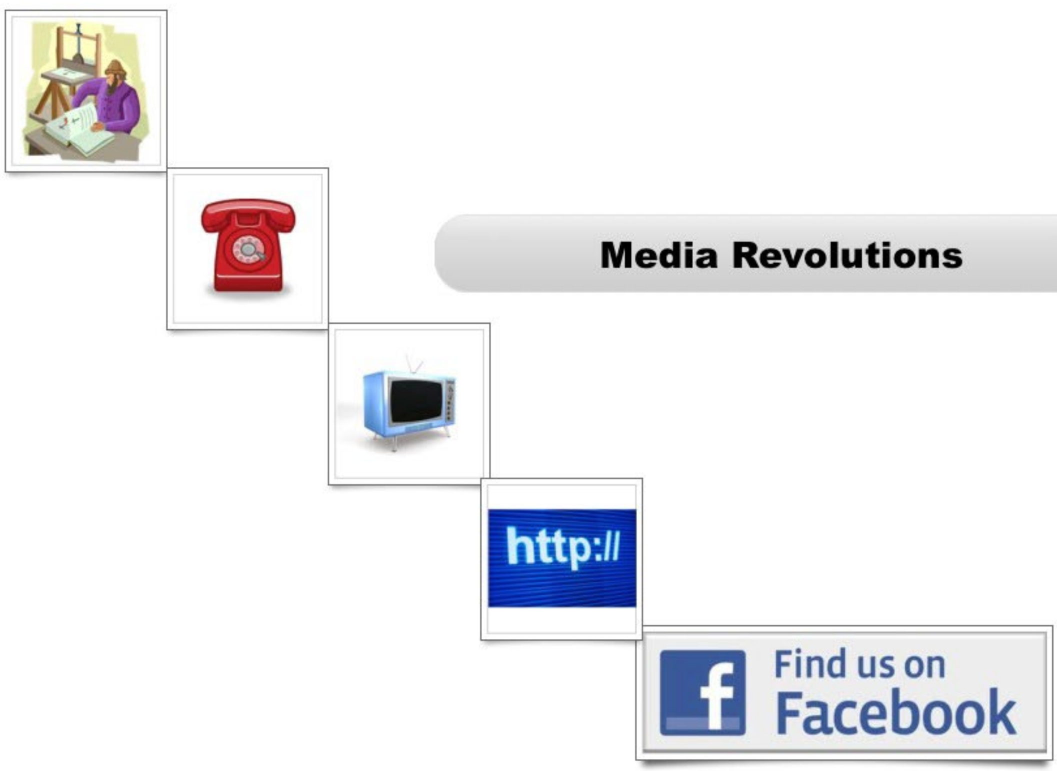
5. Ever-escalating demands for social accountability

The organization can't get away with anything anymore. Some place there is a person or organization out there watching what's going on. The other day I heard of a high-school girl putting up a blog where she took photographs of her school lunches and posted them online with comments. She encouraged others to share their comments, and the blog became very popular with the students.

Not enjoying the embarrassment, the school administration told her that she was no longer allowed to take photographs of her school lunches. She posted that she could no longer post the pictures, and the fact went viral over the Internet. Within hours, the school officials backtracked on their policy, and she was allowed to continue.

6. Media revolution

When we think about media, we see that it has had several revolutions over the years:



7. Changes caused by the pandemic

The recent pandemic forced many evolving changes in business plans to take a rapid turn. Restaurants had to adapt to takeout and delivery models, education had to shift to online learning, and many organizations were forced to adopt other online models.

C. Case study

Nike, the company primarily known for sports shoes and related equipment, has recently been selected by Fast Company Magazine as the most innovative company in America. Really? You mean that a shoe manufacturer is considered by some to be more innovative than the high-tech giants like Apple and Microsoft?

The reason is that it has been transitioning from shoes and clothes to software. It now has various products that a person might wear, but also will talk to a wrist computer that will keep track of various fitness statistics. A recent quote by Nike's CEO, Mike Parker tells it all.

> ***"Business models are not meant to be static. In the world we live in today, you have to adapt and change. One of my fears is being this big, slow, constipated, bureaucratic company that's happy with its success. That will wind up being your death in the end."***

D. Risks of business models

There is reason to believe that a significant change in the business model could represent the greatest risk that an organization faces. Think about what happened to companies like Borders and Barnes and Noble when Amazon completely changed the business model of book distribution. Now, we can be sure that giants like Wal-Mart are looking at the Amazon model and seeing the threat to traditional retail.

> ***"A revolution is coming to U.S. higher education, one that will sweep away an archaic business model, erase the value of many venerable brands, and enhance the brands of new entrants and nimble incumbents. It will be a tough time for many U.S. colleges and universities but great news for the rest of the world."***
>
> Source: "The real Winners of the Coming Revolution in Higher Education," by Bruce Guile and David Teece, Forbes Magazine, 3/12/13

One of the most recent and significant changes in business models is developing in education. This represents a great example of how a business model can be rapidly changed.

A couple of years ago, a professor from Stanford, an entrepreneur from Google, and two prestigious universities from Boston, formed three different institutions and are now providing college and graduate-level courses to the public for free. That's right, absolutely free – no change, no gimmicks, and nothing to buy. Coursera, Udacity, and EdX are the three organizations, and each has several courses available.

Stanford professor Sebastian Thrun opened enrollment of his course, Introduction to Artificial Intelligence, and he received 160,000 students. Since then, all three institutions have partnered up with several other colleges and universities, and the MOOC (Massive Open Online Course) has been born.

Needless to say, everyone in higher education is looking at this development wondering what it will do to the traditional model. When we take a course, even at the normal course of production, but open it up to hundreds of thousands of students, the cost per student plummets. We have to ask, "How will this change the business model of the traditional university?"

Another big question people are asking is, why are the universities doing this, and how will this business model make money? The answers are varied. Certainly, there is a need to bring down the cost of higher education. Education's productivity is extremely poor, and there is a lot of room for greater efficiency. Universities may also have an altruistic feeling about making their educational content available in an economic way to thousands of students worldwide.

Other people are suggesting that the companies will have an opportunity to "monetize" the efforts in the future by charging for job placement or testing, charging companies for the records, and gaining from the introduction to other courses for which they may charge. School's out on where this will go, but we can be sure that it will upset things in higher education.

E. Group activity

In a small group, choose one of the organizations represented and brainstorm how the business model in that industry could be changed thus causing a real risk for the others in the industry.

III. Tools to discuss change in the business plan

A. Where are we now?

Before we can understand where the world is going, and apply that to our business, we need to take a good hard look at where we are today. We do this through the following three-question set.

1. What is our business?

While that seems like an easy question, surprisingly it takes a lot of good thought to really define what we do. And it is extremely important that we do so in the proper perspective. For example, probably the railroad Penn Central, described itself as a railroad company. Consequently, it totally missed aviation. On the other hand, if it had described itself as a transportation company, possibly it would be with us today.

Is a restaurant in the food business, or is it in the entertainment business? Or is it in the business of providing family members with the opportunity to eat without having the effort of preparing, cooking, and cleaning up?

Generally, when we ponder this question, we should define our business in as broad a term as possible. That will enable us to change as the world changes. However, if we define ourselves too broadly, then we miss the need of being specific.

2. Who are our customers?

This also seems like an easy question, but it isn't. Take, for instance, an auto parts store. Are its customers the auto repair shops in town or are the customers the walk-in trade? In this case, the company has two sets of customers, but that can easily confuse things because we have to be careful to please both sets of customers without hurting one or the other.

A great example of this is being faced by numerous companies that sell both through dealers and also directly to the public through a website. Somehow, it needs to protect the dealers for them to make a profit, but on the other hand, it must offer an inexpensive enough product to be competitive with similar products on the Internet. It may happen that the company has to form two brands with each distancing itself from the other (and have one business per brand). If they don't do this, and if a competitor forms a new brand that only serves one of the two customer groups, the company mentioned will have problems with profitability.

3. How do our customers determine value?

We will never understand our business if we don't understand our customers. The first step in understanding our market is to understand why our customers buy ours or another's products. In the restaurant, do the customers want good food, good service, or something else?

B. Where will we be?

The above question set is fine to understand our business, but that isn't enough. Like so many organizations, if we don't go beyond where we are now, we will never become innovative and keep up with the times. Consequently, we need to look at and analyze the following question set.

1. What will our business be?

If the world keeps changing the way it is changing now, what will our business become? Pretend you are in a university and know what you do about MOOCs. The importance of this question will force you into evaluating what will be happening to your business. Will you still be relevant? Will you have to cut costs? Will you be facing competition from another unexpected place?

2. Who will your customers be?

If you know what will happen to your business due to changes in the world, you need to take another look at who your customers will become. Will they be different from who they are now? Will there be any demographic changes that should be considered?

3. How will those customers determine value?

Will the customers of the future be thinking and acting any differently than the customers of today? Are the present trends, many of which we discussed above, going to be changing how those customers will determine value?

C. What should we be doing?

After taking a good look at where we are, and where we will be if there are no other changes, we finally have to evaluate what we should be doing. We do this using the following question set.

1. What should our business be?

Obviously, this is the punch line. Here is why we are doing this exercise. We need to take what we are, what we will become if we do not change, and think about what adjustments need to be made in our business model.

2. Who should our customers be?

In the same way, we need to again look at our customers, what they will become, and determine what they should become. How should we revise our marketing plans to determine if we should change our plans with respect to determining to whom we will offer our products and services?

3. How will those customers determine value?

As the final part of the exercise, we need to look at how those newly defined customers will determine value. Will they see service as the most important thing? Will it be price? How should we react to some of those changes?

Did the answers to these questions change as a result of the pandemic?

D. Planning matrix

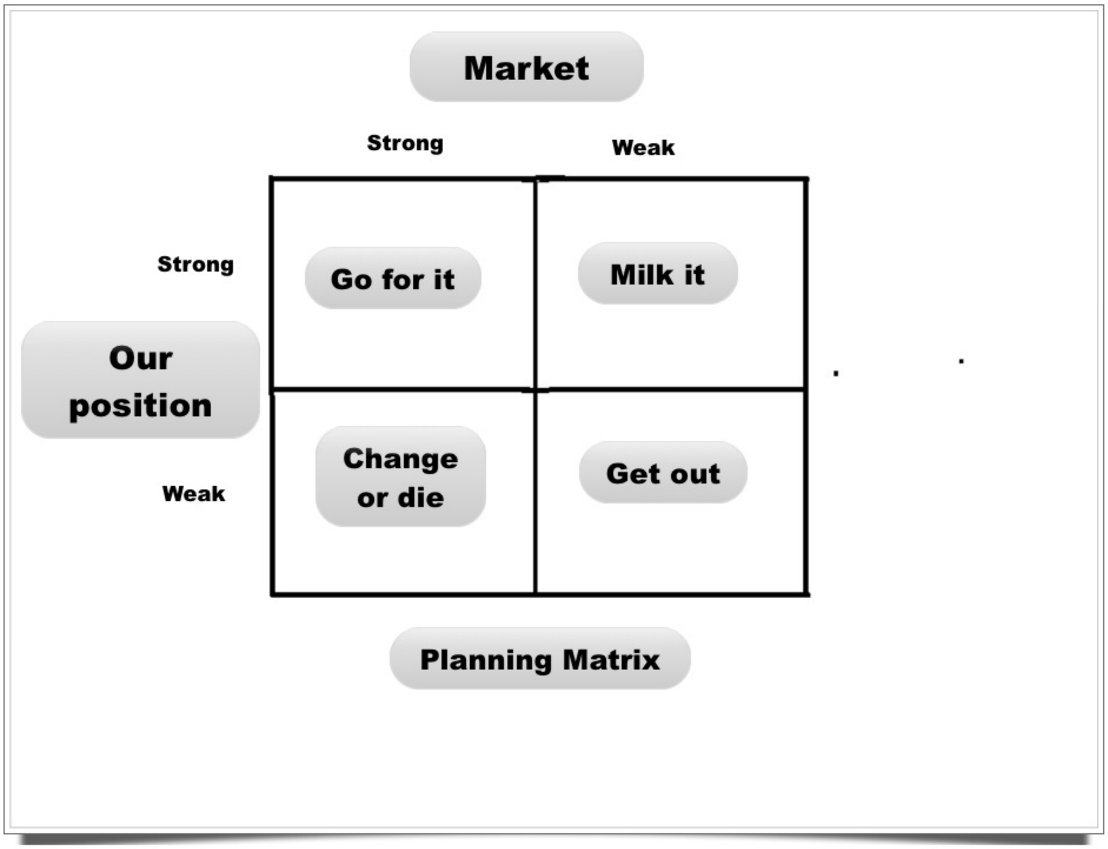
Another great tool to determine what business we should be or concentrate in is the following planning matrix. This matrix looks at both the market and our organization and determines what should be our strategy in seeing a product mix. The matrix is generally for organizations with more than one product or service and helps them choose where they should be placing their investments and efforts.

1. Market

The matrix looks first at the market to determine if it is a strong or weak market. There are actually only two things that we need to determine to put the market into one classification or the other. Those are demographics and the nature of the market. If the demographics are good, the market is growing and with people with plenty of money. If the market is not growing and the people don't have money, it would be considered weak. If the market is considered a commodity market with all the products and services seen as quite equal, then that would be a weak market. If the products, on the other hand, are highly differentiated, then that would be considered a strong market.

2. Company position

The second thing we need to do is analyze the company's position within the market. It is strong if it has a good reputation and low costs. If, on the other hand, it has a questionable reputation or high costs, then it would be considered to be weak in the market.



3. Using the matrix

The use of the matrix is relatively simple. If we determine that we are strong in a strong market, then that's where we do our investing. If, on the other hand, we are weak in a weak market, we should probably get out of the market and invest elsewhere. The other two quadrants are different. If we are strong in a weak market, we should probably milk it as best as we can and hope that the market comes back. If we are weak in a strong market, then we have to make some changes to either build up our reputation or cut our costs so we become strong in that market.

IV. Steps to the business plan

A. What is an entrepreneur?

As we discuss the various steps to a business, I'm reminded of a definition of an entrepreneur that I picked up along the way:

> ***An entrepreneur is a person who sees a problem and puts together a group of people to solve that problem in an economic fashion.***

I love the definition because it actually spells out the most important parts of the business plan, and especially the parts that need to be sold to any investor or lender. Let's take the definition apart.

1. Sees a need

There must be a need or else why should we spend the time, effort, or investment for the project? Sam Walton saw the need for a less expensive way to distribute product to the masses. Jeff Bezos saw a need to distribute books in an easier and more efficient way, and Herb Kelleher saw the need for a regional airline to serve three cities in Texas in a more economic fashion.

A business plan has to start with a need that is not being served or can be served in a better or more efficient way.

2. Can solve the problem

I have met plenty of people who see needs all the time. Their usual comment is something like, "Somebody should do something about that." That's fine, but who? Is the person willing to find out how to solve the problem? It's my opinion that there are plenty of problems out that can't be solved.

3. Put together an organization

Just knowing that there is a problem, and even knowing how to solve the problem are only two parts of the puzzle. The true entrepreneur must be skillful enough to put together and lead an organization. That's why good entrepreneurs are leaders.

4. Economic fashion

Finally, a lot of people see problems, know how to fix them, and maybe are good leaders. But their solutions can't be done in an economic fashion. It's like saying that we should solve unemployment by moving manufacturing to the US. It's a nice idea, and there are a lot of leaders who have proposed the solution. But, if the international economics don't work, the project will fail. As long as we live in a free-market economy, we will have to have economic projects to have them accepted in the long run.

5. Put it together

While the definition of entrepreneur isn't exactly the business plan, it shows the four key steps that have to be included to make the business plan work.

B. Steps to the business plan

There is no magic formula to a business plan; however, most models have something like the following list for a complete business plan.

1. Executive summary

While this is the first step in the plan, it should be the last part written. After you have completed the entire plan, then go back and take the most important parts of the plan and include them in a one-page summary of the entire plan. As you are completing the executive summary, be sure to go back to the definition of the entrepreneur and make sure that you have included the most important parts of the plan.

2. Company description

In this section, you need to talk about the company especially establishing the need that has been determined. Without a need that hasn't been met, there is no need for the organization. This business plan model is based on the well-known and tried, "problem/solution" model.

a. **Legal establishment** - Will this be a corporation, LLC, partnership, or some other legal entity? State the reason for the choice and how it will affect the organization.
b. **History** - What has been done up until this point?

c. **Start-up plans** - Where are you going from here? How will the start-up progress? Be sure to realize that you will need to integrate this part to the financial plan step.

3. Product or service

What will be the product or service, and how will this product or service meet the need expressed above? It is important to tell the audience how your product or service will be different from the competition. If you can't be different, there is a serious question if you should be in business. Nobody ever made a big splash by following the leaders.

4. Market analysis

What are the demographics of the market? Show how the market is changing, and especially how you will be able to meet these changes. In this section, you need to show your organization and the competition how your organization will be different from and better than the competition. This is also the spot to differentiate your organization and show how you won't be just a commodity, but you will be able to be different. Finally, you need to show where you are on the growth curve.

5. Management team

In this section, you need to make the case why this particular management team is the one who will be able to solve the problem. After all, if there is a problem that hasn't been solved before, then other management teams have been unsuccessful in any other attempts. You have to show why this management team is different, and has the attitudes, skills, and approaches that will be different and successful. Experience is important in this section, but it is necessary to point out why that experience is important in solving the problem that has been presented.

6. Strategy and implementation

This section talks about the company's strategic plan and how you will take that strategy into specific tactics, how management responsibilities will be aligned, and how the organization will operate. If specific management systems are included in the plan, they should be discussed at this point.

Today, people want to know the plans of the company, and specifically what will be the plans pertaining to the Internet.

7. Financial analysis

In many business plans, all the space is taken up in this section. We suggest that you keep the section brief and with summaries, saving the detailed projection for an appendix. That way, the reader will get the message of how the organization will solve the problem in an economic fashion, but you will save the financial proofs for the appendix.

Personally, I like to present more than one forecast of how the organization will look. Scenario planning is a great way to accomplish this, presenting some kind of best-case; average-projection; and worst-case scenario. Naturally, if you are applying for financing, you need to show how the lender will not lose anything even in the worst-case scenario.

V. Strategic planning

Traditional planning and budgeting look at where the organization is now and attempt to project where it will be sometime in the future. Normally, this time is one year away, and the document is called the budget. We have already discussed the problems of the traditional budget, but now we need to look at the alternative.

The alternative to the traditional budget is a strategic plan that is for a long period of time and has the iterations of the plan work all the way from five-years to the one-year annual plan.

All planning is a process of going from point A to point B. A is where we are now, and B is where we want to be at some timeframe such as five years. Traditional planning starts at our present location and moves to the future. In strategic planning, we look first at where we want to be in the future, and then come up with a plan on how to reach that target.

Many organizations do both strategic and traditional planning, but they do them separately, as completely different events, and with different people. The greatest problem with that approach is that the two processes are disjointed causing a lack of alignment.

A. Old-style strategic planning

This is a great process where the top management of the organization goes off to a nice resort-type off-site location and thinks about the future for several days. They come back with a strategic plan and may or may not tell the rest of the organization what that plan might be. Unfortunately, usually many or most of the planning staff in the company never go to the retreat; however, they are the ones assigned to come up with a good budget for next year.

B. Old-style incremental budgeting

The budget group, on the other hand, looks at planning in an incremental scope in which they determine where we are now and try and come up with good numbers of where we will be in the future. They are thinking from point A to point B, and where usually point B is at year-end the following year. Note the problem with the old system. Senior management is working from B to A, but the budget people are working from A to B. Now do we understand why the old-style planning can easily be dysfunctional?

VI. The need for strategic planning

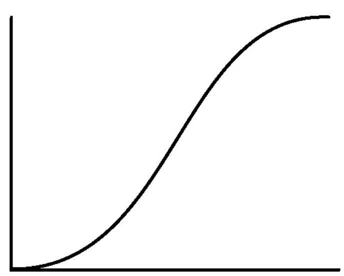
While we believe that strategic planning is always required, there are several situations that would make the exercise even more important.

A. Shrinking margins

One of the first signs of trouble for an organization is falling margins. Breaking the concept apart, we need to look first at the gross profit margin (gross profit/sales), to get an idea about both our pricing and also the cost of providing our product or service. If these margins are slipping, then we have an idea that there is something wrong with our strategy. Is our market changing? Is something happening with our competition?

B. Slowing growth

Let's remember the basic and typical growth curve. If growth has started to slow down, especially when the economy is strong, we need to take a look at our strategy to make sure we are pursuing changes that will start a new product or service that will have a faster growth potential.



If we see our growth diminishing due to economic conditions, we also need to take a good look at our strategy to see how we can overcome the economic conditions.

C. Declining asset productivity

The return on assets ratio, (net profit/total assets) is a great indicator of our efficiency. When it declines, we need to find out why, and often it will show a need for some new strategies.

D. Eroding market share

One of the most important things to watch, but also one of the most difficult things to know, is our market share. Also, we need to properly judge how we are measuring our market. For example, if we are an amusement park, we probably will get better information if we are measuring our market share against total entertainment dollars spent rather than against other amusement parks. The same is true for education. Should our public school system compare itself with other school systems, or against other educational methods such as charter, private, and home-school options?

E. Higher customer churn rates

If we are maintaining a steady level of customers but having a higher churn rate because more customers are leaving, we had better look at why. From answering that question, we can determine some new strategies to better serve and hold our customers. We need to remember that the cost of acquiring a new customer is always much higher than keeping the ones that we have.

F. Proliferation of new and unorthodox business models

Are the business models in our industry changing? If so, we had better do some serious strategic planning and come up with some positive changes to our own business model that puts us back on the leading edge of our industry.

G. Falling price to earnings ratio

If we are a public organization, often our price/earnings ratio will tell us what the outside world and analysts think about our strategy and business model. If the ratio declines, that may be an indication that the analysts are thinking about the market a little differently than us. It is an indicator that we should look at our strategy.

H. Increasing ratio of marketing costs to revenue

This is an interesting ratio that tells us the efficiency of our marketing efforts. If the ratio is increasing, it means that our efficiency is declining and can be an indicator of a couple of things. It could be that we are losing economic impact causing us to spend more marketing money to gain the same customers. Or it could also mean that we need to take a look at our marketing strategy because things about our customers and prospects are changing.

VII. What is the vision?

Regardless of having a new enterprise or one that has been going on for a long time, we need to determine where we want to be in the future. Do we want to grow? Do we want to change? Do we want to have more customers? Do we want to make more profit, or serve more people if we are a non-profit?

These are all things that we can articulate, but can we measure them? In planning, we have to have an idea how to measure success. We can say that we want to be the “best,” but what does that mean? Best is hard to measure, but the most profitable, or having the most customers, or having the greatest market share are a little more specific and somewhat easier to measure.

A. Smart goals

1. S

S stands for specific, strategic, significant, stretching, and simple.

2. M

M stands for measurable, motivational, manageable, and meaningful.

3. A

A stands for attainable, appropriate, achievable, agreed, assignable, actionable, adjustable, ambitious, aligned, acceptable, and action focused.

4. R

R stands for relevant, results-based, and realistic.

5. T

T stands for timely, time-framed, time-based, and time-limited.

B. How do you determine success?

One of the greatest problems with planning and goal setting is making sure that everyone is on the same page with what is success. We all want to be successful, but what does that mean? By forcing the strategic-planning project, we are forced to sit down and together determine what we really want. Then, as a group, we are in agreement about what is success.

Tangibles are easy to measure when we are stating the vision, but often intangibles are far more difficult to define and measure. For example, let’s say that included in our vision statement is to have an organization with extremely happy and dedicated employees. That’s a wonderful vision, but how will you know you have attained it? One way is to develop a survey asking a simple question like:

> “On a scale of 1-10 with one being completely unhappy, and 10 being overjoyed; how would you measure your level of happiness with this company?”

For even more information, you may want to break the question into parts with several specific questions about happiness with each one of the questions measured on the same scale.

1. Statistical accuracy

Whenever we do a survey, there will be people who don’t like the results and challenge the survey on the basis of statistical accuracy. The simple answer to that complaint is to use the same survey over and over again while benchmarking the results over time. If the survey shows that we are improving in the item being measured, then obviously, things are getting better. If the survey is showing a declining trend, then we know that we have a problem.

VIII. What is our mission?

The vision is where we want to be. The mission is how we are going to get there.

Strategic planning usually involves both the mission and the vision. Some planners prefer to show the mission as the broadest element with the vision being more specific. Personally, I prefer to show the vision as the broadest view with the mission as somewhat more specific. Actually, it really doesn’t matter a lot as long as you include both.

In the mission statement, management will set some guidelines and strategies of how the organization will reach the vision. For example, let’s say that we were a restaurant chain setting a vision of having the greatest market share in the state by five years. To accomplish this vision, we will need to have 20 restaurants by that five-year period. Then, it is easy to determine where we have to be within each of the years leading up to the five-year point.

Another example of the mission concept is with an airline. If its vision statement says that it wants to have the highest customer service rating in the industry by the five-year point, it will have to specifically state how it will reach that vision. Southwest Airlines embraces the concept that if you take care of your employees, they will take care of the customers. If your organization embraces that concept, then it will have to have a mission built around employee satisfaction.

Again, like the vision statement, we need to be able to measure if we are attaining the mission or missions.

IX. Core values

The third part of the strategic-planning model is to have a statement of core values for the organization. This list of values should be relatively short and extremely broad so that people can both understand them and easily recite them. Many organizations have such a list, but unfortunately the list is so long that it reads more like an employee manual rather than a statement of core values.

One of the most famous, and lasting statements of core values is that of Johnson & Johnson. That company has operated under a “credo” that was written in 1943 and revised several times. A recent statement by the CEO of J&J recently made the statement that managers wouldn’t lose their jobs over missing their numbers, but they could lose their jobs for violating the credo.

Our Credo:

We believe our first responsibility is to the doctors, nurses and patients,
to mothers and fathers and all others who use our products and services.
In meeting their needs everything we do must be of high quality.
We must constantly strive to reduce our costs
in order to maintain reasonable prices.
Customers' orders must be serviced promptly and accurately.
Our suppliers and distributors must have an opportunity
to make a fair profit.
We are responsible to our employees,
the men and women who work with us throughout the world.
Everyone must be considered as an individual.
We must respect their dignity and recognize their merit.
They must have a sense of security in their jobs.
Compensation must be fair and adequate,

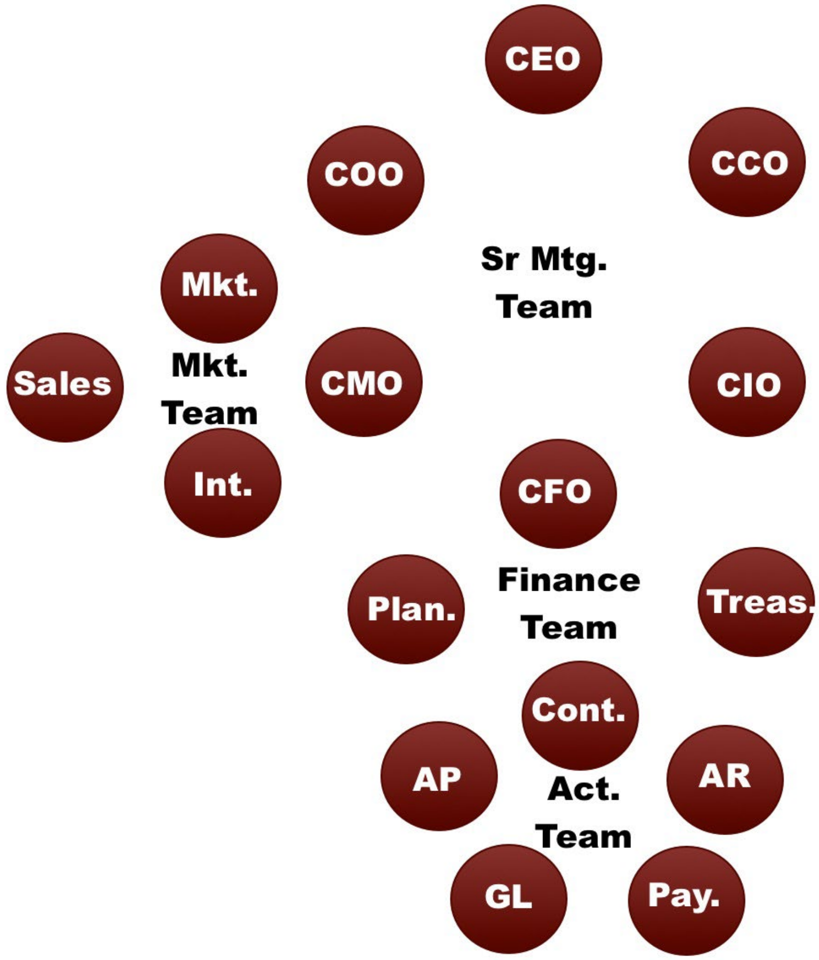
and working conditions clean, orderly and safe.
We must be mindful of ways to help our employees fulfill
their family responsibilities.
Employees must feel free to make suggestions and complaints.
There must be equal opportunity for employment, development
and advancement for those qualified.
We must provide competent management,
and their actions must be just and ethical.
We are responsible to the communities in which we live and work
and to the world community as well.
We must be good citizens – support good works and charities
and bear our fair share of taxes.
We must encourage civic improvements and better health and education.
We must maintain in good order
the property we are privileged to use,
protecting the environment and natural resources.
Our final responsibility is to our stockholders.
Business must make a sound profit.
We must experiment with new ideas.
Research must be carried on, innovative programs developed
and mistakes paid for.
New equipment must be purchased, new facilities provided
and new products launched.
Reserves must be created to provide for adverse times.
When we operate according to these principles,
the stockholders should realize a fair return.

Johnson & Johnson

Many other companies have such statements. Many are shorter and more specific, but all point both management and the employees toward an ethical value-centered environment where everyone pays attention to what is right.

X. Organizational alignment

One of the most important aspects of an organization is the alignment of its top executives, and the resulting alignment throughout the rest of the company. Some kinds of organizations are known for a lack of alignment, and a large amount of competition and silo building between departments. In other organizations, senior management sets the standard for being on the same page and the rest of the organization always seems to be well aligned.



The above chart is a partial organization chart for a small company. The primary difference between this chart, and the more traditional chart, is the shape. In this case, the chart is made up of circles and the teams are designed to link in a particular way. Notice that in each team, the leader of the team also sits on another team. Consequently, the CFO sits on the senior management team and is the leader of the finance team. In turn, the controller is the head of the accounting team and sits on the finance team. Thus, each team leader leads one team, and also is a member of the team above.

The alignment for the company starts when the senior management team agrees on the vision, mission, and core values for the company. By agreeing on those three things, the members of the senior management team all are aligned with the direction the company is going, how it will get there, and under what core values it will operate.

Alignment does not always indicate unity of thinking. The CFO will normally have some differences of opinion with the chief marketing officer on how best to operate, and he or she should speak up with respect to these issues. The senior management team is the place for such discussion, and it is the job of the CEO or team leader to encourage the debate but lead the team to consensus with respect to the issue. As a team member you may not always agree on everything, but you recognize the other's view as a way to reach the vision and mission operating under the values. When senior management does not have that kind of thinking and has not taken the time to discuss the values, silos are built and the senior executives often do not get along.

A. VMV for the departments

Now that the senior management is aligned and in agreement with the vision, mission, and values; the next step is to have the departments or teams go through the same process. For example, the company has stated the vision for five years, determined how the company would reach those milestones, and the core values under which it would operate. That has been done at the senior management team level. Now, the CFO will lead the process of establishing the vision for the finance department for five years out, and specifically how the team will reach that vision, which is the mission. Finally, the team will determine the core values for the finance team.

In all cases, the vision, mission, and values of the finance team will be aligned with the VMV of the whole company, but they will not be the same. Probably, they will be more specifically designed for the finance team.

Taking the example one more level, the controller will have been a part of the finance team determining the VMV for that team. Taking that as an example, he or she will move on down to the accounting team and lead it in the exercise of determining the vision, mission, and values for the accounting team. Again, the VMV for the accounting team will be more specifically designed for that team and the entire team will have had a part in designing the statements.

As this process proceeds down through the entire company, we end up with an aligned company and not one that is disjointed and with everyone on a different page.

1. The key

In my career as a consultant, I can honestly tell you that alignment is probably the most important aspect of the organization's culture that determines its success. Many will think that having all of the departments do their vision, mission, and values statements is not that important and expensive due to the use of time. I can promise you that it is important and that the time will be more than made up for because alignment brings about a whole lot of savings. One little thing to remember is that time should not be spent on the working of the statements. It is the meaning that counts.

XI. Group discussion

In a small group, go around the group asking if they have vision, mission, and values statements and if they can remember them. Ask if the different departments have VMV statements.

Revenue Plan

Revenue Plan

Learning objectives

Upon completing this chapter, the reader will be able to:

- Understand the benefits of bottom-up sales forecasting;
- Know how to use various analytical tools for sales forecasting; and
- Understand some new tools like crowd sourcing.

I. Importance of the revenue plan

The revenue plan is possibly the most important individual plan of the entire planning system; however, it is often the furthest one-off target and the one with the most politics. In order to plan for our business future, we need to forecast our revenue, but it isn't easy.

A. Why the revenue plan is difficult

1. Economic factors

We often have little idea how the economy is moving. Some of the largest organizations have an economist on staff, but the vast majority of companies do not. Consequently, the CFO is often given that task and must take that economic analysis into the planning process. Probably the best example of that was the recent "great recession." Who predicted it? While many did, and broadcast the pending doom and gloom, most of the company leaders didn't believe problems would happen to them and did not forecast for the downturn.

The recent pandemic certainly provides an example of this. During 2020, most of our organizations were running ahead with good growth for the first two to three months, then suddenly our revenue was shut down. On the other hand, other organizations flourished if they were part of an industry that promoted working or even recreating from home. We all saw the growth of tools like Zoom, but did you also know that the sale of musical instruments increased because people decided to learn a new hobby while at home?

2. Market factors

Often with the economy goes the market. But there are many other factors that determine demand including new trends in various businesses along with customer spending habits.

3. Internal politics

Unfortunately, internal politics can cause the organization to put out a revenue forecast that is either too optimistic or too pessimistic.

4. External politics

We might say that this category goes into the economic factors, but actually external politics can have a major effect on demand, regulatory, compliance, and several other factors.

5. Competition

What is our competition doing? Unfortunately, we really don't know as much as we should, and consequently, our ignorance makes the planning process more difficult.

B. Is the revenue plan being used to try and motivate the sales team?

The simple statement here is, if the revenue plan is used as a tool for motivating the sales team, it is doomed to failure. We are not saying that it won't be good at motivating, but we do say that it will not be a good way of predicting revenue.

1. Case study

Ajax Manufacturing Company just completed its best year ever. Sales were up a record 5 percent, gross margin was up, and expenses were down. The company's profit had increased on a year-to-year basis by 15 percent.

Jim Smith, owner and CEO of the company came to a special sales meeting of the company to address the sales team. They had just seen the results of the last year and were pretty excited that they had done so well. As a group they had exceeded the sales budget and thus were in line to receive a nice bonus. Consequently, they were looking forward to Jim's address and what they expected to be some nice congratulatory remarks.

When Jim stepped up to the podium, this was part of his speech.

> "Ladies and gentlemen, I know that you are pretty proud of the way you have done, but I'm sorry that I am not. While the company did well last year, the fact is that we could have done much better. The economy flourished causing the demand for our products. That helped, but it really made it easier for you.
>
> In this coming year, I expect much more from you. Our economy is doing well, and the demand for our products is increasing. Due to the demand, we will be raising prices by 10 percent across the board. I know that you will have no problem maintaining the unit sales, although you will have to work harder. Good luck and I look forward to a great coming year."

At that, Jim walked off stage and the group was stunned. Expecting a celebration, they came away feeling chastised by the boss.

2. Case study discussion

Could this happen in your organization?

Why did Jim talk this way?

What do you think it will do to the production of the sales department?

C. Motivating method comparing sales to sales forecast

Many companies have their sales force somewhat involved with revenue forecasting, and then they somehow set the bonus system against the plan. For example, "if you exceed your forecast numbers, you will get an extra bonus."

The trouble with this system is obvious. If the sales force will be rewarded for exceeding the forecast, obviously it is in their best interest to try and push the forecast down and make it easier to exceed. Thus, by having this incentive system, the company is automatically establishing a system that hurts the accuracy of the plan. Because of this, the establishment of the sales plan is actually a negotiated settlement between the sales team and senior management. Management wants the forecast higher, and the sales team wants the forecast lower. The final numbers tend to be a compromise. The important fact is that the sales plan has been reached through a political process between the two parties, and not a financial process aiming at the best and most accurate numbers.

D. A better way to motivate salespersons

Since we are suggesting that motivating salespeople based on the plan creates too many problems, we need to come up with a viable alternative.

Probably the best way to motivate salespeople is with straight commission, possibly augmented with quotas. The following diagram shows some variations to the straight commission.

1. Sales

When commission is paid on sales, we get a lot of sales, but not necessarily profitable sales. One improvement is to pay on gross profit thus incentivizing the salesperson for getting a higher price.

2. Collections

If we want the salesperson to be concerned about credit, then we can deduct from the commission past due accounts. Obviously, when we make these changes, we need to adjust the commission percentage numbers depending on the margins and amount past due.

3. Travel and entertainment

A novel, but proven idea, is also to deduct from the commission the travel and entertainment of the salesperson. If T&E is about 1 percent of sales, we can increase the commission rate by that amount to 20 percent in the example. Thus, the salesperson would effectively be paying 20 percent of the meals and hotel thus giving an incentive to eat and stay a little more economically. On the other hand, when the salesperson knew that certain expensive entertainment was important, he or she would still do it for the benefit of making the sale.

E. Be sure to monitor accuracy of the plan

Most companies use the plan as a way of evaluating the sales force. We are strongly suggesting that the company also evaluate the accuracy of the plan as a way of determining if the sales plan is doing its job.

II. Major differences in revenue planning concepts

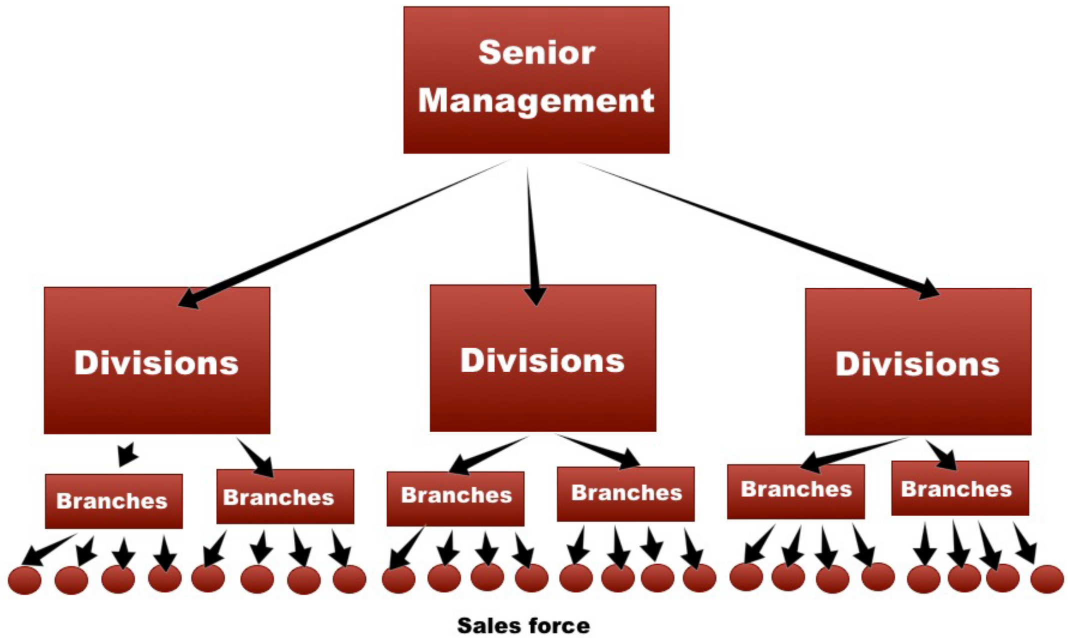
While we can honestly say that nothing is completely black and white, there are two major approaches to revenue forecasting – the top-down method and the bottom-up method.

A. Top-down forecasting

Top-down forecasting is when the sales or revenue number comes from senior management, continues down through the various divisions, branches, and departments to the point where each salesperson has his or her share of the forecast. Salespeople are evaluated by their hitting the target as are managers, division heads, and sales managers.

Some industries are well suited to this method of revenue forecasting, although it does tend to be very hierarchical. Usually auto, heavy equipment, and large ticket dealerships use this method of forecasting.

The theory is that the company determines its capacities and inventories and then challenges the sales force to make the numbers happen.

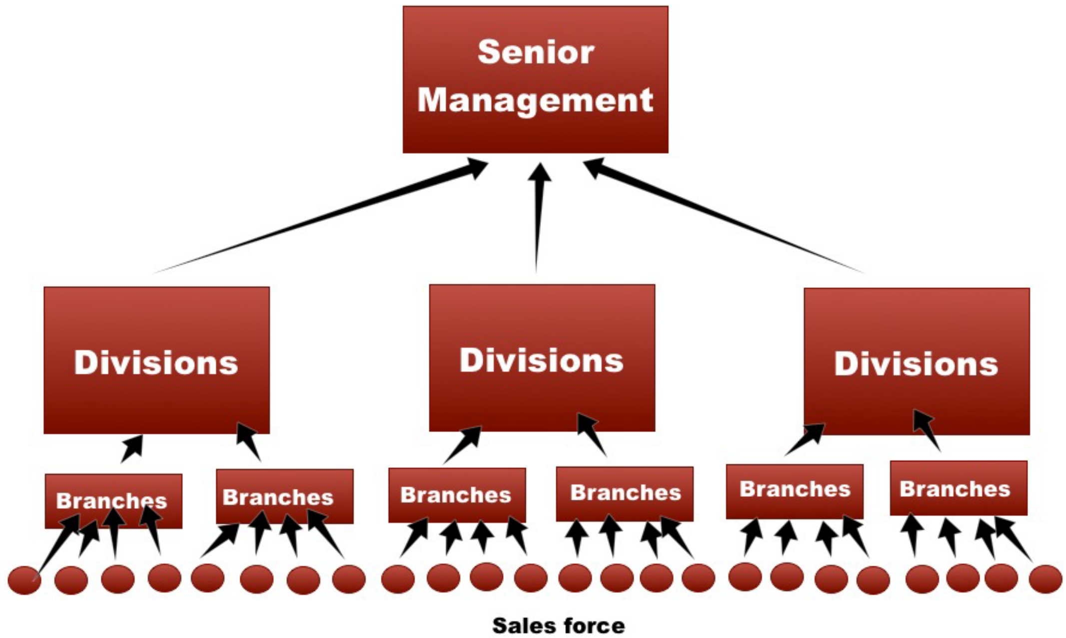


B. Bottom-up forecasting

Exactly the opposite from top-down is bottom-up forecasting. Here the salespeople communicate with their customers and get an idea of what they plan on buying for the next year. The salespeople add on an amount for customers they expect to drop and the others that they expect to gain. The salespeople assess the competition and the economy and come up with their numbers.

Those numbers are passed on to the sales managers who, in turn, pass them up the line through the various parts of the company. Finally, all the numbers are combined, and the company sales figure is determined.

Many feel that this system is superior because the real decision making is closer to the customer who really has the final say in the organization's sales.



C. Most common reality

Recognizing the advantages, most companies at least give lip service to the bottom-up method; however, few follow the system completely. The most common system is some kind of a mixture where the process starts with the bottom-up method and the numbers move up the line. When they get to the top, senior management doesn't like the result, and tells the people to try again. After a couple of tries, settlement is reached, and the final forecast is determined. Personally, I like to call this the "bottom-up, cram-down" system.

III. Suggested preferred method of revenue forecasting

Our suggested system for revenue forecasting is to follow the bottom-up system with major assistance from the corporate finance department. In too many organizations the finance department is seen as the enforcer of plans as they publish variance reports. In this case, the finance department becomes a service center as it helps the sales groups with the financial analysis to produce a better revenue forecast. If fact, if possible after the process, the salespeople should have the opportunity to rate the finance department on its level of customer service and help.

The need for help is obvious. Salespeople do not necessarily possess the financial and analytical skills necessary to produce a good forecast. But they have the intuitive knowledge of the customer, competition, and the market. Consequently, the collaboration of the different skills will produce a better plan.

In too many organizations, the salespeople or sales managers are given spreadsheets and told to fill in the blanks. In this model, the salespeople are given the assistance to fill in the blanks with better and more accurate information.

This being said, we also must recognize that the senior management group will usually do the strategic planning for the company in concept. Consequently, that group will want to have general revenue numbers that go along with that plan. Those numbers are then passed down through the organization and the individual departments work with those broad numbers and refine the thinking based on what the department knows. The local departmental knowledge is often about capacities to make the plan happen. The best way for it all to work is having a collaborative effort within, bouncing the revenue plan back and forth between the various departments and also the senior management group.

A. Analytics from the systems

The first things that the finance group must give to the sales team are the analytics that have been developed from their various software packages. Programs like SalesForce.com make available actionable analytics to help all levels of the sales organization in making decisions about products, prices, orders, and similar data. The salespeople need this information, but often need to be taught how the data becomes important in their decision-making and reaching the revenue plan.

B. Concentration on customers

If we are not careful, the revenue plan can become so numbers-oriented that we stop watching the behavior of customers. For example, it's easy to prepare a revenue plan based on last year's sales without seeing what is happening out in the field. Collaborating directly with the sales force in the field; however, brings into the forecasting project their direct knowledge of the reality on the ground. One of the reasons why sales forecasts fail is they have not integrated the knowledge of the sales force. The expectation of management may be one thing, but our hypothetical salesperson, Susan, knows that her customers are becoming much more price conscious and turning toward other markets or places to buy. Without her knowledge, the forecast is obviously wrong.

C. Outward- not inward-focused

As we do all of the analysis, it is easy to have our revenue forecast be inwardly rather than outwardly focused. We look at the trends, the bottom line, our capabilities, and our costs; but we fail to look at our customers, the economy, and the market.

D. Collaboration is the key

When the finance department is seen as anything other than a service department, walls and silos will be built. We need to recognize that the finance department has the analytical ability, and the sales team has the knowledge of the customer. Both are needed to have a great revenue plan. Those departments, and often others, need to contribute information. Our finance people know things like regression analysis and many of the other analytical tools on the spreadsheets. We need to get with the salespeople and help them use these tools to get a better forecast. In fact, in many cases we need to do that analysis for them using their skills and knowledge of the customers and market.

IV. Steps to the process

The following represents a step-by-step process to the revenue-planning system.

A. Analyze the past

While revenue planning needs to start with where we want to be in five years and work backward from year five to year one, we still must understand what happened in the past.

1. Sales by product broken down by month

This part of the analysis is needed to produce the analysis of where we go from here. We need to fully understand the breakdown of sales by product and by month. The latter is so we can analyze the seasonal trends.

2. Calculate the number of returns and cancellations

This is an important statistic since its analysis can tell us a lot about the sales efforts, changing market, and other current information. By benchmarking this number over time, we often can spot trends.

3. External factors

In addition to the external factors affecting our sales, we also must track some of the external factors that will affect our pricing and market decisions. These include:

- Economic forecasts;
- Price changes in raw materials;
- Employee contract negotiations; and
- Changes in the competitive environment.

B. Study the market

Here we need to study the market and what has happened to our revenue against several other factors. We need to look at demographics, and especially the amount of people in our market with earnings or wealth that correspond to our typical customer. In B-to-B situations, we still need to study the retail market since often our product may go to another business, but that business will be influenced by the retail market.

As we study the market, we also need to look at changing economics. A growing economy, a shrinking economy, or some other specific change in the economy may influence our revenue. For example, local lumber will probably be affected by changes in the net income for consumer sales, but it will also be heavily influenced by housing starts since they influence our contractor customers.

As we study the market, we need to be looking for demographic and economic changes that correlate with our revenue. But we also need to understand a very important aspect of correlation. That is that something may correlate perfectly, but not be the cause of change in our variable. Correlation does not necessarily prove cause and effect.

C. Competitive analysis

One of the most important parts of our analysis is to study the competition. In this study, we need to look at the following categories.

1. Product-specific categories

When we examine product-specific categories we must look at the following factors:

- Performance;
- On-time delivery;
- Cost of production if available; and
- Price.

2. Organization categories

When we examine organization categories we should focus on the following factors:

- Reputation;
- Customer relationships;
- Financial strength;
- Service; and
- Culture.

One way to perform this analysis is to rate the above categories on a scale of 1 to 10 of each of our competitors and then rate our own company and see how we compare.

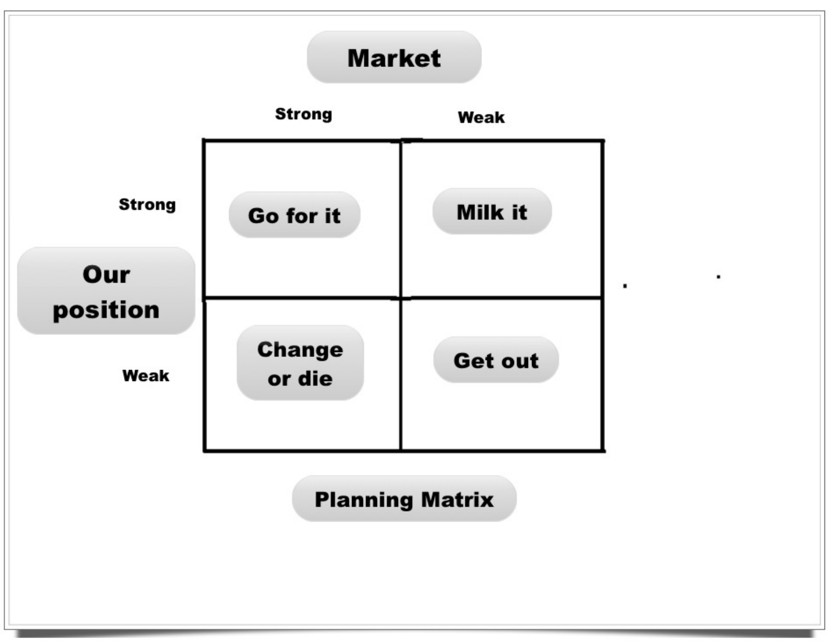
D. Check capabilities

In this step we must try and answer that age-old question, which came first, the chicken or the egg? Or, we might think of another cliché, “Build it and they will come.”

When looking at capacities and capabilities, we need to decide what capabilities we want to change if all other factors in the market and competitive position are favorable. For example, if we are at the start of growth in the market and our profits are high, we might consider building a factory or making some other large investment to expand our capabilities to meet the coming demand. If, on the other hand, the market seems to be declining with our margins shrinking, such a risk would probably be unwarranted. Capabilities can be adjusted in the long run, but generally can’t in the short run.

E. Evaluate the product mix

Periodically, we need to evaluate the product mix to determine how we might want to utilize any available capacity.



With this tool, we examine two factors – market and our position. Each of those factors is divided into two other factors to help us do the analysis. When looking at the market, we have to look at the demographics of the market and also if the product is a commodity product or a differentiated product. When we look at our position, we also look at only two primary factors – our reputation and our costs. From this analysis, we can determine if we want to encourage a product that has a strong market and also our position in the market is strong. We want to eliminate the products where we are weak in weak markets. In a weak market where we are strong, we probably want to adopt a defensive strategy by staying in the market but expecting that eventually it will go away. Finally, in the situation where we have products in a strong market, but where we are not strong in that market, we need to reduce our costs and improve our reputation to compete well.

F. Review delivery strategy

In many instances, products don't change a whole lot, but the method of delivering those products takes a great change. For example, today books look pretty much the same as they did 100 years ago, but the way of distributing those books has changed radically. As part of the revenue planning, we need to take a serious look at how our products and services will be delivered five years from now.

V. Revenue forecasting tools

Following are several tools that can be used in sales forecasting. While many are analytical tools found on most spreadsheets, the first is a unique one that is gaining some serious analysis.

A. Crowd sourcing

In his book, *The Future of Management*, author Gary Hamel talks a lot about using the power of crowds in forecasting sales at the electronics retailer, Best Buy.

Jeff Serverts, vice president at Best Buy, was troubled why the company's performance was below the sales forecasts. His knee-jerk reaction was that marketing was at fault, but he also wanted to look into the sales forecasting techniques. From investigation, he learned that the forecasts could easily be 10 percent wrong forecasting only one month in the future.

After hearing an address by James Surowiecki, author of the book, *The Wisdom of Crowds*, Severts decided to try a new idea about forecasting. After a smaller experiment that went well, in August 2005 Severts sent out a mass email inviting employees from across the company to estimate the company's sales for the 2005 holiday season running from Thanksgiving to the end of the year. He gave the group limited financial information other than the net revenue for the previous fiscal year's holiday period, and the year-over-year revenue growth for the first three months of the current fiscal year. He also gave the employees an incentive that there would be a $100 gift card award for the person who came closest to the actual number. At the end of the year, Severts computed the results and gave away the reward. The final result was that the traditional forecasting system produced 95 percent accuracy. But the average of all the guesses of the 350 participants of the contest, turned out to be 98 percent accurate.

The crowd-sourcing system is based on a simple but profound behavioral psychological concept. That is that when guessing some random item, such as the number of jelly beans in a jar, the average of all the estimates of the group members will be closer to the actual number than the estimate of the closest single member. Companies are now using this technique in many other planning and decision-making arenas.

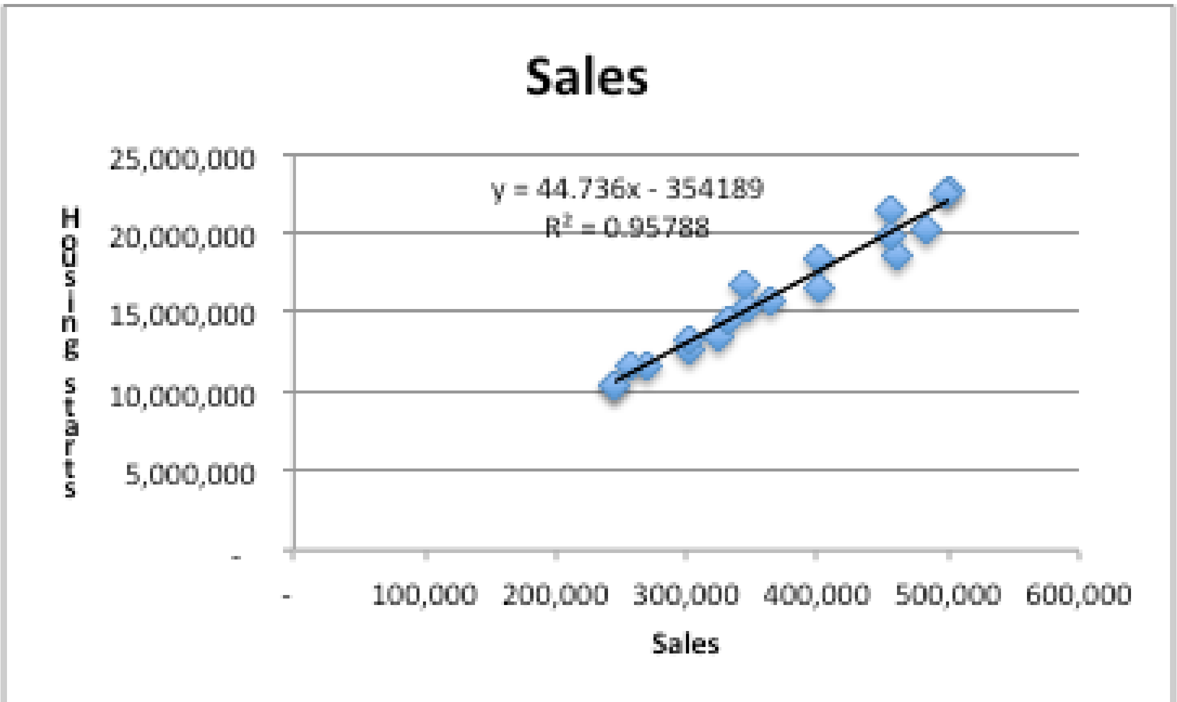
B. Regression analysis

This is a powerful and needed tool because it allows the forecaster to analyze past financial data using it to project the future.

With almost any spreadsheet, we can create a scatter chart to show the relationship between two numbers. Following is an example for a construction company that wanted to see the relationship between its sales and local housing starts. Using data over the past 19 years, the company created the following chart. It then created a chart of the two series of numbers and had the computer fit a trend line to the data. It also showed the formula for the trend line that produces the R Square value showing correlation. In this case, we can visually see the tight lineal relationship between the series and the correlation value of almost 96 percent, which would be considered to be a very high value.

An interesting point to make is that high correlation doesn't necessarily prove cause and effect. Especially if you have a relatively small data set, you could get a close correlation without their being a cause-and-effect relationship. One still has to use some logic to determine if this is good data.

Year	Housing starts	Sales
1	245,657	10,456,874
2	245,544	10,466,485
3	270,244	11,582,133
4	256,877	11,566,877
5	301,244	12,657,844
6	301,566	13,256,544
7	325,655	13,456,875
8	331,455	14,566,877
9	345,688	15,245,655
10	364,568	15,687,544
11	344,788	16,789,546
12	400,566	16,458,788
13	400,455	18,423,544
14	459,888	18,655,455
15	482,882	20,279,844
16	455,688	19,788,544
17	500,122	22,568,400
18	498,788	22,468,755
19	455,214	21,456,878



Once we have the data and the chart, we are able to project our sales based on published forecasts of housing starts.

C. Exponential smoothing

This technical-sounding tool is relatively simple and a good one for sales forecasting, especially for single products on a monthly basis. The concept behind the technique is similar to a moving average; however, using a factor to give more weight to the more recent data and less weight to the older data.

The technique needs three values to work. It needs the previous actual value; it needs the previous forecast; and it needs the "alpha value," which is a factor telling the formula how heavily to weigh older discrepancies between forecast and actual.

A smaller value of alpha means the smoothing has a longer "memory" of the previous values in the series and therefore you get a "smoother" result. However, if alpha is too small, you can smooth out features in the data that you wanted to keep, so there is no single "best value" for every purpose.

For the example shown below, we will do a forecast of units sold on a month-by-month basis. We will use an alpha value of .5. Because the technique needs a previous forecast to calculate error, the first period requires us to make a simple forecast using another method. In this case, we will estimate that we will sell 125,000 units. Starting with the second period, we can use the exponential-smoothing technique with the formula.

	alpha value	0.5
Period	Units sold	Forecast
1	123,746	125,000
2	135,488	124,373
3	134,322	129,931
4	125,844	132,126
5	134,500	128,985
6	135,455	131,743
7	140,314	133,599
8	154,555	136,956
9	145,878	145,756
10	156,879	145,817
11	135,488	151,348
12	135,988	143,418

The formula for the exponential smoothing is:

Alpha value × previous period forecast + (1 - alpha value) × prior forecast

D. Data table

In many cases we will want to produce a sales forecast with “worst case,” “best case,” and “best guess” scenarios. We can do that easily with multiple spreadsheets, but they can take up a lot of room and produce a lot of confusion when a reader may be interested in only one answer.

Another valuable tool is the data table. For example, we have here a very simple sales forecast.

Number of items sold	1,235,488
Price per item	8.45
Shipping per item	0.55
Cost of sales percentage	0.34
Sales	10,439,874
Cost of sales	3,549,557
Shipping	679,518
Net profit	6,210,798

Since management feels that the two most important determinants of our forecast are the number of units sold and the price, we can set up a data table as follows.

	1,000,000	1,100,000	1,200,000	1,300,000	1,400,000	1,500,000
7.5	4,400,000	4,840,000	5,280,000	5,720,000	6,160,000	6,600,000
7.8	4,565,000	5,021,500	5,478,000	5,934,500	6,391,000	6,847,500
8.0	4,730,000	5,203,000	5,676,000	6,149,000	6,622,000	7,095,000
8.3	4,895,000	5,384,500	5,874,000	6,363,500	6,853,000	7,342,500
8.5	5,060,000	5,566,000	6,072,000	6,578,000	7,084,000	7,590,000
8.8	5,225,000	5,747,500	6,270,000	6,792,500	7,315,000	7,837,500
9.0	5,390,000	5,929,000	6,468,000	7,007,000	7,546,000	8,085,000
9.3	5,555,000	6,110,500	6,666,000	7,221,500	7,777,000	8,332,500
9.5	5,720,000	6,292,000	6,864,000	7,436,000	8,008,000	8,580,000
9.8	5,885,000	6,473,500	7,062,000	7,650,500	8,239,000	8,827,500
10.0	6,050,000	6,655,000	7,260,000	7,865,000	8,470,000	9,075,000

We use the data table similarly to how we used to read the mileage chart on an old-fashioned roadmap. We line up our favorite price in the left most column, go across to the column that represents the number of units sold that we want, and at the intersection is the profit for those two variables.

People often ask if the system can handle three variables. The answer is no, but if I wanted to do the same analysis and also change the gross profit percentage, I would probably do three or four different data tables as above, but with the different cost of sales percentages.

VI. Restaurant case study -- Revenue forecast

It will be recalled that we have been using an on-going case study of a successful family restaurant that is planning to grow by opening in 10 new locations over the next five years. While the company recognizes the realities of inflation, it will use constant dollars for all projections making the results easier to understand. As the company revises its plans on an annual basis, it will be adjusting to the new value of the dollar.

As the firm began to look at per restaurant sales in the future, it analyzed the capacity of its present location. It conducted this analysis by time periods and also by month to spot trends that might be used in future marketing.

From the strategic and people plans, the company determined that it was going to execute the following initiatives that should have an effect on per restaurant sales:

- Expand fringes creating happier and more involved employees;
- Bring all employees into a marketing program with discounts and benefits for friends and family;
- Establish a bonus plan giving employee incentives for restaurant bottom-line profits; and
- Establish a training program for customer service.

With no other changes, the company calculated that it could increase restaurant sales by 10.6 percent. While the food costs would be affected, there would be no increase in direct labor expense. Increases in fringe benefit, training, and bonus costs will be seen in further budgets.

Following is the revenue forecast of the business showing the number of locations at the end of each and also the sales for the total. The numbers are based on the first restaurant sales. In the “after changes” line, we have adjusted the sales for the anticipated 10.6 percent increase due to expected changes.

Year (000s) omitted	Present	2	3	4	5	6
Number of restaurants	1	3	5	7	9	11
Sales	3,714	11,142	18,570	25,998	33,426	40,854
After changes		12,925	21,541	30,158	38,774	47,391

People Plan

People Plan

Learning objectives

Upon completing this chapter, the reader will be able to:

- See the difference between an old-style and new-style people plan;
- Understand how the people plan is about solutions and not people; and
- See new ways of learning.

I. What and why of a people plan

An important and traditional part of a planning or budgeting process was always the people plan. Since many of our organizations are highly dependent on labor, the proper allocation of this resource is a crucial part of the overall planning process.

A. Traditional people plan

In the more traditional bureaucratic organization, the people plan can be one of the more political parts of the budget. It seems like the operating departments are always wanting more people and management is always wanting to keep the head count low to save money. The final result is a highly political, and often dysfunctional, system.

1. Case study of traditional system

We have a case of two controllers who run accounting departments in different companies. Both companies are approximately the same size. Both earn about the same profit. Both are in the same city. Both controllers have about the same amount of experience and education. They both are CPAs and are about the same age.

Ann's department has 6 full-time people in addition to her. Her department annual budget is about $500,000. Susan, on the other hand, has 3 people in her department and makes much more use of contractors and outsourcing. Her department's budget is about $350,000. Both departments are turning out the same amount of high-quality work and both management teams are totally satisfied with the work of both controllers.

In your opinion, who is making a higher salary?

If you were the owner of the company, to whom would you like to pay more money?

2. Case study discussion

As a seminar leader, I have been doing that case study before groups for several years. While I don't have any statistical evidence, I can tell you that the anecdotal evidence shows an interesting trend of change. Several years ago, almost the whole class would properly identify that Ann was making a greater salary because she had both more direct reports and a greater budget. Often, organizations establish their salary ranges and reward systems around those two factors.

Several years ago, very few people would say that Ann was making more because she was operating a more efficient department. When asked who the owner might want to pay more, the voting changes to reflect that owners would like to reward the productivity, although they often do not.

As I have continued to do the case study over time, the voting has moved more toward Susan as more and more organizations discover ways to reward productivity and not necessarily head count and size of budget. This case represents significant change in how people are rewarded, and that concept has a lot to do with how we construct our people plan.

B. Traditional motivation system

Unfortunately, traditional systems do not motivate toward greater productivity, but toward more people. Consequently, managers will always try and get larger staffs, both to get larger departments and also to relieve the workload. Unfortunately, in many cases executives succumb to these requests to keep the manager happy and also to try and solve problems.

A key concept in management is that executives have a tendency to “throw money at the problem,” or “throw people at the problem.” Some problems can be solved with people or money, but most can’t. We need to dig down and discover the cause of the problem. Then, we can solve it. But throwing people or money at the problem is often an excuse for not working to discover the true cause of the problem.

C. The new workplace

While there are still traditional workplaces out there, we need to concentrate on planning in the new workplace. This is where our workplace is not the traditional one where we hunker down, be obedient, and perform tasks. The new workplace is where people collaborate and exchange ideas with colleagues and customers about how they can improve both the company and the customer experience. The workplace has transformed from a “command and control” hierarchy to teams and collaboration.

In this new workplace an individual’s value to the organization is determined not only by how well he or she does the job, but also on how he or she contributes ideas back to the organization. The new organization develops metrics to determine the quality of the work rather than how, where and when it is done as long as it is done in time.

The recent pandemic has certainly radically changed the workplace. Suddenly, we were expected to have many of our people working from home, where they could not be closely supervised and where they were more responsible for doing work than putting in time. As we have all seen, this has caused a lot of adjustments to how we view work supervision.

D. The new people plan is more about solutions not about people

While the old-style people plan was all about headcount and full-time equivalent (FTEs), the new one is all about solutions. The following examples show how this idea works.

1. Customer support

Our organization is coming out with a new product that has some interesting technological twists. We know that some customers will be challenged in its operation, thus needing some kind of customer support system. The old solution would have been people in a room, thus creating a people plan issue. But some of the questions that have to be asked are:

- **Should the room be offshore?** Customers generally don’t care for offshore customer service rooms, but the cost is lower. Is the lower cost worth the probable decline in customer service ratings?
- **Can people work from home?** The technology is available to seamlessly transfer customer calls to individuals working from home. The workers like the flexibility and the

customers like talking with a more local person. These employees can be paid on the number of calls and also rated by the customer service metrics from customer surveys.

2. Restaurant servers

When opening up a new restaurant, obviously we need servers thus causing a people plan issue. But is there a more creative way to meet the need? People have obviously developed buffets requiring fewer servers. Back in the early 20th century, Horn & Hardart developed automats in New York City and Philadelphia. The food was put in a little glass case, and the customer deposited money and received the food. The last one closed in 1991.

3. Libraries

For years librarians have been saying that they needed a certain amount of people to check the books in and out. Now the more progressive libraries have installed kiosks for the patron to check in and out the books without individual interaction. The trend started with banks using ATMs, and has expanded to airlines, ski areas, and similar institutions.

The key to these examples is that people are not automatically saying that they need people, but that they need problems solved. If those problems can only be solved with people, that's fine. But we must use our creative skills to also look at other, sometimes less expensive, solutions.

4. Where the technology plan and the people plan come together

Please note that the proper people plan is about solutions to problems, not necessarily about people. The same way, the good technology plan is about solutions and not about technology. All planning must be solutions-oriented and not oriented toward the subject of the plan.

II. Training and management part of the people plan

In the old-style organization there was not much talk about needing creative employees. After all, we wanted obedient people who would do as they were told. We would set them on a production line or in a cubicle, tell them what to do, and expect they would do it. The ones who did would get their normal cost of living raise, and the ones who didn't, would get fired. Unfortunately, our training programs followed this thinking.

A. Why we need creativity

As our organizations move more to a problem-solving environment, we need more employees who will work to find creative answers to problems. It's not that we want disobedient people, but we want creative people who are also obedient.

B. Difference between teaching and learning

As we pursue the need for creative people in our organization, we need to take a good look at how our people learn to be creative and to better manage creative people.

1. Teaching is what institutions do

Schools, colleges, and many companies have long held the idea that they should teach. Many doctoral theses have been written about how to teach better and countless billions of dollars have been spent on experiments to improve teaching. The trouble is that teaching is what those organizations do, but not necessarily what the students do. When we teach, we hope that someone is learning. But that is not necessarily the case.

2. Learning is what people do

People, on the other hand, do the learning. They discover ways to combine what they are reading, watching, or listening to with their other experiences of life, and come up with new ideas and solutions.

3. Teaching hurts creativity

Unfortunately, traditional teaching hurts creativity. When we teach, we ask the students to learn ways, facts, dates, and other specific things that they parrot back to us in the form of multiple-choice tests. When you think of it, those students are learning to be obedient, but they are not learning to be creative.

4. Learning promotes creativity

Learning is the transformative process of taking in information that, when internalized and mixed with what we have experienced, changes what we know and builds on what we can do. It's based on input, process, and reflection. It is what changes us. From the process, we learn how to be creative and how to solve problems.

C. How to get and keep creative people

Assuming that you agree that we need creative people in our organization, these are some of the steps of the plan that will make that happen.

1. Make the decision that this is important

Creativity is a cultural issue and must be discussed at all levels of the organization. If senior management doesn't see the need for creative people, it will never go ahead with the various steps designed to encourage creativity among the staff. This first step must come from the top.

2. Hire for creativity

Instead of hiring people just for their technical skills, make the final hiring decision on how they creatively handle problems. This can be done with case studies where they are given a problem and asked how they would solve the problem or react in this situation. The case studies can and should be answered both in writing and also verbally since both ways give you important indications of the creativity.

3. Case study

Well-known author, Seth Godin, discussed a great example of this kind of thinking. He wanted to hire a paid intern to work in his social network marketing operation. As part of the process, he set up a private Facebook page and invited all of the candidates to be part of the page. Some actively posted opinions and thoughts about the company and social networking in general. Others, not wanting to make any mistakes, really didn't engage but mostly just watched what was going on with the page. Is there any question who he hired: The lurkers or the active participants?

- Would this work for your company?
- In what situation could you develop a Facebook page to help with your hiring?
- How could the idea be used to hire in a department in your company?

4. Don't micromanage

Empowerment and authority can be one of the most important aspects of creativity. We all know that people learn from their mistakes. In fact, it's almost impossible to find a person who doesn't agree with that concept. Why, then, do we manage them so that they don't make mistakes, and therefore, don't learn?

When we manage people too closely, fear develops. Surviving becomes an exercise to avoid making mistakes. Consequently, that fear of making mistakes and being ridiculed becomes so great that no one determines to be creative. Creativity and fear are polar opposites.

5. Encourage people to make suggestions

If we want creative people, we need to figure out how to encourage those people to be active in making suggestions in both how we can serve the customer better and also to do it more efficiently. We can do this in several ways.

a. **Weekly team meetings** -- We need to have regular team meetings. These meetings should not be about reading and reviewing reports, but about how to solve problems. Such meetings encourage participation and thus encourage people to make suggestions.
b. **Employee forums** -- These are internet forums that can exist behind the company firewall and get various topics going regarding ideas on how to solve problems.
c. **Company blogs** -- These are similar to forums in that they can be very targeted in asking employees to participate and help solve problems.
d. **Company social networking sites** -- We are all familiar with Facebook, but are we aware that similar platforms can exist behind the company firewall, which are totally safe from intrusion from the outside public? Many companies are developing these systems for several reasons. We know that people like to network, and that is the great reason for the success of Facebook. But the organization can also use the system to network employees and get them to discuss problems and find ways to collaborative solutions. Employees on these sites have profile pages showing photos, interests, and other personal information. Companies that make frequent use of these sites find that people are happier and feel better connected with both the company and other employees.
e. **Company Facebook pages** -- While not as secure, but much easier to establish are closed pages on Facebook where people have to be invited to be members and the general public does not have access to the material.

6. Encourage managers to learn new management methods

This step is especially true about older managers or ones who either do not know how or are uncomfortable with the new leadership ideas. Fortunately, there are books being published each week talking about how to lead in the organization of the future. In addition, the authors of the books and others have blogs where they are posting great articles daily on how to be a better leader. We need to find a way to better encourage those people to learn new techniques.

7. Encourage people to learn about the entire organization

Too much of our training is about how to do our job better, and all too little about leadership techniques and about the company as a whole. Recently there was a magazine article about Starbuck's leadership event. The company did not put the store managers into a room and have them listen to lectures by noted celebrities and company management. Instead, they had them travel through a huge exhibition hall experiencing how to grow coffee, how to rake the beans, and how the processing and roasting processes work. They did this so that the partners (they are called that because the company gives them stock), could have better experience and be excited about the company brand.

At this conference, the participants didn't watch lectures about how to better make coffee or serve the customer. They were not taught, they learned on their own. Starbucks has a passion for coffee and also a passion for its employees.

8. Have a talent mobility policy

A great way to keep people happy and productive within the organization is to allow them to choose in what area to work. The concept is that people will only be happy when they feel productive and are working in an area that they want. If the company does not allow this mobility, the unhappy ones will just leave the company for another organization. The concept is in place, and works very well for the W.L. Gore Company, maker of GORE-TEX®.

III. A plan for more efficiency

Because the only things that employees need to do is serve the customer better and do it more efficiently, our people plan must concentrate on efficiency.

A. Key promise to all employees

Generally, people want the organization to be more efficient; however, there are often two things causing the idea to fail. The two negative things often going through an employee's head are, "Efficiency means more work for me," and "I don't want to suggest gains of efficiency because the idea may cost me my job."

The first thought is actually not a reality. In most cases, gains in efficiency make it easier for an employee to do a job. More importantly, the gains will usually allow the employee to do more interesting work rather than the mundane work.

The second thought is more important, but easily solved. The organization needs to make and keep an important promise such as:

"If you come up with an idea for more efficiency that might decrease or eliminate your job, we absolutely guarantee that you will not lose your job, but you will be transferred with every attempt to move you into a higher paying job with more authority and enjoyment."

It is only when that promise is part of the culture of the organization that employees will be willing to creatively think of and present ideas for greater efficiency.

B. Paying people to do work not put in time

This is probably the most important concept in workplace leadership today. More and more companies are moving to a way to reward people for their results rather than reward them for just showing up.

When we think of it, we generally pay people on the basis of seat time. In fact, our wage and hours laws are totally based on that concept. The problem is that those systems were developed back in the industrial revolution when people worked on the production line and obviously had to be at the correct place at the appointed time.

Today, things are different. We have few production lines, and most of the work can be done from any place. Consequently, we need to come up with good metrics and reward the people for doing the work and not just for showing up. The beauty of that system is that it has the result of both being more efficient and employees like it better. It is more efficient because we don't have to hire supervisors to stand over people to make them work and also the employees love the freedom.

1. Case study

Tom was the controller and manager of the small accounting department of a plumbing parts distributorship. Susan was the person in the office that handled receivables. She was responsible for both the accounting part and also the collection of the receivables.

Prior to any changes in the leadership systems, everyone in the department came in at 8:30 and left at 5. One day Susan came in to talk with Tom about some problems she was having at home. She explained that home life with two children was more difficult since one was at home and the other in school. While she had day care facilities, sometimes things happened where she wanted to spend more time at home.

As an attempt to help with the situation, Tom proposed a change in the work schedule. He was very happy with all aspects of Susan's work including the accounting and the collection efforts with the accounts showing 45 days sales outstanding. She generally spent about 3 days a week on collections. Tom proposed to Susan that she be given total freedom in how she broke up her job and from where she did it. They both determined that she needed to come to the office to do the accounting, but she could do the collection from home. Consequently, Tom said that she could determine when she would come in, when she would work from home, and all aspects of her job. The only thing that he required was that the accounting stay at its high level and that the receivables stay at 45 days.

After 6 months of the experiment, Tom reviewed the progress of the idea. He found that the receivable accounting was up to date and probably in better shape than before going onto the new schedule. More importantly, he found that the receivables were running at 43 days. Susan said that he was much happier with the arrangement and her home life was far easier to manage.

- Does this case study surprise you?
- Could you do it in your company?
- What might be some of the problems?

C. Gain-share systems

Continuously through this course we have said that the plan or budget should not be used to control expenses. Since many people see the budget as the only good way to control expenses, we need to suggest another way that will work better to achieve the same end. The answer is a gain-share system.

Simply put, a gain-share system is where every department in the company is placed as some kind of profit center and then the members of the department get rewarded on the profitability of the department. Obviously, when they share in the profits of the department, they are more interested in both serving the customers better and doing it more efficiently.

With profit centers that gain outside income, the system is relatively simple. With cost centers, however, it becomes more problematic since there is no income. The simple way to remedy the problem is to give the department income based on what they do. For example, the accounting department serves the entire company. Consequently, giving the department a small percentage of sales as income would give it income that could match the expenses, and thus a hypothetical profit.

The income number would be a percentage of sales that would be fixed. The amount of income that is given to the accountant might be just enough to cover costs when the program was started. That way, when the company expanded its sales, the employees would be rewarded if they could handle the increased sales with a smaller percentage increase in expenses.

It is important to note that this system obtains the income from a percentage of sales and not by charging other departments. While the former is a simple calculation, the latter system can easily become complicated and even produce serious negative unintended consequences. There are many instances of companies that internally charge departments for accounting services. The result of that kind of charge is that the operating department is responsible for that charge but has little or no way to control it. Assuming that the operating department manager is incentivized on the profit, it is never good to have an expense in the calculation over which he or she has no control.

D. Efficiency case study

A large plumbing contracting company in the southwest had an interesting situation. The plumbers in the organization were paid on a piece-work basis as they did the “rough” plumbing in developments. They were paid an amount for each house on which they did the plumbing, and the average plumber could do about three houses per day.

A new controller came into the organization and immediately noticed that one plumber was making significantly more than the others. In fact, where the average pay was $50,000, this particular plumber was consistently making over $ 100,000. His first reaction was that possibly the plumber was violating a policy and personally hiring one or more helpers off the books.

An investigation found that the plumber was not violating any policy but had refined several techniques that caused him to be much more efficient. He memorized the plans, went to the truck one time to get and cut all of his materials, and set them all out ahead of time next to the trench. He then went in and did the plumbing. Using this method, he was able to do approximately twice as much as anyone else.

When asked to take a management position and teach the others how to do this, he refused knowing that he made more money doing the piecework.

It is interesting to note that during the slow times in the construction industry, the company continued to get some work, and the plumber was able to stay busy and continued to make a six-figure salary. At the same time, many of the executives didn’t get their bonuses and found themselves making less than the plumber. If you were one of those executives, how would you feel?

How would your company have handled his situation?

IV. Restaurant case study -- People plan

For this course, we will be using a hypothetical restaurant as a continuing case study. In the case, the company has a vision statement wanting to become the largest family-oriented restaurant in a three-county area with a population of 1, 456,255 people. It has determined that it would be able to reach that vision using several techniques including:

- Unique food;
- Exceptional service;

- Efficient operation; and
- Dedicated workforce.

Since the last three items on the list involve people, the next step was to determine how it would be able to accomplish those things using a people plan.

A. Exceptional service

This goal would have several tactics including the following:

1. Specific training

Every employee of the company would participate in extensive customer service training. The curriculum would primarily be based on case studies, but it would start with a full understanding of the value of the customer and how customers want to be treated. The case studies would be full of hypothetical situations with the employees discussing how to handle the instances. The training would be collaborative in that there would not necessarily be one answer dictated by the company, but there would be a lot of suggestions coming from the workforce. The company had learned that this kind of training was much more fruitful than classroom lectures.

2. Efficient operation

Meeting this mission would be accomplished by establishing a gain-share system where all of the employees were given bonuses based on the profitability of their area. The kitchen's bonus would be based on metrics as would the servers. The company would establish a private blog for all employees to make suggestions and discuss how they could make the restaurant more efficient and more profitable. This way, they would be more engaged in the goal of efficiency and also benefit through the restaurant's profits.

3. Dedicated workforce

The company would also establish a bonus program where the employees would be given company stock. Because the organization was privately held, the liquidity of the stock was questionable, but the owner had expressed a willingness to repurchase any stock if the employees desired. In addition, going public was a possibility in the future, making the stock very valuable.

Another initiative was to encourage employees to use social networking in their available time thus encouraging them to help market the restaurant. Management had decided to offer a special gift such as a free desert when employee's friends and family visited; however, the details of that program would be set with the employees involved.

Another of the company goals was to make the company a favored place to work in the area. For this, they would provide health care to all workers including part-time. The firm recognized the expense of that benefit, but it felt strongly that the benefit would be more than the cost.

Finally, the company was determined to manage the restaurants with the greatest amount of freedom and empowerment. Consequently, it would set up a system where the employees would schedule themselves. The company, along with the employees, would establish guidelines including shifts and how many were needed for the various shifts. It would also set minimum and maximum hours for each employee in conjunction with that employee. Then, each month, the company would post the schedule and have the employees schedule themselves. Management knew that starting this practice would probably be a little difficult as some employees might try and force others to work on certain days. But management was sure that in the end it would be well received and would cause more employee engagement.

Marketing Plan

Marketing Plan

Learning objectives

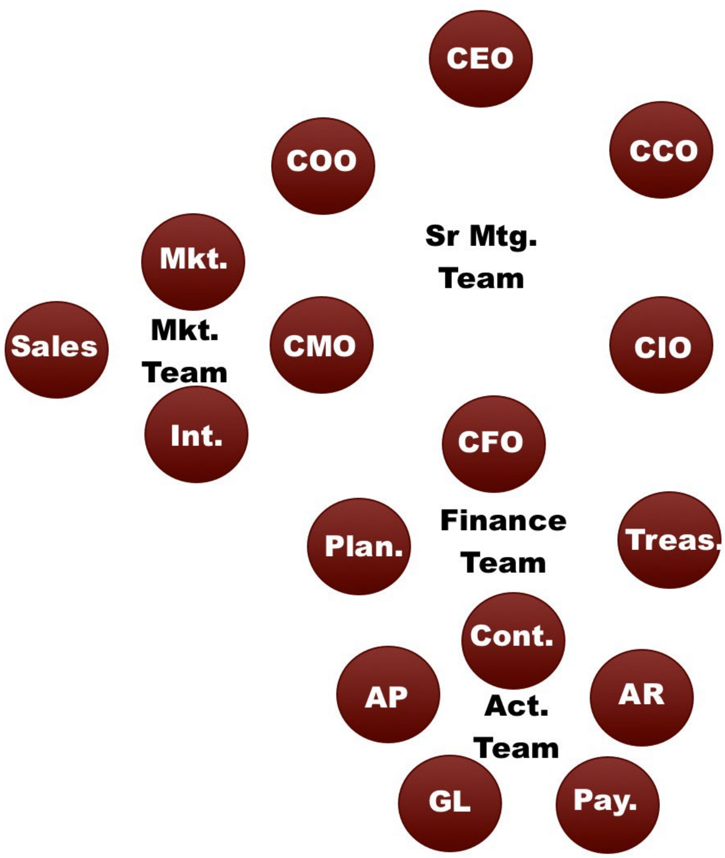
Upon completing this chapter, the reader will be able to:

- Understand the old style and the new style of marketing;
- Develop a marketing plan with the new style of marketing; and
- See how the new style of marketing can be more productive.

I. Introduction

Hey, wait a moment. Why on earth are we talking about marketing? If I wanted to be in marketing, I would have studied marketing and gone into marketing. I didn't, I went into accounting.

The reason is simple and has to do with the diagram of the company.



We are assuming that people taking this course are CFOs or ones who might aspire to that position. Consequently, we need to recognize that the CFO, sitting on the senior management team, will need to allocate resources to marketing and generally be partially responsible for the success of the marketing program. Further, the CFO and the finance team will need to understand marketing metrics, and help the marketing and sales departments track their results. Finally, if the finance group is responsible for the overall plan, it must have a good handle on the marketing plan.

II. Three approaches to the organization

A. Factory age

Starting this section in a broad and philosophical fashion, it's necessary to look at organizations and companies over the ages. First came the factory. We often think of Henry Ford as the pioneer of the industrial revolution. It's interesting to note that we didn't hear much about Ford's marketing efforts, but rather his efficiency efforts. That's because early organizations obtained their competitive advantages from being more efficient. As long as they could cut costs and make a product in an ever more and more efficient manner, they would become more competitive.

The way to achieve this efficiency or productivity would be to keep wages down and constantly invent and introduce more machines into the production line. This is a great idea; however, at some point it has its limitations. There is only so far the organization can go in becoming more efficient.

B. Advertising age

Along came a new invention called the radio, and shortly after, the TV followed into the homes of the public. Suddenly, organizations saw whole other ways of achieving competitive advantage – they advertised. Yes, there was traditional marketing done in newspapers, but the game really changed when companies could get into homes more easily through radio and television.

However, there was a quick challenge that came about with traditional media advertising. Yes, if you spent enough money, you could get your message into the homes. But that was expensive. Consequently, organizations became limited in their competitive advantage by the amount of money they had to spend on advertising.

C. Connected age

Within the past few years, things have changed again. Yes, there is the traditional media of newspapers, TV, and radio; however, they have all become less relevant as the Internet has increased in importance. No longer are we limited in our marketing efforts by the amount of money we may have in the bank. For virtually nothing, we can have a Facebook, Twitter, blogging or YouTube account, and be marketing to millions of people. Needless to say, this has severely changed the approach to marketing.

III. Key questions of the marketing plan

A. How are we different?

The first thing that any organization must answer is how it is different. After all, if the organization is not different from the competition, why does it exist? To be successful, any organization must do two things – it must be different, and it must be able to tell the market how it is different. It has to be different, and it has to be able to quickly articulate that difference.

B. How can we tell our market that we are different?

Being different is only half the battle. The organization must be able to tell the market how it is different. For example, you can have the best restaurant in town with the best food, best service, and freshest ingredients. But, if no one knows it, you will fail. Just being the best isn't enough. You somehow need to convey to the market how you are different and why you are better. Many entrepreneurs will say that the word will get out by “word of mouth.” That may be a noble approach, but don’t count on it. In today’s crowded market, don’t expect your word to get out, or at least don’t count on having a lot of time and staying power to wait till it gets out.

C. What are we trying to accomplish with this program?

This might seem obvious; however, it is the question most often not asked. With a marketing plan of any kind, what is the real thing we are trying to accomplish? While the answer might be, to sell more products, actually we need to look a lot deeper. The conversion factor is a concept that says how many of the people who are reached by our marketing are actually converted to some action that is requested. That might be to buy the product, click on a link on our website, or give us an email address. But the key is that we want the person looking at the ad to perform some behavior. Defining that behavior is key.

Marketing is all about change. We may want to change attitudes, perceptions, or the trust of our organization. The challenge of mass media was to run ads that would cause the greatest number of people to change. The problem was that the actual message was received by only a very small number of people who would want the message. The rest of the effort was a complete waste.

Today, with a new-style marketing, we have the opportunity to target a much smaller market, but one who has a greater likelihood to change in our favor. But, to do this, we need to specifically determine the purpose of each and every marketing effort.

D. Can it be measured?

As financial people, we are happy with this question. We know that we must have meaningful metrics to measure our specific marketing efforts. We must be able to define success and compare that success to the costs of the program.

E. Will our program build trust?

We have learned that for people to want to do business with us, they need to trust us. If they don’t, even at almost any price, they will go to a competitor. There are many things that we can do and ways to increase trust; however, there are also many ways that we can destroy that trust. Surprisingly, many organizations do things that erode trust all of the time. Spamming email accounts, for example, may reach a lot of people, but the practice will also cause plenty of people to hate to see your email. Giving good useful information, on the other hand, can increase the trust level of the customer.

F. Can we control our message?

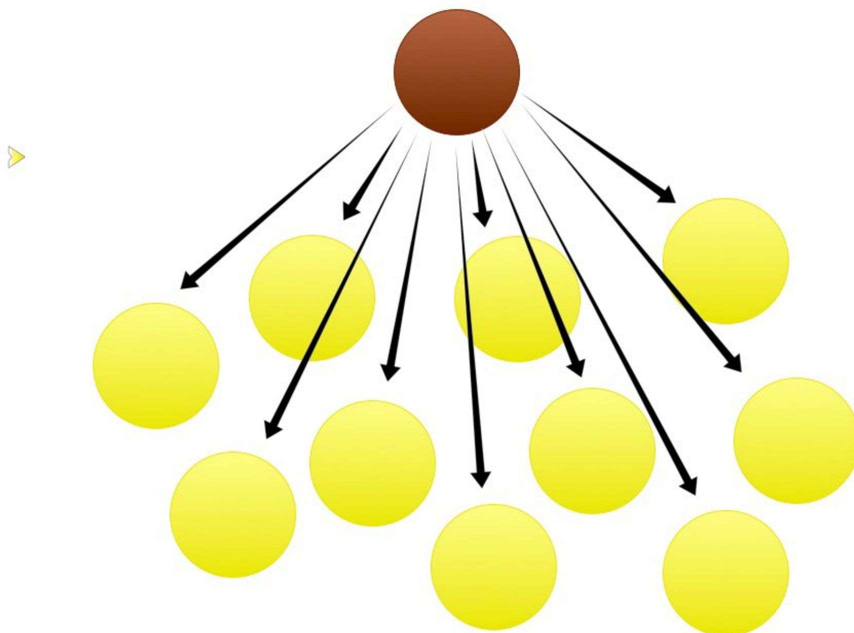
A mantra of marketing has traditionally been to control the message. That’s why organizations joyously guard media access and try to control what is said by members of the company. Years ago, that might have been a good goal, but today, it’s absolutely impossible. Remember this, no matter how hard you try; you cannot control your message.

G. What does the customer want?

A key to success is giving the customer what is wanted. The recent pandemic emphasized an interesting thing about customers: As a result of people being more isolated, their need for personal contact has increased. Consequently, those companies that have been able to increase personal touch with their customers have radically improved their customer satisfaction.

IV. Traditional marketing

While we won't spend a lot of time on traditional marketing, it's necessary to understand it to see how it differs from new style or connected marketing.



Traditional Marketing

A. The company is in control

Until the Internet, we always thought that the organization was in complete control of its marketing and public relations efforts. That is why we had centralized marketing departments, and media representatives who controlled the message. Many organizations today have hard rules that prohibit anyone from the company from saying anything to the public without the permission of the public relations or marketing department.

B. Reach

Traditional marketing is all about a combination of frequency and reach. Reach is defined as how many people will be reached by a particular message. For example, an ad on the Super Bowl has a reach of many million people. In fact, not only will people see the ad on the most-watched game of the year, but the best ads will be discussed by the media for weeks. Those ads have a lot of reach and get to a lot of people in a short period of time; however, they have two important drawbacks.

1. They are expensive

A thirty-minute spot on the Super Bowl in 2013 would have cost you about $4,000,000.

2. Most of the money is wasted

There is a great quote out there that says, "I'm totally convinced that easily one half of my advertising is totally wasted. The problem is that I don't know which half." Broad-reach marketing is a shotgun approach recognizing that most of the people watching the ad are not interested in what is being said. Consequently, the ad has a low conversion rate and causes relatively little behavior change.

The reach can be extended for no cost when the company takes the ad recording and posts it to YouTube and the website.

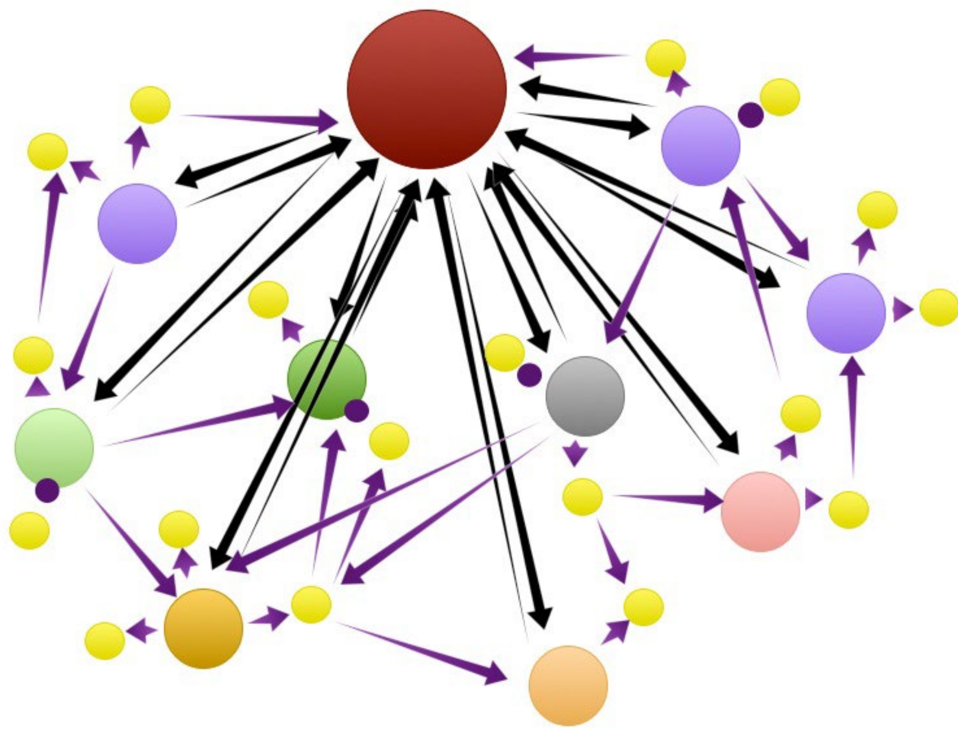
C. Frequency

The other side of the traditional equation is frequency. Studies have found that the success rate of conversion increases with more frequency. Say the same thing over and over again, and finally the message might sink in. That’s if we don’t get tired of a company constantly bombarding us with the same message over and over again. Connected marketing with social media allows high frequency at a low cost.

D. We love our creativity

One of the specific problems with traditional marketing is the fact that we have fallen in love with our own creativity and messages. Ads are written by ad agencies and designers to be as clever as possible. Some of the best appear on the most-watched TV shows and are obviously expensive. The problem, however, is that they often don’t work. Yes, they win awards and have us all talking about them in social media, but do those ads result in any serious conversion? We love the message and skills in production, but the customer does not necessarily love them. In fact, sometimes even the viewers are taken in by the message or design of the ad, but in the end can’t remember what company had sponsored the ad or what was being advertised. I’ve tested that theory out by asking the attendees at a Super Bowl party if they remember who or what was just advertised. Surprisingly, many said they loved the ad, but had no idea what it was for.

V. Connected marketing



Connected Marketing

The new style of marketing is radically different from the traditional. It no longer is about control, but about knowing how to manage and lead the marketing effort to better results.

A. Organized chaos

Certainly, the above chart looks a little chaotic, and it is. But that's exactly how marketing works today. Instead of a model where the company sends a message to the general public, now it may send a message out to small, select, and targeted groups only to have that message re-sent to other groups, which, in turn, re-send to still more groups. That is what the marketers call going "viral."

Probably the greatest fear of marketers is that they feel that they can't control their message. And they are correct. But the fact is that they can't control their message regardless of their participation in the new connected marketing system or not.

1. Case study example

A small-town police force takes great pains to attempt to control its message. Individual officers, including the chief, are prohibited from talking to the media. That job is left to the public information officer who handles all press conferences and even prepares "talking points" for the chief and other senior officers should they be called upon to make a statement.

The town is controlling its message, right? One evening, an officer made a traffic stop and said some things that may have been interpreted as being inappropriate. The woman had a dash camera in her car that was running, and she also triggered her cell-phone recording device before the officer approached her. The following day, the entire experience had been tweeted to her followers, posted on YouTube, and had a corresponding message on her Facebook page with the link to the video and audio. The video went viral, and the town was very embarrassed.

Could the town control its message? No!

2. Our message can't be controlled no matter how we try

With the Internet and various social networking media, our company message must be completely rethought knowing that we can't control it. We can, however, manage it differently with the result being a much more effective marketing program that will translate into better conversion at a lower cost. The difference, however, is that we need to develop this new strategy using the new media yet in conjunction with traditional media.

We are not saying that we won't use traditional media. An excellent example is the Go Daddy Company. Some years ago, the completely unknown company spent a lot of money with a sexy ad on the Super Bowl game. That traditional ad got people talking, and they sought out the website when they wanted to register their own new website. From the Go Daddy website, the marketing totally differs using social media heavily in most of their marketing program.

3. New media

Examples of the new media include the following.

a. **Facebook** -- Probably is the largest social media network. While often seen as a personal network, companies and organizations make use of it with commercial pages, advertising, private groups, and similar parts of the media.

b. **Twitter** -- Similar to Facebook, this platform allows only short posts, but companies utilize it heavily sending messages to individuals, employees, customers, and the public.

c. **LinkedIn** -- This tends to be a professional linking platform used mostly by individuals. However, it can be very effectively used in recruiting as well as networking between executives and other professionals.

d. **YouTube** -- This is a great example of choosing to use a part of social media for the organization's benefit or waking up some morning discovering an embarrassing video about your company going viral. Many companies use the platform for training, promotion, or helping customers to better use their products.

e. **Amazon** -- Often not seen as a social media platform, it can be a very effective way to reach the public with products.

f. **eBay** -- Similar to Amazon, we don't see this as social networking; however, it can be used to move excess inventory as well as to get the name of the organization into the market.

B. Greatest mistake in connected marketing

The single greatest mistake that marketers make today is to think that the organization's connected marketing strategy would work similarly to that of traditional marketing.

There are many differences between traditional and connected marketing, but probably the largest is that traditional marketing is one-way, from the company to the public; whereas, connected marketing is multi-way with messages traveling back and forth among the groups. This kind of marketing is collaboration at its best.

It is interesting to note the similarity between management and marketing in this respect. In the traditional command and control management system, orders, delegation, and knowledge generally run downhill from the top to the bottom. In the new style of management, the buzzword of leadership is collaboration where leaders empower and use their teams in making decisions.

The same is true of marketing. In the new style, the messages go through collaborating groups; consequently, the organization needs to completely re-think the strategy.

1. Case study example

A performing arts center has a large email list of its patrons. The primary way it uses the list is to send out "blast" emails reminding the patrons of upcoming shows and available seats and specials. It also has Facebook and Twitter accounts, and it uses them the same way sending messages from the organization to the patrons.

Another performing arts center engages its groups in a different way. While they also will send out messages and posts on Facebook and Twitter about shows, they will also periodically use both of their accounts to survey the public on shows. In addition, when selecting acts to book for the theater, the group will hold contests and use other creative ways to get input from the patrons.

Which performing arts organization do you think is making better use of social media?

C. Myths of marketing in the age of connected marketing

While there are probably several others, here are some of the most common mistakes when thinking about connected marketing.

1. Hits on the website is the best way to determine success

While programs can easily measure how many hits came onto a website, the true measure of the effectiveness of the site is sales made or some other metric. Good websites ask for action – and recording how many times that action is performed is the best way to measure the success of the site.

2. If you build it, they will come

Not true. With over a billion websites out there, the chances of yours being the one seen is pretty remote. It may have worked a few years ago, but no longer. A website is not an Internet strategy. It's like printing a brochure and then leaving the copies in boxes in the storeroom. It might make you feel good for having such a nice brochure, but they won't do a bit of good without being seen.

3. Our website should be pretty like our brochure -- If it is, people will see it

There are plenty of pretty and well-designed websites out there, but that's all they are, and they don't work. The good website asks for action and records the success of that request.

4. You can sell stuff on the Web if you spend enough on a good website

Again, not true. Money isn't the answer; strategy is.

5. Search engines and SEO are the key to success

Search engine optimization may get your site near the top of the lists of the search engines; however, the strategy is flawed for two reasons. First, it is an expensive strategy. Second, most people do not surf the Web through search engines, but they go to sites specifically for specific reasons. A good strategy will lead to a scalable amount of traffic that does not rely on random searching.

6. The Web is like TV

They are very different. The Web is two-way whereas TV is one-way.

VI. Tribes

In his book of the same name, prolific author Seth Godin recognized a unique aspect of connected marketing involving tribes. In his definition, a tribe is a group of people connected to each other, with a leader, and for a common cause.

The Tribe

A. Crowds and tribes

We need to make an important distinction between crowds and tribes. Both are groups of people, but there are some important differences.

1. Crowds don't have leaders

A group of people is just that, a group of people. A tribe, on the other hand, has a leader of the group of people. However, it's important to recognize that leadership is different from management. The leader coaches the group in a more collaborative fashion and does not dictate, which would be more normal in a bureaucratic group.

Some of the key things that the leader does for the tribe is to organize it, set the vision, and help perpetuate the passion of the rest of the members.

2. Crowds don't have communication

That may not always be true, but when a crowd has communication it is almost always only one way.

3. Examples of tribes

When we see some examples, we clearly see the difference between crowds and tribes. Jerry Garcia was a musician, but more importantly, he was the leader of a tribe. It's easy to see the difference between the followers of most musical groups and the followers of Jerry. We called them "Dead Heads."

Another somewhat humorous example is pirates. They were certainly groups with a communication system, a leader, and some clear values. Today, we might not agree with those values, but they were shared by the tribe. To top it off, that tribe had its own way of dressing and a flag.

The Tribe

B. Tribes used to be local

Prior to the Internet, tribes used to be local and confined to churches and similar organizations that met locally on a periodic basis. Today, thanks to the Internet and social networking, tribes can be anywhere in the world. All they need is a leader, people, and a cause.

C. Marketing to tribes

One of the most important keys in the understanding of tribes is how we reach them with a message. While a one-way message might have worked with crowds, tribes thrive on networking and therefore, two-way messages. We make a huge mistake thinking that we can market to tribes the same way we used to market to crowds.

D. Building tribes as a marketing strategy

The hottest trend in marketing today is forming tribes, building loyalty, and marketing to that tribe. We see obvious examples of this every day. Musical groups no longer survive on selling CDs. They rely on building their faithful followers in the form of a tribe who often travel across the country for a performance. Recently I attended a concert of a group that had a type of "frequent flyer" card to have stamped to receive discounts on show tickets and merchandise. Look at the tables after concerts, and you will see how the group leverages its tribe into merchandise sales.

In fact, airline frequent flyer programs are some of the first tribe ideas; however, few airlines have been able to overcome the problems of bad service to properly utilize their tribes. Southwest Airlines has had much better success, and it is a regular on Facebook and Twitter as it makes specials available to its tribe. But, while making offers on the Facebook page may be one-way, the company also allows people to post complaints making it a two-way media. More importantly, when they get a complaint, they don't act defensively, but investigate it and post back to the complainer.

Please remember an old concept. Statistics show that most unhappy customers will never tell you, but they will broadcast their unhappiness far and wide. But when you do hear from them, and you are able to satisfy their needs by listening and doing something about it, they will then stay with you and praise you.

E. Tribe strategy

There are certain steps needed to use tribes as your marketing strategy.

1. Start the tribe

While the concept may be simple, it's not necessarily easy. An organization starts building its tribe using all forms of social media in concert and in conjunction with traditional media. For example, let's say that you own a restaurant and would like to start and build a tribe.

a. **Make it worth their while** -- Generally, people aren't going to join a tribe without some kind of incentive. As a restaurant, you may offer a special free gift at the table if a person will give an email address and fill out a short form with special dates like birthday and anniversary. Then, on a person's anniversary, you send a special invitation and say that a complimentary rose or glass of wine will be at the table.

b. **Give away something useful** -- The same restaurant might give away recipes on the website or via a Facebook page. At the time, the tribe members will be receiving valuable free content, and all the time the restaurant will be building the tribe.

2. Build the tribe

The key to the tribe is passion. A tribe at a restaurant may be a list of email addresses, but that won't be translated to a lot of business if there is no passion. The tribe members must become passionate about their experience and build loyalty to the brand. When that happens, you will have them using their own Facebook and Twitter accounts praising your brand and re-tweeting or sharing your messages. It is up to the business to give the tools to the members. If they are enjoying tribe membership, they will tell their friends.

The trouble is that the business also has the power to destroy the tribe. All you need to do is start spamming the email accounts with material that the members don't value. If they value the information, education, and other materials, they will stay with you. If not, you will quickly see them leave the tribe.

3. Develop the true fans in the tribe

The final goal of the tribe strategy is to develop a loyal group of fans that are so passionate about your product or service that they have become true fans. You will be able to recognize this when they:

- Go out of their way to do business with you.
- Recommend you to friends in their networks.
- Are willing to pay a little more to buy from you.
- Are passionate about your product or service.

VII. Permission marketing

Godin also describes the new way to market as permission marketing. He does this by contrasting the new way to market against the old way, which he calls interruption marketing. When we think of it, the contrast is obvious. In traditional marketing, you sit down to watch some TV or read a paper, and the media interrupts you to give you a message. Especially in the paper, you might try to avoid the interruption, and may succeed if lucky. But the ad designer has done all he can to trick you into being interrupted.

Permission marketing, on the other hand, is totally different. In this case, you have given the marketer permission to give you some information. In fact, you may have even asked for the information and are very pleased to read the content. This might be a newsletter or blog to which you have subscribed or some educational material that you want. In any case, you are happy to get it and will devote your attention to it. You have given your permission to get the information.

While traditional interruption marketing is like a shotgun hitting only a very small percentage of the people who may see it, permission marketing hits a much smaller targeted market, but all of the market wants to read the material. Where interruption marketing is expensive, permission marketing is far more economic.

A. Why people give permission

People give their permission to be interrupted for several reasons.

1. Information

You are agreeing to provide information to the prospect that he or she wants and can get at no other place. A review service of restaurants might be an example. People want to read the reviews, and they might give you an email address to get the reviews if they are good enough.

2. Education

Let’s say you have that restaurant. Many people will be willing to give you their email addresses for some great recipes.

3. Entertainment

Possibly you have posted some entertaining content on YouTube, and by giving you an email address, they can take home the audio of the song.

4. Cash

While you probably won’t actually give away cash, you might have a contest with the winner receiving something of significant value. The people will give you their email addresses to be entered in the contest.

B. Permission marketing to the tribe

It’s interesting to note how these two concepts work together. People give us their permission in the form of joining our tribe. Then, once members of the tribe, they gain loyalty to the point where they are exhibiting the traits discussed above.

C. Customer is in control

It is very important to realize that in both permission marketing and tribes, the customer is always in control. That person has to give us permission to allow us to market to him or her. And, we have to continue to give good content and avoid violating the trust that has been given to us.

D. Levels of trust

1. Spam – No trust

At the bottom of the trust levels would be where a company sends out spam to email accounts. In this case, the person has not given permission to receive this information and won’t generally do anything with it. This is often done by companies using the Internet and social media as they would with traditional media. It can also be used with Twitter, Facebook, and YouTube when all the company uses the media for selling something. This does not gain trust.

2. Situational trust

A little better than spam is situational trust. Here the customer makes a call to a call center or clicks on a website to get specific information. The trust level is low and only for that situation. The customer trusts the company to give the information. If the contact is handled well, the trust level can grow from here.

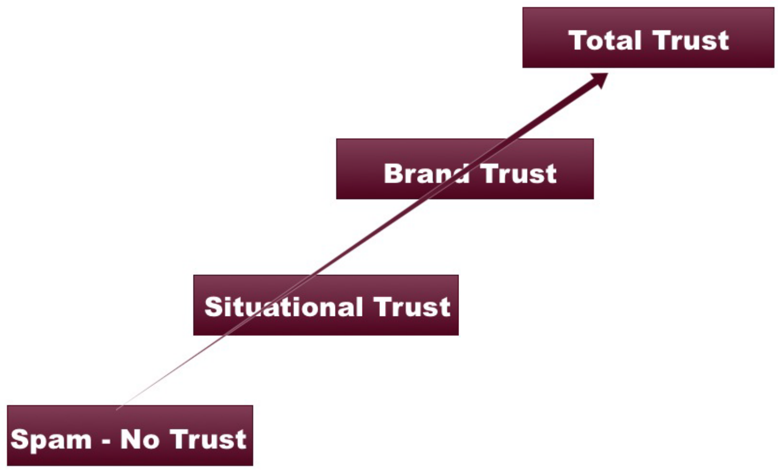
3. Brand level trust

In this case, the customer has gained more trust in the company and actually trusts that good value will be given. At this level of trust, the customer may not sign up for any long-term contract, but they are willing to trust that the company will give good value across a broader range of services.

4. Total trust

This is the level of trust at which we are striving. Here the customer has given control over to the company because he or she is confident that the company will give good value and make the right decisions. This is the kind of trust that a client gives to the CPA who is preparing the taxes. After all, the customer is not about to research the tax law, but they trust the accountant to have done the proper research. Another example is where periodically the customer may call the cell-phone company asking if he or she is on the best plan for the usage encountered. In this case, the customer trusts that the person on the line will give a good opinion, and not one that is just in favor of the company.

This, and all levels of trust, can be violated and the trust diminished. For example, the customer has a good brand level trust, but that trust will quickly fade if the customer finds out that the company is giving better deals to others. Or, if the client discovers a tax advantage that wasn't made available to her, the trust level will diminish. Consequently, we have to work hard to maintain the high level of trust.



E. Advantages of permission marketing to the tribe

With this new style of marketing, the company has huge amounts of data on what customers are buying, when, and for what reason. It is also much easier to track results of campaigns. For example, Southwest uses the system to make offers to their best customers through their frequent flyer program (tribe). They can easily send out the offer through the emails to a small group of flyers, Twitter, or Facebook, and watch the change that occurs on the website. What we have is instant metrics.

Once the company has those kinds of tracking information, it is easy for them to adjust the offers and discounts to appeal to specific groups.

Let's remember where we started. All marketing is about reach and frequency. In the case of permission marketing to the tribes, the reach is targeted to the point where people interested in the offer are much more apt to respond.

F. Simple five-step process for connected marketing

1. Marketer offers the prospect an incentive for volunteering or giving permission

Interestingly, this first step may very well be as a result of interruption marketing. The prospect may have seen an ad on TV, newspaper, or some other more traditional media. The ad may promise a reward, contest, or some other incentive such as a limited-time subscription for the prospect to go to the website and opt in for the special.

2. Marketer gives information or education about the product or service

In turn for the entry-level permission, the marketer gives the reward to the prospect. It's important that the prospect sees the information or education as valuable, or trust will be diminished rather than built. Remember that a primary goal of this whole process is to build the tribe and build trust.

3. Marketer uses email to remind the customer to return to the website

If we don't follow this strategy, the prospect will disengage from the tribe and see no real value for continuing.

4. The incentive is reinforced to guarantee that the prospect maintains permission

Just having the customer at this point is not enough. He or she needs to be nurtured and further reinforced.

5. Marketer gives more incentive to get higher permission

From here on, the relationship is to give more incentive to get more permission and more commitment to the tribe. Our goal is to convert this person from a casual customer to one who will recommend the product and forever build the tribe.

VIII. Group activity

In a small group, pick one represented organization and brainstorm how it could build a tribe. Discuss:

- **Who would be the leader of the tribe?**
- **What incentives might be used to opt into the tribe?**
- **What metrics might be used to measure success?**

Technology Plan

Technology Plan

Learning objectives

Upon completing this chapter, the reader will be able to:

- Understand the importance of a technology plan;
- Know the latest technology trends that will affect a plan; and
- Know how to establish the plan.

I. Overall philosophy

The technology plan of the organization is not about hardware and software, it should be about what is needed now and will be needed in the future. The plan must be about solutions to problems, and not about technology. While the technology may finally be the solution to a problem, other solutions must be considered.

For example, SalesForce.com has been a leading solver of problems using Cloud software for the past several years. It was founded in 1999 and went public in 2004. It originally was focused on its customer management platform, and has since branched to several other services available over the internet for both desktop computers and mobile devices. The important point is that the company concentrates on solutions and not on software.

The experience with SalesForce.com has pointed out the necessity that the users of the technology rather than the IT department must drive the technology plan. They are the ones with the needs, and they know the results for which they are looking. IT has the knowledge about what is out there that can solve the problems, but the users must drive the future.

II. Why a technology plan

A. Avoid crisis management

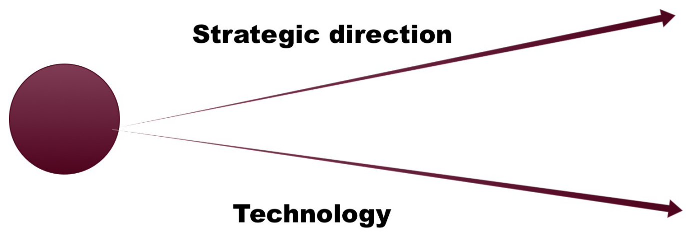
Theoretically, any plan should go a long way to avoid crisis management. If the organization doesn't have the plan, crises will come up requiring management to deal with them one after another. Unfortunately, especially in technology, that kind of management can be expensive and far less efficient.

The recent pandemic is a great example. In many organizations, there was a panic to make many changes to the technology to accommodate online teaching and working from home. We have to ask if our technology plans were ready to make those changes quickly.

B. New equipment is purchased as part of the plan

New software, hardware, and services are purchased by the organization as part of the plan and not in some kind of "knee-jerk" reaction to a recently stated need. Often it is internal politics that drives expenditures, and in hindsight, those expenditures may not have been warranted.

C. Technology is tied to the company's vision



Without a technology plan

It is crucial that the technology plan is directly tied to the vision, mission, and core values of the organization. If not, the purchases and direction may contradict where management wants the company to be heading.

D. Purchase the correct systems

Without a good plan, often purchases are less than well-considered, and expensive mistakes can be made.

E. Save money with better planning

When decisions are wrong, generally they are expensive. By considering a well-conceived plan, there is better chance that buying decisions are more efficient.

F. Avoid crises

Without a plan, hardware wears out and software crashes. These occurrences can easily cost the organization huge amounts of money and good will.

G. Better use of staff time

Without a good plan, often staff has to spend a lot of time fighting fires or fixing and patching hardware and software that can, and should, have been replaced.

H. Protect against staff turnover

In my experience, this is the one part of the organization where people fear employee turnover. This is because all too often one or a few IT people have all of the technological knowledge, and everyone else is kept in the dark. Such a plan recognizes that kind of situation and sets in place a protection. The knowledge of the technology should be in the plan, and not in the heads of the IT staff.

III. Needs of the plan

Clearly the most important need of a good technology plan is for it to allow the organization to be nimble and change quickly. An important part of any organization is that it must be able to change as quickly as the environment in which it operates. If it fails to change, it will die.

Unfortunately, many organizations are seriously hampered by their inability to adopt their Information Technology, which is both expensive and restricting. You may spend a lot of money in a system that serves your customers only to have a competitor come out with a new system that is either more convenient for the customer or less expensive for the company. Either way, that competitor has a huge advantage.

Consequently, the organization has to recognize the need for quick change and not be too highly invested, either monetarily or emotionally, in one system.

A. Case study example

In the 1970s a small finance company was started by a large bank holding company. When the company was small, it did its accounting on cards and the system worked. Suddenly, it discovered an untapped market, and the company's business exploded. The manager went to the holding company data processing department to get the system computerized. He was told that the computer priority committee would review the needs and set a priority to the project. Somewhat concerned about speedy reaction, the manager inquired about the possible timing of being computerized. The data processing person explained that the waiting list of approved projects was presently four years.

The manager went back to the company, called IBM, and purchased an IBM 5100, which was the predecessor to the modern PC. In six months, the finance company was computerized; however, the data processing department was not at all happy for having been left out of the loop. The finance company did what it had to do.

B. Need to be nimble

When many people see something like a technology plan, they immediately see a bureaucratic process that slows things down. We can't allow that. If the company is to stay competitive, it must be able to move with the times.

1. The cloud

In this section we will pay a lot of attention to the cloud. This is a concept where computer applications are not housed on the company's computer or local area network, but rather are housed on some computer servers, usually belonging to another party.

The company reaches the applications through the internet and the computing is performed in what is called the cloud. The system has several advantages, but probably the three most important are cost, accessibility, and speed.

Because the software applications are so scalable, the cost is generally far lower than if the company custom designed the applications or bought them off the shelf. This is because the application company can leverage its development over so many more customers.

We quickly saw that we needed to accommodate people who wished to get into our systems from home. Generally, that was easier with cloud-based programs.

The other advantage is that the company will constantly be developing improvements to the system with those improvements automatically going into effect without the customer having to purchase an upgraded version of the system.

Some consider security to be a disadvantage to cloud software. There is a feeling by some that the software company's systems might not be secure enough thus causing a potential liability to the company. Others will argue that the cloud company's systems are more secure than most company's firewalls.

There is another possible reason why often internal IT people are not happy about cloud computing. Let's face it, by switching some or all of the company's software to the cloud, the jobs of the IT department might be threatened.

IV. Important technology trends

Following is a list of trends that directly affect the technology plan. As we review the plans, it will become obvious that we may not like many of the trends and wish they would go away. But, regardless of our feelings about them, we must recognize what is happening and what will happen in the future.

A. Move to the cloud

Just as computing moved from the mainframe to the PC, it is now beginning to move to the cloud. While there are several types of clouds, the concept is the same as explained above. The importance is that movement to the cloud is obvious, regardless of our belief that it is either a good or bad trend. Consequently, we must rethink how we deliver information to our customers and employees. Data privacy and regulatory issues may delay the adoption in some industries, but it will happen. Some believe that this trend will be as important as the trend from the mainframe computer to the PC. Decentralization is the key, and the cloud makes that decentralization less expensive and easier.

Our application to this trend is that we have to get together and determine how we can make data, information, and knowledge more available to our customers and employees through cloud applications. Using the cloud may very well make it more efficient and less expensive to fulfill the needs of our departments.

B. People want to drive their own choices

People want to drive their own choices about where they work, when they work, and even how they work. They want to specify what cell phones they use, what software they use to make decisions, and what kind of computer they use. Some are Mac users, and others prefer PCs.

Because of this trend, organizations are making more choices available to the workers and also the customers. People want to be free from restraining infrastructure. For them, there is no longer just one corporate device.

The application to this trend is to recognize it among both our customers and employees. We need to understand and allow our employees to have the devices they want and the software to best do their job. Our IT department is challenged to do this in an efficient fashion, but we can't ignore the trend.

C. Agile development

Software development is becoming far more agile with companies developing programs on the cloud through organizations such as Force.com. While cloud programs started out as relatively non-customizable, now there are many things that developers can do on the cloud platforms.

The application to this trend is that our IT department must pay more attention to the needs of both the operating departments and the customers coming up with custom-designed applications that will give them better and faster data in the way they want most.

D. Be small to be more nimble

We are seeing a huge trend from large IT functions to small "skunk works" groups in larger organizations. Some of these are even contracted out. Companies are discovering that small is nimbler, and nimble is necessary for success.

The application to this trend is to make sure that our own IT department hasn't become too large so that it can't be nimble and change quickly to meet needs.

E. Move to a user-driver environment

As people become bombarded with more and more data, they are finding new ways to filter out what is unwanted. For example, customers create their own groups in Facebook or Twitter allowing them to filter out the extraneous information coming from all over. People want to pull the information they want, and not have it pushed to them through more traditional media.

Our organizations need to respond to this trend if they want to remain relevant to the public. In the old way of thinking, the company needed to develop a message that was considered "sticky," in that it held many people's interest. Now, the message must be more "spreadable," in that it will be repeated to more and more people and groups. Now we have the cliché, "If it doesn't spread, it is dead."

F. Mobility

Data has moved from the mainframe to the PC, and now to the mobile device. With the use of the mobile device, now more of the data is actually moving to the cloud. Now, more people are interfacing with the cloud with mobile devices to access that data. By 2013, mobile devices were on track to pass PCs as the most common Web access tool.

The application to this trend is obvious. We need an active mobile device policy seeing new and innovative ways to use the devices. A simple example is where a car salesman was showing a new pickup to a prospective customer the other day. The customer was planning on pulling an RV with the truck and was inquiring about towing capacity. Instead of answering the question with statistics, the salesman pulled out his iPad and quickly showed a video about towing. That video was located on the company's cloud and immediately available to the salesman and customer. The salesman quickly transferred the video to the customer's mobile device so he could show it to his wife.

Another sales use of the mobile device was when the salesman quickly placed the potential customer near the truck he was most admiring, snapped a photo on his iPhone, and transferred the photo to the customer. Salespeople have known for years that if the customer can take home a picture of the car, boat, airplane or any other expensive toy, the potential customer will show friends and maybe even post the photo on Facebook, and the sale will be made.

G. People want an app for everything

In conjunction to the former trend, people are shifting away from the keyboard and want an app for everything. As people are using their mobile devices, they are actually shifting away from using their Web browsers and toward obtaining their information through custom applications.

The application to this trend is important. If we want to be more convenient to our employees and customers, we must find ways to allow them to interface with our company through custom apps on their mobile devices.

One of the big reasons for this is that people are more using their mobile devices as output devices and less as input devices. When they first came out, a lot of people were going to use their iPad similarly to how they used the laptop. When they found that much typing on them was not easy, they stayed with the laptop for inputting, but the iPad for retrieving and watching movies, photographs, and also for reading books. That is why the iPad Mini has been so successful.

H. Internet of things

Another huge trend that is relatively recent is that we are becoming a society with an internet of things. For example, we can operate our home lights, security system, appliances, and many other things through apps on our mobile devices. Even Nike recently received an award as being the most technologically innovative company because it is integrating its shoes with all kinds of other devices.

The application of this trend is that we cannot only look at technology as a way to do bookkeeping, but as an avenue on which we will serve our customers and clients in new and innovative ways. And, what about Google glasses?

I. Enterprise app stores

When Apple launched its app stores for mobile devices and computers, it probably didn't think it was setting a trend. A key for the method of marketing was controlling safety of the software that could be marketed. Recently, organizations are doing the same thing for the same reason. If you work for a large firm, it is possible that it has a type of app store where you can connect and download versions of software and applications that have been approved by the company for downloading onto company devices.

The application to this trend in the scope of the technology plan is to make sure that we have a good way to meet the needs of the trend showing that our employees want more say in the software they use, but that meet that need in a safe way.

J. Shift from teaching to learning

Ever since the industrial revolution, our educational system has concentrated on the best ways to teach. Today, we are seeing a huge cultural shift from one of teaching to one of learning. The difference is simple. Teaching is a pushing of information to people. Teaching methods have been changed, refined, and adopted to try and get the best teaching possible.

Learning, on the other hand, is a process of receiving and absorbing information. Obviously, the educational systems hope that students learn what they teach, but that may not always be the case.

Today, more organizations are working at facilitating learning where they are transferring the responsibility of that learning to the learner, and not the teaching institution.

The applications to this trend are huge – obviously for the teaching organization. But all organizations can also benefit from the trend as they put online educational content that can easily be accessed by both customers and employees. We will continue to see a huge shift in corporate training as our organizations spend more time helping people to find the content rather than developing new content to be taught in classrooms.

The application for our technology plan is that we will be able to sharply reduce our training costs by providing a platform of learning materials and seminars online, and avoid the costs of hiring trainers to our businesses or having the expense of our employees traveling to conferences and seminars. Some will say that they don't want to do this because of the networking opportunities at conferences; however, much of that networking can now happen with social media.

K. We are becoming a participatory culture

As we shift to more of a participatory culture, we are seeing more examples of where the public wants to be more involved in what is happening, and less willing to just sit around and watch what's happening. For example, news is moving from a media where people watch the news to where people film the news on their cell phones and post it on YouTube. They also broadcast the news on Facebook and Twitter, or even editorialize about the news on blogs.

The application to the technology plan is obvious. If we want to keep current in this trend, we need to develop easier and better and more ways for both our employees and customers to relate to the company. They want to participate.

L. Shift from institutions to networks

Institutions are becoming less important in the lives of individuals and networks are becoming more important. In education, the university is less relevant, and YouTube is more relevant in training someone how to do something. The hospital is becoming less relevant and the internet more relevant in people diagnosing their possible diseases.

One hundred years ago, information was stored in books, but only the wealthy could afford books. Consequently, only the wealthy could afford the knowledge. Along came Andrew Carnegie with the vision that the less affluent should have access to knowledge, and the free public library was born. We had an important institution.

Today, knowledge is no longer held in books – it is stored on the internet in the cloud. Consequently, the library as an institution has almost completely lost its relevance for that purpose. Smart libraries have recognized that and are reinventing themselves to stay relevant in the new world.

The application to this trend is that we need to look at our technology plan with this in mind. We need to see that our information needs to be stored online with easy access to our employees and customers through app stores and mobile applications. As institutions, we have to adapt.

V. Implementing the plan

A. Establish leadership and support

As we direct our attention to the plan itself, we need to recognize that it is an organizational-wide plan, and not a plan for the IT department. This is probably the most important concept with the plan. If the plan is seen as belonging to the IT department, it will not be embraced or supported by the remainder of the executives and employees in the organization.

As we think of it, this need is obvious. In today's world, everything we do, how we manage, and how we interact with both employees and customers is based on technology. Consequently, similar to our marketing and people plans, the technology plan must be supported and confirmed by everyone and must be totally aligned with the organization's vision, mission, and values.

B. Designate a point person

Designating the correct person to head up the technology plan is crucial if the plan is to be organization wide and not belong to the IT department. Most important, it should probably not be the person in charge of IT. The reason is simple. While that person obviously should be involved, he or she will tend to make the project too hardware- and software-focused and not primarily focused on the needs to be met and the problems to be solved.

1. Future thinker

The person in change should be a future thinker focused on where the company is going and not on where it has been. An interesting question to ask is should the organization have a "senior future officer?" Probably most companies do not; but such an idea is not too far-fetched. I searched such terms and titles as chief information officer, chief digital officer, and chief learning officer. Those titles are similar and encompass a similar idea: A chief or senior future officer might be the person to take the reins of the technology plan.

2. Reader and learner

The person heading up the technology project must be constantly ahead of what's happening. He or she should be subscribed to the blogs about the economic and business future as well as to the blogs and magazine articles about what is happening in technology.

3. Interest in, but not necessarily an expert in technology

While this person should understand technology, he or she doesn't have to be overly proficient. Mostly the person needs to understand what is happening in the field and how the future needs of the organization can be met with technology.

4. Servant attitude to the operating departments

Servant leadership should be throughout the organization, but it would be especially important in this role. This person will constantly be interfacing with the operating departments helping them find the solutions to their needs and problems through technology. The person must have the respect of those departments as well as from the customers. Customers can't be overlooked since often the technological needs will be new systems for the benefit of the customers.

C. Access the resources

The key question is what do we have now? How is it working? Is it out of date, or will it be going out of date soon? This assessment needs to be in three areas.

1. Systems

This part includes the local area network and other broad communication systems affecting both employees and customers.

2. Hardware

This assessment will include computers along with communication devices, laptops, iPads, and similar hardware.

3. Software

This includes word processing, accounting, internet connectability, database, website development, and similar software.

4. Skills and training

This area is often overlooked in such an assessment and is the reason why so many organizations have hardware and software in place along with many people who don't know how to properly use either.

D. What are the needs?

It is important to complete this section not around hardware and software, but around needs. For example, "We need a better way to communicate with our customers," or "We need a better way to have more information about our customers quickly available to our salespersons in the field." These are problems that need solutions rather than software. Software needs would be more like, "We need an upgrade to our Microsoft Word."

Obviously, this part of the plan needs to be done in conjunction with the operating departments. The person heading up the technology plan needs to be in constant contact with the people in the field who have the needs. Trust me; they will be able to tell you what is needed. Then, it will be up to the technology team to discover creative ways to help solve the problems and meet the needs.

As you do this part of the plan, remember company alignment by constantly referring back to vision, mission, and values. We need to do that while, at the same time, trying to stay ahead of development curves. We need to constantly look at how people want to solve problems, and not necessarily how they are told to solve problems.

1. Case study

There is an interesting story about the best way for architects to design walking paths in a new building complex. The traditional way would be to design the paths according to the way the buildings and grounds are designed. Actually, the best way is to put no paths in at first. Populate the area with people who are going from one building. Then, when they have worn paths in certain places, pave the paths and you have a proper design done – for the convenience of the people doing the walking and not for the convenience of the institution.

Can you see how this case relates to technological needs?

E. Explore the solutions

1. Automatic replacement

One of the greatest problems in a company can be about who gets the latest and greatest new computer, and who gets to keep theirs for ten years. Favoritism is rampant, and those who often cry the loudest get the most attention. One solution to this is to determine a proper automatic replacement schedule for all laptops and desktops, and then give as much choice about type and configuration to the employees as possible.

2. In-house systems

Many of the needs will find solutions with home-built and developed systems. In some situations, this will be the most cost-effective approach due to the needed customization.

3. Outsourced solutions

In other situations, the needs can best be reached by employing contractors to build systems. They may be in this country; however, many of the best computer engineers are in India and China, and that avenue must not be overlooked. With the connected economy, we need to remember that people can work for us, either as employees or contractors, from any place and at any time. Time and place are no longer barriers to doing things the smartest way.

4. The cloud

In many cases, the solutions are most efficiently handled with a cloud solution that can often be customized for our needs.

F. Break projects into tasks

Once we have the assessments, needs, and possible solutions determined, we need to take the projects and break them into individual bite-sized tasks.

G. Assign responsibilities

In this step we are assigning the individual responsibilities for the various tasks to be determined; however, we are not delegating the solution to the problems. At this point, this is still an investigating problem as we are looking for the best ways to solve the anticipated problems.

H. Determine limitations

At some point in the project, we need to determine our limitations. These can be money, but they can also be training or knowledge. After all, we may have the money to do a project, but not possess the knowledge to solve the problems.

I. Establish priorities

When resources are limited, we need to allocate them to the highest priority projects. Often we don't have either the money or the talent to do everything. However, by opening our possibilities to outsourcing and the cloud, we are often able to develop solutions faster.

J. Write the plan

This is the simple part. When we have done all of the above, it's time to write up the plan.

K. Be ready for change

We put this last step in the planning process because it is the most important. The best plans will change, and probably technology plans change faster than most other ones. The reason is simple. The speed of change is probably greater in this area than in any other. Consequently, we need to be prepared for that change, and prepared to come back to the drawing board. We need to remember that the technology plan is a moving flexible document, not a thing that gets put into the can and forgotten.

Capital Plan

Capital Plan

Learning objectives

Upon completing this chapter, the reader will be able to:

- Understand the need for capital planning;
- Know how to be sure that the capital plan doesn't hurt innovation; and
- Understand the different methods of capital return analysis.

I. Why we do a capital plan?

There are many reasons why we bother with both the time and expense of producing a capital plan.

A. From politics to financial planning

Possibly the most important reason why we do some kind of capital planning is because otherwise, the person or department who gets the capital assets is generally the one who made the most noise about the need, or the one who is most favored by the boss. Without a good plan, capital expenditures and new projects are all about politics and not about real earnings.

B. Big bucks

Major projects and capital asset purchases generally amount to large expenditures. Consequently, it's important to watch the money.

C. Long time periods

These projects usually are for several years and the expenditures are for assets that will remain on the balance sheet for a long time. Poor decisions will stick with us for a long time.

D. Loss of liquidity

When we purchase fixed assets, we tie up important working capital or we utilize our borrowing power. Either decision can be costly if not well thought out.

E. Capacity issues

Bad decisions with respect to capital expenditures can hurt our capacity to react to market conditions at a later time.

II. Innovation and the capital plan

As we have said throughout this program, we must be planning for innovation or we will not keep up with the real world, and we will die. Often the traditional capital budgeting system can be so restrictive and bureaucratic that the status quo is far more favored. Thus, as we look at some of the more important aspects of a good plan, we need to pay attention to the need for change.

A. Competition for resources

1. The difference between large and small projects

Often, our companies set a relatively low limit above which the department heads had to go to a large committee to get projects and purchases approved. It is important to put the giant expenditures to a strong test; however, the smaller ones should be able to be funded with little trouble.

If the company wants innovation and experimentation, it needs to encourage risk-taking. Consequently, the firm must allow people and teams to make mistakes.

2. The status quo has an advantage

While moving from the status quo is important for innovation, we need to remember the strong advantage possessed by the status quo. Very few people have ever been fired for keeping the course, even if that course will eventually cost the company a lot of money. But people have been fired for taking risks and having them fail.

The status quo has the distinct advantage of knowing the cash flows. We are certain of the cash flow last year, and we can be reasonably sure of the cash flow from the project next year. But, when someone suggests a new project, market, or way to be more efficient, there is far more uncertainty to the increases in cash flow from the project. Thus, we often don't go in a different direction unless there is an emergency.

3. Showing the upside

Because of this aversion to risk, we often don't properly recognize the potential upside profits. We generally know the costs, but trying to estimate the gains is difficult. Consequently, people often discount the positive flows to the extent that the project has almost no chance of approval.

4. Force departments to compete in the market

One of the primary benefits to a capital plan is to force departments to compete in an open market for scarce resources.

5. Set aside a share of available capital funds for experimentation

If every department had to compete for every idea, there would be less chance of innovation. Consequently, our organization needs to set aside a portion of capital funds and allocate them for experimentation.

6. Set multiple sources of funding for new ideas

In a larger company, establish several ways that a person or team could get funding for an idea. In traditional capital budgeting, one person can kill a great idea. With some of these ideas, the promoter of an idea may have several places to go to get the idea financed.

a. **Internal company incubator** -- This is a special location in the company where a person can take an idea and use pool engineers, designers, and even clerical help. Just like a small-business incubator at a university, entrepreneurs can take ideas, experiment with test marketing, and conclude with a business plan.

b. **Company venture capital fund** -- This is where the company establishes a venture capital fund that operates in all the same ways as a public venture fund, but where the managers and the capital of the fund are within the company. Employees and teams with ideas present them with a business plan the same way they would in the outside market.

c. **Giving managers discretionary funds for experimentation investment** -- Many nimble companies today give significant money to the departments to do some experimentation. When the projects fail, and many will, they are not chastised but encouraged because they learned something. After all, each failure is just discovering a new way that the idea won't work.

B. Cautions with capital planning

1. Watch long-term commitments

Long-term commitments tend to be riskier because they often can't be reversed without spending a lot of money. These might include the following.

a. **Labor contracts** -- As many municipalities are now discovering, expensive labor contracts, especially with expensive fringe benefits, can kill the organization. These are risky and often prevent innovation.

b. **Special purpose buildings** -- General-purpose buildings are far less risky than fixed purpose buildings.

c. **High fixed costs** -- Fixed costs are far more risky than variable costs. Interestingly, it is often relatively easy to avoid them with a little creativity.

d. **Case study on fixed costs** -- Several years ago a person who had been laid off from a corporate job had a great idea about building a plastic kayak that could sell at retail for $200. He presented the idea to several venture capital funds with no takers. Not having sufficient capital for the traditional manufacturing model, he decided to get creative.

   He located a naval architect, offered him a small percentage of the ownership. That person took his napkin drawings and designed the plans. He then found a mold maker, who also took a small percentage of the ownership, and made the mold. From there, he contracted to a custom molder who agreed to build the boats and ship them to our entrepreneur's home. In the meantime, he went to a large outdoor store and contracted with them to sell the boats at $100 each delivered to the stores. He set the receivable and payable timing so that he would require no short-term borrowing. The last step was to arrange with UPS to pick up the boats from the molder and deliver them to our friend's garage, and also to ship them from the garage to the stores. The entire project worked, and the entrepreneur was in the boat business with absolutely no capital or no fixed costs.

III. Reasons for capital budgeting

We use a financial tool to determine proper capital and project decision-making for several important reasons.

A. Higher profits

We determine that we are able to make more money in the long run by making good purchases today. We make these investments to increase income.

B. Lower expenses

In some cases, we may want to invest in equipment or technology because the investment will cause our operation to be more efficient.

C. Growth

It could be that we need to make an investment to capture a new market, product, or direction.

D. Diversification

In some cases, we lower our risks by diversification into new markets. This thinking often requires capital expenditures.

IV. Exemptions to the system

Before going into a useful tool for capital budgeting, we need to look at the types of capital expenditures that would not be subject to this scrutiny. Many companies eliminate the following four areas; however, care must be taken not to allow too many projects to “qualify” for exemption. This will only bring us back to politics.

A. Amount too small

Most organizations have a dollar limit of capital expenditures below which they will not have to justify through a capital budgeting tool. Personally, I have seen that limit be as low as a few thousand dollars up to $100,000 or so. Generally, the amount should be relative to the size of the firm as well as the available funds for capital expenditure. It is important not to set the limit too high without having another way for experimenters to get small test projects approved.

B. Replacement

This would be when the organization has determined an automatic replacement program for certain types of assets. Things like automobiles, cell phones, and computers will often come into this category. Despite the fact that the expenditures on these items are relatively small, they are very political. Employees always want the latest technology, and executives always want the newest car. Management should establish guidelines on the replacement schedule on these items and thus take the politics out of the replacement.

C. Compliance

In some situations, regulators require capital expenditures to remain in compliance. In those cases, we may say that we have to make the purchase and therefore, there is no point in trying to justify it with any kind of analysis.

D. Emergency

Similar to the compliance exemption, with fixed assets that have to be purchased for emergency reasons, you may not want to subject them to any kind of financial analysis.

Caution:

> In the case of the exemptions for replacement, compliance, and emergency, there can often be a difference of opinion on what may constitute an emergency or something needed for compliance reasons. We urge great caution in exempting significant asset purchases from this system.

V. Good capital projects

Organizations make investment decisions within the framework of a strategic vision that should be leading the organization to achieve financial goals. The framework for capital planning is that a project must have certain characteristics.

A. Desirable

The project should represent a worthwhile goal for the investment of funds. It must achieve a financial, reputational, or other goal within the risk appetite of the firm.

B. Feasible

The goals of the project should be realistic. That is, the objectives must be realizable within the capabilities and resources that can be allotted to the project.

C. Focused

The capital budget itself should provide guidance for decision-making. It starts with the outlay that begins the project and concludes at the end of a planning horizon with a forecasted financial value.

D. Directional

The numbers should show a pathway to follow from the launch of the project to maturity of financial outcomes.

E. Flexible

Discussions of cash flows and returns should include adjustments that might be needed if assumptions do not work out or conditions change.

VI. Capital projects analysis

A. Limitations of available capital

We need to start our capital planning analysis with an analysis of how much capital we have available. Our firm may easily have restrictions about our liquidity and debt ratios thus limiting our ability to borrow above a certain amount. These restrictions may have been placed on us either by lenders as loan agreement covenants, or they may be the result of management deciding that we don't want to see our ratios exceed a certain point. Leverage and liquidity are the key risk measurement ratios, and they are most often watched by the current ratio (current assets / current liabilities) and the debt ratio (total liabilities / total net worth).

Following is a hypothetical model of a company that has, at the present time, a current ratio of 1.29 and a debt/worth ratio of 1.12. One of the smartest planning techniques we can do is build such a model to project what will happen if we add fixed assets to the balance sheet. In this case, we constructed the model and then built a single variable data table that would show the two ratios depending on the level of new fixed assets. We made the assumption that all new fixed assets would be financed at 100 percent with 90 percent of the amount being long term and 10 percent being current.

We can see from the table how both the liquidity and leverage risks change as the amount of new fixed assets increase. Assuming that either loan agreements or company policy might limit one or both of those ratios, we can easily see the limitation of increasing fixed assets.

(000s omitted)	
Sales	14,256
Cost of sales	6,415
Gross profit	7,841
Selling expenses	3,265
Operating expenses	4,000
Net profit before tax	576
Income taxes	230
Net profit after tax	345
Cash	234
Receivables	1,782
Inventory	1,604
Other current assets	135
Current assets	3,755
Net fixed assets	4,000
Total assets	7,755
Bank loans	1,062
Payables	1,565
Current portion of long-term debt	120
Other current liabilities	154
Total current liabilities	2,901
Long-term debt	1,200
Total liabilities	4,101
Capital stock	1,500
Retained earnings	2,154
Total net worth	3,654
Total liabilities and net worth	7,755
Current ratio	1.29
Debt/worth	1.12

	Current ratio	Debt/worth
0	1.29	1.12
500	1.27	1.26
1,000	1.25	1.40
1,500	1.23	1.53
2,000	1.21	1.67
2,500	1.19	1.81
3,000	1.17	1.94
3,500	1.15	2.08
4,000	1.14	2.22
4,500	1.12	2.35

B. EVA concept

EVA stands for economic value added.

This idea is to look at a project and either analyze the actual results or project future results to see if they add economic value to the organization. The determination is simple. They add economic value if they produce a net return (before borrowing costs) that is more than the average cost of capital. If the return is less, than the project decreases the economic value. If the return is greater, then economic value is returned.

Calculating the weighted average cost of capital is as follows:

Capital type	Amount	Rate	Interest
Short term	2,000,000	4%	80,000
Long term	3,000,000	6%	180,000
Preferred stock	2,000,000	8%	160,000
Equity	6,000,000	10%	600,000
Total	13,000,000		1,020,000
Weighted average cost of capital		7.85%	

While it is relatively easy to determine the borrowing rates for debt and preferred stock, calculating the rate of return for equity is much more difficult. In fact, books have been written about how it should be done. Personally, my favorite method is to calculate the rate of return for the company in question, and then look at the rates of return for similar publicly held companies. Finally, I will adjust the rate of return of my company based on the relative risk to the public companies.

The reason we use the cost of capital, and not the borrowing rate, that might be possible for a particular project is that only looking at debt rates does not take into consideration the capital requirements, which have a higher rate. Below we will see several methods of analyzing the cash flows of the projects to determine if they exceed or do not exceed the average cost of capital.

C. Analysis methods

While many companies use political methods and award capital expenditures to managers who scream the loudest, the best way is to put significant projects to some kind of objective test. The most prevalent kind of test is to analyze the net cash flow of the project or asset over its useful life.

While a complete course on capital budgeting would go into the detail of how to determine the yearly cash flow of a project, this program will take the analysis from the point of the cash flow.

1. Probability introduced into cash flows

With sophisticated Monte Carlo analysis techniques, we can specify the risks into the projections. We then input those cash flows, adjusted for risk, into the analysis.

D. Different methods

When capital projects warrant the scrutiny of analysis, the best way to do it is with some sort of present value or return on investment analysis. For example, let us take a proposed capital purchase of $100,000.

1. Net present value

In this example, we will assume that we will receive a net cash flow over the next five years as follows:

Year	Net positive cash flow
1	20,000
2	30,000
3	20,000
4	30,000
5	20,000

Should we make the purchase? Simply adding the flows would give you a yes since we will make a net of $20,000 over the five years. The problem with this logic is that we are not taking into consideration a reasonable cost of money calculation. Let’s assume that we determine that we need to make a minimum of 10 percent on any investment. We can then analyze the cash flows by taking the annual flows to present value as follows:

Year	Cash flow	PV at 10%
1	20,000	$18,181.82
2	30,000	$24,793.39
3	20,000	$15,026.30
4	30,000	$20,490.40
5	20,000	$12,418.43
		$90,910.33

Since the total of the discounted cash flows is less than the original investment, the project should be rejected.

2. IRR

Another way to analyze the project is to determine the annual rate of return for the project.

Year	Cash flow
0	(100,000)
1	20,000
2	30,000
3	20,000
4	30,000
5	20,000
IRR	6.39%

3. MIRR

An interesting thing about the internal rate of return analysis is that the formula makes certain assumptions. The math assumes that any negative cash flows are borrowed at the final IRR rate, and any positive cash flows can be reinvested at the IRR rate. While that might be ok when the final IRR rate is in normal tolerances, it is not ok when the IRR may be very high.

For example, let's take a project where the return is very high:

Year	Cash flow
0	(100,000)
1	30,000
2	40,000
3	30,000
4	40,000
5	30,000
IRR	20.67%

The assumption that the positive cash flows would be reinvested at the rate of over 20 percent is not reasonable. Consequently, we may want to use the "modified IRR formula" or MIRR.

Year	Cash flow
0	(100,000)
1	30,000
2	40,000
3	30,000
4	40,000
5	30,000
MIRR	12.99%

In this case, the MIRR formula asked us to input an investment rate and a borrowing rate. We used 6 percent as the borrowing rate and 4 percent for the reinvestment rate. This sharply decreased the IRR.

E. Hurdle rate or "best rate"

There are two common ways to determine which projects are the ones to receive the go ahead in the company – one is to use a rate that must be surpassed and the other is to compare all the projects and select only the ones with the best rates down to the amount of available funding.

The hurdle rate method usually starts with a calculation either of the weighted average cost of capital or the organization's rate of return. Often an increase in the rate is added to allow for risk.

When there is a scarcity of available capital, all of the projects are compared with each other. A list is made with their returns in the order of the returns. Projects are picked until the capital funds are used up, regardless of the return of the ones that didn't make the cut.

For this example, let's assume that we have a capital limit of $7,000,000. We can see that we can pick the projects down through Project 3, but if we would pick Project 2, it would put us over the limit. Because we still have excess room, we may want to consider project 8; however, we would want to check to make sure the IRR was above the average cost of capital rate to make sure it added economic value to the firm.

Project	Amount	Cumulative	MIRR
14	484,877	484,877	19.55%
8	126,484	611,361	19.32%
16	2,458,455	3,069,816	19.04%
18	1,234,542	4,304,358	18.20%
9	365,123	4,669,481	17.44%
19	1,265,411	5,934,892	10.24%
15	126,545	6,061,437	10.07%
3	256,544	6,317,981	8.90%
2	2,548,455	8,866,436	8.50%
6	265,745	9,132,181	7.66%
5	654,877	9,787,058	6.96%
1	1,256,121	11,043,179	6.50%
17	1,265,488	12,308,667	5.74%
13	135,633	12,444,300	5.58%
4	458,744	12,903,044	3.18%
12	267,897	13,170,941	2.59%
7	265,899	13,436,840	2.44%
10	459,511	13,896,351	0.71%
11	235,433	14,131,784	0.68%

Short-Term Planning

Short-Term Planning

Learning objectives

Upon completing this chapter, the reader will be able to:

- Recognize the importance of bottom-up planning with respect to monthly accountability;
- See the steps to create a monthly cash-flow plan; and
- Specify ways to increase accountability.

As we close the issue of planning, we will take a look at several short-term aspects of the plans.

I. The one-year plan

This document used to be called the budget; but, as you can see, the numbers were derived from the five-year plan and not from the actual plan of this past year. That's what is totally unique about integrated planning and so different from traditional budgeting. Once we have completed our marketing, people, technology, and capital plans, we put that information into our strategic plan and set the numbers starting with the "new year 5." The old 5th year becomes the 4th year. The old 4th year becomes the 3rd year, and so on down the line as the numbers cascade one year newer until they become the plan for next year.

As we move the numbers one year closer, we both adjust them for what we now know, and we also increase the detail.

A. Increasing efficiency

1. Metrics

While the planning process is designed to tell us where we will be, it also serves to stimulate creative thoughts on how we can become a more efficient organization. This starts with the metrics that we will use in benchmarking our departments to see if they are focused on being a more productive operation. For example, if we operate the accounting department, we should watch the ratio "total operating costs of accounting department / company sales." Since the accounting department serves the entire organization, it needs to carefully watch this ratio. If the company is growing, some of the accounting expenses should be fixed, which would mean that the ratio should be decreasing.

At the same time, the department should be measuring its level of customer service by surveying the customers and asking them if we are doing a good job.

2. Reward systems

Several of the other ways to increase efficiency have been discussed, but some can be reviewed here. The most important thing is that we need to be sure to incentivize people for being more efficient rather than less efficient. If we have any kind of reward system that rewards people for having larger departments or more employees, then obviously, we are rewarding them for being less efficient.

On the other hand, we need to have incentive systems throughout the company that reward people for doing the most important two things:

Serve the customer well;
and
Do it efficiently.

3. Transparency

Transparency is also an excellent way to encourage efficiency. When other employees see how company money is being spent, they are often more judicious about being more efficient. OPM (other people's money) is a real problem in some organizations and becomes part of the culture. Partially this can happen because people do not think the organization is fair and therefore, will attempt to get their share through unethical or illegal ways.

There is a company that places all of the requests for reimbursement for meals, travel, and entertainment online on the company's Intranet for everyone to see. While they haven't necessarily had anyone contact the accounting department to make a complaint, they have found that metrics have shown that travel and meals have decreased as a percentage of sales. It's amazing how people are more careful when others are looking.

4. Efficiency is a team business

Old-style hierarchal companies operate in a way that indicates that the management wants to be more efficient, but the workers are either not interested in efficiency or do not want to do it. Consequently, those companies create old-style budgets where the budget is the permission to spend money and is completely top-down. In modern organizations that have plans, and not budgets, people are empowered to make decisions for greater efficiency. We must remember that it is the workers who have better ideas about efficiency, and it is management's job to establish a culture in which the workers want to participate in the efficiency process.

The simplest way to improve efficiency in any area is to ask the workers to help with a project to gain efficiency in this particular area. Then, allow them to make suggestions and collaborate to examine ideas. While team meetings for this exercise are good, now these projects can easily be established on the organization's Intranet in the form of a blog, discussion group, or even a social networking closed page.

B. Increasing accountability

1. Understanding accountability

The concept of accountability is often misunderstood, and the term is wrongly used. We all want to have others to be accountable, but we don't necessarily want to use the term with respect to ourselves. Especially over the airwaves we hear the statement, "that person has to be held accountable." While no one can argue with that statement, there will quickly be argument about how that accountability should be enforced or if the person should really be punished. In many cases, an honest mistake happens, and it can be more destructive to punish the person rather than allowing the person to be forgiven and learn from the error.

2. Culture of accountability

When building a culture of accountability, we need to recognize that several things go into it. We also must remember that accountability does not go alone – it goes along with responsibility and authority. If we are going to have a culture of accountability, we must have a culture where all parts of management carefully practice a system of proper delegation. That practice is that when we are delegating any responsibility, we also delegate the authority and the accountability. If we do not, the organization quickly becomes dysfunctional.

For example, let's say we are a division head and delegate to our branch managers the responsibility of the branch profits. We will hold that manager accountable for those profits, but when the manager asks to be able to hire people, fire people, or give certain people raises, we withhold that authority. Thus, the manager has the responsibility and accountability, but not the authority. In this case, the manager is frustrated, and more importantly, will not do as good of a job if he or she stays with you all. People will never want to be held accountable for decisions they do not have authority to make.

For this reason, several things will have a significant effect on your culture in determining whether it is one that favors accountability or not. These include the following.

a. **Leaders' behaviors** -- When the organization sees the senior executives splurge on luxury, it is difficult to get the troops to pay a lot of attention to austerity.

b. **Rules and regulations vs. policies** -- Policies are broad and subject to interpretation. Rules and regulations are narrower and subject to less flexibility. Rule-based culture actually does not foster a culture of accountability since the workers are accountable to the rules and not accountable to their own judgment. For years, Nordstrom was famous for having had a four-word employee manual. It said, "Use your best judgment."

c. **Training** -- Training is important, but the right training is more important to the culture. In our training, do we train in rules and regulations, or do we train people in how to think, solve problems, and how to be creative?

d. **Customs and tradition** -- How things are done has more to say about the culture of the organization than what is said to be done. In way too many organizations the rules are for the workers, but then the senior management is much more flexible and does not follow the rules. It may be okay on the basis of, "rank hath its privileges," but it is not good for the culture.

e. **Communication** -- The more transparent the organization is, the better the culture. Some companies actually publish every salary in the organization so that everyone has an understanding about how the organization works. Many don't like this idea, but the companies that do it find that they have better cultures.

f. **Reward system** -- Probably the most important thing about the reward system is that it must reward for desired behavior and not reward for poor behavior. In addition, it needs to reward the people in the operating departments and not just management. The reason is simple – and think about it. If you are leading the accounting team, who would you say would be most responsible for the efficiency of the accounting department – the leader or the people in the department? When asked that question, almost everyone will say the people in the department. But many of those same companies will reward the manager of the department, but not the employees. If you want the culture to be one of efficiency, you need to reward the ones who really control that efficiency.

II. The monthly plan

While the annual plan has a lot of line-item detail, we may wish to either omit the detail or revert back to broader classifications as we prepare the monthly plan.

The monthly plan is simply extracting from the annual plan the details to convert it into its 12 months. Some people begin by developing the annual plan; however, since our annual plan starts with the two-year plan, then the monthly plan needs to derive from the annual plan.

A. No seasonal variation

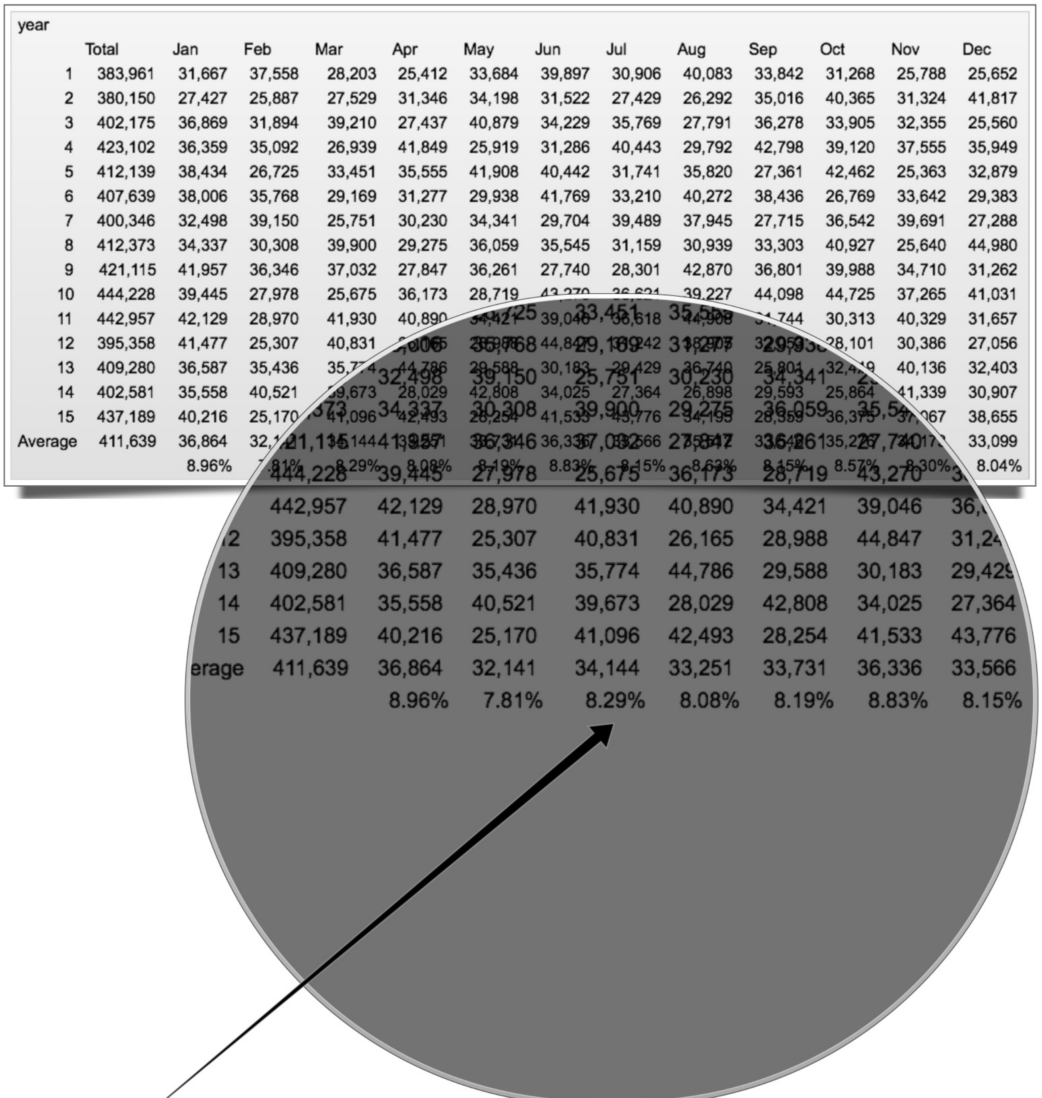
In companies that do not have seasonal variation, the simple formula of dividing the annual by 12 will give us the monthly plan. Obviously, this is a simple spreadsheet maneuver.

B. Seasonal variation

Most companies have seasonal variations causing them to require a little more thinking in the preparation of the monthly plan. Probably the most common method of doing this is to set the variable expenses as a percentage of sales and set the fixed expenses either uniform during the month or at the months they will occur. Then, all that is needed is to calculate the percentage of sales that will occur each month and insert those formulas driving the seasonal sales numbers. The variable expenses will then calculate, and you will have a monthly plan.

Probably the easiest way to estimate the percentage of total sales occurring each month is to analyze several past years and do some calculation. Take several years in the past and determine what percentage of the annual sales came in for each month. Then, if there is an obvious trend to the seasonality, use the weighted average of the years giving preference to the most recent years. If there is no pattern, you can probably use the average of the years.

Following is a chart of sales for a fictitious company over a 15-year period. Because there was no particular trend to the pattern, we used the average percentages over the past years.



year	Total	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1	383,961	31,667	37,558	28,203	25,412	33,684	39,897	30,906	40,083	33,842	31,268	25,788	25,652
2	380,150	27,427	25,887	27,529	31,346	34,198	31,522	27,429	26,292	35,016	40,365	31,324	41,817
3	402,175	36,869	31,894	39,210	27,437	40,879	34,229	35,769	27,791	36,278	33,905	32,355	25,560
4	423,102	36,359	35,092	26,939	41,849	25,919	31,286	40,443	29,792	42,798	39,120	37,555	35,949
5	412,139	38,434	26,725	33,451	35,555	41,908	40,442	31,741	35,820	27,361	42,462	25,363	32,879
6	407,639	38,006	35,768	29,169	31,277	29,938	41,769	33,210	40,272	38,436	26,769	33,642	29,383
7	400,346	32,498	39,150	25,751	30,230	34,341	29,704	39,489	37,945	27,715	36,542	39,691	27,288
8	412,373	34,337	30,308	39,900	29,275	36,059	35,545	31,159	30,939	33,303	40,927	25,640	44,980
9	421,115	41,957	36,346	37,032	27,847	36,261	27,740	28,301	42,870	36,801	39,988	34,710	31,262
10	444,228	39,445	27,978	25,675	36,173	28,719	43,270	36,621	39,227	44,098	44,725	37,265	41,031
11	442,957	42,129	28,970	41,930	40,890	34,421	39,046	36,618	[illegible]	[illegible]	30,313	40,329	31,657
12	395,358	41,477	25,307	40,831	26,165	28,988	44,847	31,242	[illegible]	[illegible]	28,101	30,386	27,056
13	409,280	36,587	35,436	35,774	44,786	29,588	30,183	29,429	36,740	25,801	[illegible]	40,136	32,403
14	402,581	35,558	40,521	39,673	28,029	42,808	34,025	27,364	26,898	29,593	25,864	41,339	30,907
15	437,189	40,216	25,170	41,096	42,493	28,254	41,533	43,776	34,195	28,359	36,375	[illegible]	38,655
Average	411,639	36,864	32,141	34,144	33,251	33,731	36,336	33,566	[illegible]	[illegible]	[illegible]	[illegible]	33,099
		8.96%	7.81%	8.29%	8.08%	8.19%	8.83%	8.15%	8.63%	8.15%	8.57%	8.30%	8.04%

Averages that can be used

C. Variance analysis

Often it is the monthly plan that will be used to analyze the variances between the actual numbers and the plan. In fact, many of us have worked at organizations that almost completely manage by the variance analysis. The interesting thing is that in those firms there is a habit of doing one of the two following things.

1. The blame game

At all levels in the bureaucratic organization, monthly meetings are held in which managers and staff meet and discuss what went wrong with the plan. Why did we "miss our numbers"? Then, one by one, the people attempt to place the blame on something, someone, or some other factor. People don't want to make mistakes, and they certainly don't want to be blamed for them.

2. The plan is never at fault

The other key factor is, why do we always assume that the operating departments were at fault, and never that the fault was in the plan? When we review the actual numbers to the plan, we must do so keeping an open mind about what happened. Because we are assuming that this is a true plan, and not a traditional budget, we can assume that something went wrong in the planning process. Maybe we missed something that happened in the political or economic environment. Possibly there was a snowstorm or a tsunami in Japan. The fact is that we always need to watch our planning system and find ways to improve it.

III. The cash plan

From the monthly plan, the last step in the process is writing the cash plan.

A. Purpose

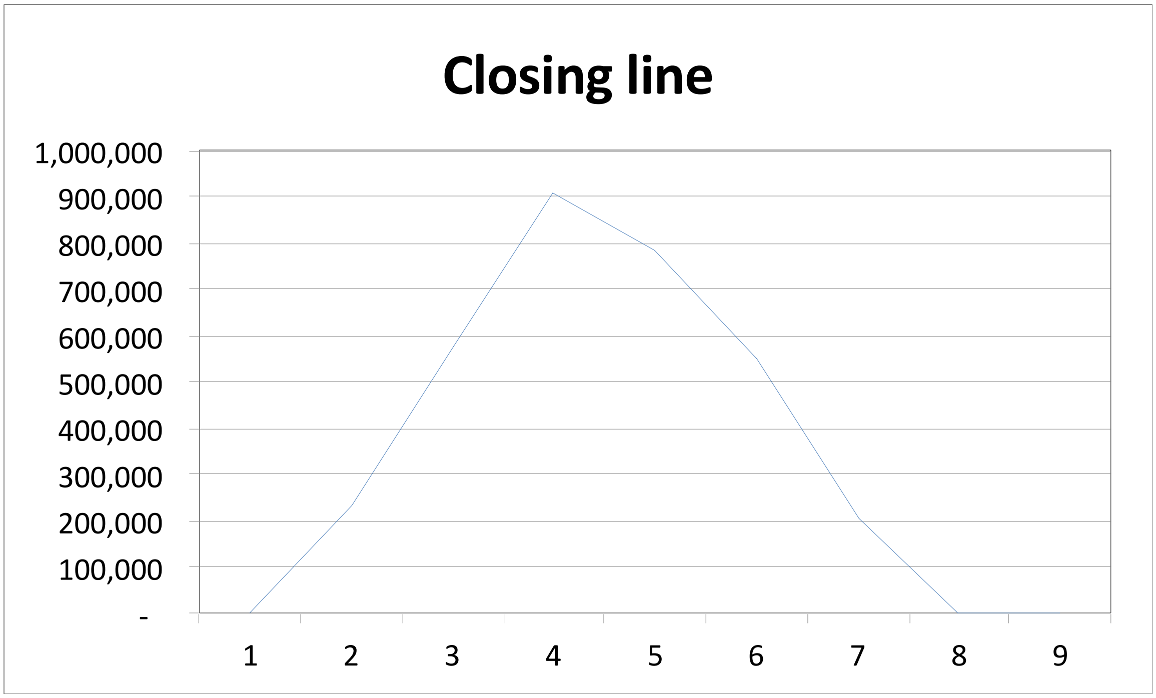
The cash plan is needed for two specific reasons.

1. Information about borrowing

Especially if we have a seasonable business, we need to project our cash flows to understand when and how much we may be borrowing. Most companies have revolving lines of credit at the banks that will advance when the cash flow is in a negative position and pay down the line when the cash flow is positive. This can go from one direction to another from month to month. The following is a partial cash flow showing the anticipated borrowing.

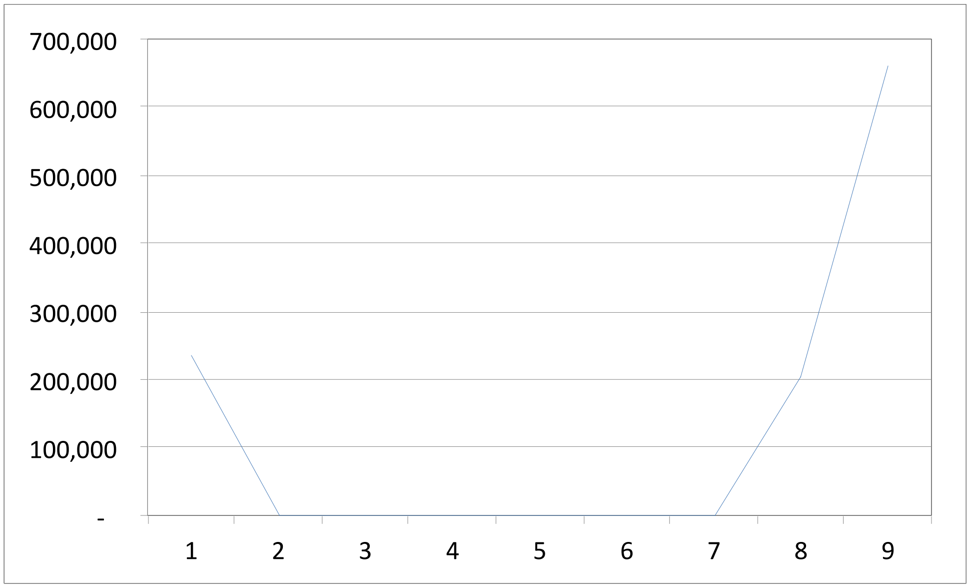
The bank wants this information for an important reason. It has made the line available with the anticipation that you will pay off the line (clean up) prior to the end of the season. If you are a constant borrower on the line, the bank will want to know what you intend to be your line balance at the end of the year. Obviously, your bank will want you to have a net positive cash flow at the end of the year, which will be indicated because your closing balance will be below your opening balance.

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Net cash flow	234,566	(465,744)	(345,678)	(564,877)	126,544	236,455	345,687	354,566	458,600
Opening line	-		231,178	345,678	910,555	784,011	547,556	201,869	-
Borrowing	-	231,178	345,678	564,877	-	-	-	-	-
Payback	-				126,544	236,455	345,687	152,697	-
Closing line	-	231,178	576,856	910,555	784,011	547,556	201,869	-	-
Opening investments	-	234,566	-	-	-	-	-	-	201,869
Addition to investments	234,566		-	-	-	-	-	201,869	458,600
Deduction from investments	-	(234,566)	-	-	-	-	-	-	-
Closing investments	234,566	-	-	-	-	-	-	201,869	660,469



2. Investment information

You company may not need a line for the whole year, and thus will invest idol funds on a short-term basis. In order to make the best investment decisions, you will need a cash-flow forecast to have a plan about how much will be invested during what months. Using the same forecast above, we can see that the company usually starts and ends the year with a positive cash flow and will invest funds when available. The following shows a graph of the investment account.



B. The procedure

Creating the cash-flow plan from the monthly plan is a relatively simple procedure with a spreadsheet. Actually, there are many different ways and several small differences within the methods, but we will suggest one simple way here:

(i) Analyze past numbers to determine receivable collection time, payable time;
(ii) Adjust sales for collection time to determine when payments will be received;
(iii) Adjust raw material and other purchases with payable time to determine when payments will be made;
(iv) Adjust other expenses with payables time to determine when payments will be made;
(v) Add in uneven payments such as tax and debt payments; and
(vi) Adjust for any other non-repetitive receipts and payments.

With this, you should easily come up with a reasonably accurate cash-flow plan.

