

Strategic Planning at the Crossroads

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The economic stress of the past two years has thrown companies' planning processes into turmoil, sharply reducing the effectiveness of their performance management programs. Revitalizing planning requires mastery of these three key capabilities.

President Dwight D. Eisenhower, the great World War II general and strategist, once famously said that "plans are nothing; planning is everything."

Encapsulated in that remark is a great truth: Plans are worthless on their own. It's the planning process — the ability to incorporate real-time adjustments based on external factors — that matters, not a static, written document that often becomes obsolete shortly after it's approved.

Since the financial crisis and prolonged downturn that began in 2008, many companies have discovered this the hard way. Plans that were developed in the course of a schedule-driven annual exercise, based on historic performance and flawed economic assumptions, proved to be worse than useless. Companies not only failed to prepare themselves for changes in the market, but also misled their investors and created an atmosphere of skepticism and doubt.

At least companies acknowledge that there's a problem. According to Accenture research, internal dissatisfaction with traditional planning processes is on the rise. Only 11 percent of surveyed companies described themselves as "fully satisfied" with their planning capabilities, compared with 17 percent two years ago and 20 percent 10 years ago. Satisfaction (or lack thereof) with the planning process is closely linked to corporate performance.

More than two-thirds of companies surveyed reported that planning accuracy diminished because of economic volatility, even as more than 80 percent of respondents said that the importance of creating accurate plans has increased.

In this new environment, effective planning requires mastery of three areas in particular:

1. Flexible and dynamic planning processes;
2. More sophisticated analytics and frameworks for resource allocation; and
3. A broader planning perspective to account for the greater weight given to future value and intangible assets.

While corporate managers cannot predict the future, they can anticipate a broad range of possibilities and can create a structure for quick and decisive action, no matter what course events take.

Creating Flexible and Dynamic Processes

Companies seeking to make their planning processes more flexible and responsive need to remember one word: focus.

Too many organizations rely far too much on their own historical performance as a benchmark for setting targets. In our survey, only half of the companies used three or more major sources of external data for planning purposes. A great deal of time and effort goes into tracking and assembling information that has little predictive power. As they say in the mutual fund business, past performance is no guarantee of future results.

Companies should instead focus on the most material and volatile aspects of their businesses, and they should do so at a higher level of detail. Accenture's work with clients across industries indicates that high-performing companies take greater advantage of external information about customers, competitors, investor expectations, and regulatory developments. They incorporate external benchmarks into their business targets.

Another key contributor to flexibility and responsiveness is effective scenario planning. This is a relatively new practice, but it's taking hold rapidly. Three-quarters of respondents who report that they use scenario planning also say that they've been using it more extensively as a result of recent economic volatility. Scenarios can help managers anticipate material changes in the business environment and make decisions (including, of course, corrections) more rapidly and effectively.

While the calendar rules planning at most companies, events rule in the real world. Event-driven planning reflects the reality that business circumstances can change quickly and unexpectedly. The most useful way to incorporate events into the planning process is to monitor a set of value drivers chosen both for their volatility and for their material impact on the business. For a pharmaceutical firm these might include, for example, patent expirations. A food company might select grain price fluctuations. Tolerance ranges can be defined for each factor, and when the tolerance level has been reached, the organization can revise its plan and re-allocate resources to close the expected gap.

We have found, though, that scenario planning and event-driven analysis will not succeed in isolation; that is, if they're restricted to a small, centralized team, or to the finance function. Fast, intelligent course corrections and plan adjustments require the involvement of front-line operating people who are attuned to shifts in customer priorities, competitor pricing moves, and other changes in local market conditions. The front line is best placed to provide the assumptions for key value drivers, starting with accurate forecasts of demand, since changes in demand affect sales, inventory levels, production volumes, and staffing needs. Finance should retain the central role of building the planning model, challenging the assumptions of front-line managers and coordinating the effort, while ensuring that senior management understands the financial impact of its decisions and plans.

Leveraging Sophisticated Analytics and Frameworks for Resource Allocation

Global companies face greater complexity these days in making investment choices in individual markets. Each market has different risks, regulatory regimes, and customer priorities. Managers

can improve the return on their investment decisions and make better resource allocations across multiple geographies by adopting more rigorous technologies and frameworks for analysis.

Advanced analytics — quantitative methods to derive actionable insights from data — have become a key source of competitive advantage over the past decade or so. In fact, high-performance companies are five times more likely to use analytics than low performers are.

Superior analytics starts with good data. For the purposes of planning, companies must identify their highest priority data and then invest resources in validating, cleaning, and consolidating it. Many firms have surprisingly little solid information on the market share of their major product segments, customer repurchase intent, brand equity data for their own and competing brands, and similar indicators of progress.

Advanced analytical techniques fall into three broad categories:

Predictive Analytics. These tools take the information that's made available through standard analytics today and combines it with more sophisticated modeling, forecasting, and optimization techniques to anticipate the impact on business outcomes. This includes extracting hidden patterns from the data and making predictions about the future impact on business outcomes.

Consensus Methods. These techniques use the opinions of experts and crowds, along with mechanical algorithms, to guide decisions about major investments. Prediction markets, for instance, operate on the principle that a crowd can often make better collective decisions than individual managers.

Probabilistic Techniques. These include techniques such as Monte Carlo simulation, and consist of “what if” analysis enhanced by the random generation of multiple scenarios with associated probabilities. An oil company, for instance, might predict the time and cost of its new oil projects using Monte Carlo analysis to capture variables such as bad weather, equipment malfunctions, geological surprises, and the number and type of wells that might be needed to exploit a discovery.

Ideally, such advanced analytical methods are linked with an effective framework for capital allocation. Resource allocation processes are often flawed, because they tend to ignore the true cost of capital and its impact on shareholder value creation. For instance, performance targets for individual departments often undermine capital cost effectiveness, because the metrics used to assess managers are based on accounting principles rather than on measures that favor value creation. Projects that do not meet the cost of capital, but appear to help meet revenue or profit targets, may proceed despite the fact that they ultimately destroy, rather than create, value.

A more effective capital allocation framework rewards employees who act like owners, by ensuring that only projects with a return greater than the cost of capital are allowed to go forward. A structured framework also links capital allocation with the strategic plan. Clear strategies and clearly stated criteria help senior managers make informed choices that lead to value creation.

Taking a Broader Perspective

In volatile times, managers may tend to focus on shorter-term planning components, such as budgeting or current year forecasting, without covering the coming year. Overreacting to short-term economic fluctuations, however, impairs long-term strategy and compromises a company's ability to create value in the future.

A broader planning perspective strikes the right balance between short-term and long-term performance. Similarly, a broader perspective takes into account both capital and investment activities that may fall into the selling, general and administrative (SG&A) category but are nonetheless crucial for future value creation.

Although the discipline of strategic planning has lost some of its prestige in the recent economic turmoil (indeed, 13 percent of the organizations that Accenture surveyed said that they're executing no strategic planning at all), the discipline helps companies identify and address key questions. Businesses need to know, for instance, if they are being rewarded for their differentiated strategy and plan, and, if so, which components of the business portfolio generate those rewards. They need to identify critical elements of the strategy and decide how to communicate those elements to investors in order to achieve or maintain a premium valuation. And, of course, they need to know which projects deserve the most funding.

Investor expectations as to how a company's future growth will exceed GDP growth or outperform a peer group should be the cornerstone of strategic planning. Companies that rely on extrapolations of past performance may set targets too high or too low, almost guaranteeing investor disappointment.

Properly executed strategic planning also helps to maintain a healthy balance sheet. Companies with strong cash flow and balance sheet planning are more effective at executing their strategies and at responding to new opportunities and challenges. Over 90 percent of our survey respondents who said they're fully satisfied with their cash flow and balance sheet planning processes said they are also able to execute their strategic plans effectively and efficiently.

Balance sheet planning should address, among other concerns, the expected cash flows from operating, investing, and financing activities; the relevant ratio trends of a strong balance sheet; the special needs of key assets over the projection period; and the forecasted internal sources of funds, along with needs for new external funding. Such planning should also incorporate scenarios to adjust the financial plan as economic and competitive events unfold.

Finally, it should be clear to all by now that intangible assets such as brand, intellectual property, channel relationships, and human capital represent a growing proportion of business value. Yet traditional planning misses this trend. One-third of the organizations we surveyed have no plan for intangibles in any form. While measurement of intangibles can be difficult, as can devising links between intangibles and financial outcomes, companies risk under-managing some of their most important drivers of value. A broader perspective recognizes, for instance, that certain SG&A costs should be managed strategically, especially when they affect key intangibles such as employee engagement, communication, and company culture.

Taking a new and revitalized approach to strategic planning encourages managers to think like investors, pursuing long-term value with less concern for short-term profitability. With better information and analytical tools, management can identify and pursue long-range objectives and provide investors with the information they need to evaluate the company's performance against those goals.