

A Study on Strategic Framework for Profit Planning: Concepts, Systems, and Structure

***Sathya Narayanan.SR**

****Dr.S.Vijay**

*Research Scholar, Faculty of Management Studies, SCSVMV University, Enathur, Kancheepuram.

**Assistant Professor, Department of Business Administration, Sri Malolan College of Arts and Science, Madurantakam.

Abstract

A framework for providing a long-term strategic perspective for profit planning exercises is suggested. The recommended corporate policy guidelines spell out strategic planning parameters, e.g., a) future external environment, regulatory policies, end-user operations, past performance, etc., which are likely to have a substantial bearing on the organization's planned operations and b) the desired level of performance, by way of tentative financial and non-financial targets. These guidelines (translated in regional or product-group terms) provide the basis for formulating draft budgets which are then analysed and settled on the basis of the original guidelines. Recommendations are made relating to the nature and content of such guidelines, the iterative process of budget formulation and settlement, and development of contingency plans. A structural back-up is provided by way of quarterly Policy Review Committee meetings to review the initial planning assumptions. An external environment scanning and information system is suggested for providing the required data and information for up-dating the assumptions and identifying the policy and tactical shifts necessary for achieving the original financial and non-financial targets.

Key Words: Profit planning, Regulatory, Policy, Environment, Tactical shifts.

Introduction

In many organizations, a great deal of attention is now being paid to sophisticated environmental and competitive data analysis in preparing strategic or long-range plans, but the annual planning or budgeting exercise re-mains essentially a numbers-oriented exercise setting out the targets of order booking, sales, production, inventory, variable costs, overheads, profit, and cash flow to be achieved by different units and regions in the broad context of the total financial plans of the organization. It is quite useful to find that the environmental and competitive data collected for long- range planning is not reflected in the budgeting procedures and systems. (See, for instance, "Ophthiorro-Pronto Chemical Corporation Limited" case.) The implications of such a planning system are that strategic and tactical assumptions are not formally reflected in the short-term profit plan with the result that it is only by happenstance that the short-term plans are congruent with the long-term strategic plans. Budgeting in such a situation becomes a purely financial numbers game, divorced from environmental and competitive realities, with all the elements of "games - man ship" inherent in such a process.

The "Chicken and Egg-Problem in Corporate Goal Setting

We can easily agree on the need for the specific formulation of corporate as well as unit-level (product group or region) desired targets, prior to the formulation of annual plans, based on an analysis of the contributory factors as well as the supportive strategy, tactics, and policies. Many practitioners of planning will, however, contend that it is not possible for corporate management to formulate such tentative targets or to specify strategies, tactics, and policies in the absence of a prior effort on the part of the executive and operating managements to brief the corporate management as to the potential levels of achievement and the feasibility of strategies, tactics, and policies to be adopted. This leads us neatly to a "chicken and egg" problem highlighting the dilemma as to which of the two processes should precede the other. Since by definition, it is not possible to specify the precedence of one before the other, an iterative process is recommended. In this process, the three levels of management simultaneously provide inputs regarding the planning estimates and derive understanding relating to the desired levels of performance as well as the strategic assumptions to be developed, subject to the following assumptions:

a. The responsibility of providing guide lines at a specific point of time in the planning sequence is identified as a managerial task relative to the management level.

b. A budgeting or estimating process exists, which allows constant opportunities to the operating and executive managements to match the initial aggregate estimates with the corresponding tentative targets, identified in the policy guidelines and to formulate new alternatives in the light of the strategies, tactics, and policies enunciated (when there is an initial mismatch between desired performance level and estimate of potential).

The process of development of corporate and product group policy guidelines by way of an iterative process, which enables the executive and operating managements to link their targeted levels of achievement with the tentative targets built down from the long-term goals and strategies of the organization.

The further process of development of estimates and the settlement between the superior and the operating management for ensuring that unit-level, product group, or regional-level targets and desired level of corporate performance are in alignment in the annual plan is outlined in Appendix II. In using policy guidelines as a backdrop for annual planning, the interaction of management at all levels and the intensity of their participation are the most important determinants of the effectiveness of the process and the quality of the output. Particularly important in this context is the requirement that while staff departments have responsibilities of developing information and policy inputs for the formulation of policy guidelines, the final determination of the desired level of achievement must essentially be left to those who are concerned in their managerial roles at the executive or corporate management levels. Unless the policy guidelines bear the clear imprint of the personalities of the Corporate and executive managements, they will not have the required degree of acceptance at the operating level, thereby ensuring their low

credibility as inputs to the planning process.

Similarly the clarity of managerial focus with which policy guidelines are framed will determine to a substantial extent the quality of the analysis and review of draft budgets between the operating management and the executive management. In the absence of clear strategic and policy focus of the organization, the generation of fresh alternatives, where aggregate targets do not match the identified levels of performance in the policy guidelines, will be a difficult and frustrating process. The effectiveness of the planning process will also be substantially determined by the design sophistication reflected in the budget formats (i.e., whether they are in line with the broad rationale and approach reflected in the formulation of policy guidelines), timing, sequencing, and administration of the budget formulation and settlement activities.

Operationalizing the Annual Plan Formulation Based on Strategic Policy Guidelines

Perhaps the first step in introducing the suggested planning process based on policy guidelines will be to get managers in the organization to accept the concept of linkage between strategic and financial planning. It is not easy to make the shift from a purely financial projection based budgeting system to another system which seeks to link the corporation's long-run strategy, derived from systematic scanning of external and internal environment as well as competition with a view to developing formal quantitative targets both in financial and operational terms for the plan year. It will perhaps be necessary to have internal meetings whereby the benefits of these linkages can be demonstrated and validated prior to the introduction of the new system.

It will also be necessary for managers in the organization to accept the notion that a budget which is "settled" between superior and subordinate management levels, based on common data and assumptions relating to environment, competition, and past performance data, is qualitatively superior and more meaningful and acceptable in managerial terms. The acceptance of the notion of the strategic linkage with annual plans will be more readily accomplished if it is evident to the managers that the corporate and executive managements are truly involved in and committed to providing a strategic perspective for meaningful planning and that the document providing such perspective, i.e., corporate or product group or regional policy guidelines, bears their unmistakable imprint. The extent of the "homework" done by the corporate and executive managements in preparing the policy guidelines will substantially determine the credibility of these documents in the eyes of those managers who will be required to prepare annual plans based on these documents. One other important requirement in this context, as already mentioned, is that the budget formats must reflect the same framework (though with much greater quantitative emphasis) ensuring that managers at all levels relate their plans to environmental, competitive, and past performance data relative to their own operations.

Assuming that a large company with multi-product and multi-location operations is to implement the suggestions regarding the re-commended annual

planning system based on policy guidelines, by mid - August the concerned planning manager in the corporate management charged with the responsibility of monitoring the development of policy guidelines will be required to advise the members of the executive management (i.e., managers heading product group activities and those in charge of regional operations) as also operating managers concerned with marketing and production activities about the environmental, competitive, and past operational performance data which will have to be collected by them for formulating the plan beginning January next.

To develop understanding of some of the information to be provided in this context, it may be useful to look at the broad outline of the papers to be developed relating to the various aspects, e.g., environmental, competitive, operational, and past performance trends.

Sequence in Developing Policy Guidelines

Appendices III and IV highlight the broad sequential steps in the development of the corporate policy guidelines and product group policy guidelines for an organization whose plan period commences from January. It should be noted from that in addition to the competitive, end-user, environmental and past performance data, the forecasts relating to capacity and delivery commitments (which will approximately include availability of critical raw materials, power, and personnel) are provided by production managers heading the plants producing the various products marketed by the product groups.

The process of development of corporate policy guidelines and product group guidelines is essentially iterative. The process could be compared to two rivers flowing in a parallel direction with canals interlinking them at various points. The continuing linkages in in-puts from operating management to the executive management to the corporate management by informal processes of consultations, discussions, and meetings also ensure that there is informal feedback relating to the broad corporate policies and targets formulated. This is done, even prior to their formalization, by way of specific corporate and product group response to the mutual inter-dependencies of the three levels of management, in formulating strategies and policies on the one hand and in simultaneously assessing future potential and settling targets on the other hand.

The other design feature which needs to be highlighted is that while all the three levels of management participate in the formulation of the corporate policy guidelines and product group policy guidelines, the responsibility for handing down the explicit guidelines rests with the corporate management and the executive management respectively and specific deadlines are set for this purpose. It is also noteworthy that the process design enables group policy guidelines to be issued within a period of 10 days of the issue of corporate policy guidelines by ensuring that the work relating to both these plan documents is carried on simultaneously with continuing linkages.

Process of Development of Annual Plans

The broad process of the development of annual plans, within the framework of product group policy guidelines, will broadly follow the sequence outlined in

Appendix II. Since the sequence and procedures described correspond with practices adopted in most well-organized companies, the details of the annual plan formulation process are not repeated here.

However, it will be useful to identify some of the distinctive features of an annual planning process which is based on development of corporate, product group, and regional policy guidelines, backed up by target setting from positions of mutuality and collaboration:

- 1.** The draft budgets prepared at the unit management level becomes congruent with the long run corporate objectives and purposes as operating and unit managers have available with them the product group or regional policy guidelines to serve as a backdrop for their planning. This is further strengthened by the design of the budgeting formats which reflect in quantitative terms the basis followed for formulation of corporate and product group policy guidelines, i.e., environmental, end-user's, competitive, and past performance analysis in the context of corporate strategies and policies identified.
- 2.** "Gap analysis" becomes possible both at the executive management and at the corporate management level as the consolidated operating management performance targets can now be matched with the previously determined targets for the product group (or region) set out in the product group policy guidelines. Similarly, the consolidated draft budgets for the product groups or the regions can be "matched" with the pre-determined corporate performance levels highlighted in the corporate policy guide lines for identifying the gaps in projected performance.
- 3.** The planning process outlined in Appendix II provides for mutual review and discussion of the budgets between operating management and executive management and between executive management and corporate management on the basis of commonly shared assumptions and data for identifying untapped potential and policy shifts required to remedy the gaps identified.
- 4.** The iterative process of planning based on mutual discussions and consultations Prior to settlement of targets is maintained during the annual planning process ensuring the maintenance of the mutuality of understanding and collaborative and coordinated action for formulation of targets at all levels leading to achievement of desired organizational targets fixed in the context of long-run goals.
- 5.** The process is participative and leads to "fair" determination of targets while retaining the responsibility of the superior management level for providing guidance and direction and specific articulation of assumptions.

Systemic and Structural Responses to Likely Changes in the Forecast Environment

It is fairly certain that however comprehensive the process of formulation of policy guide-lines and annual plan targets is, many of the assumptions relating to environment and com-petition will change during the plan period. Given the current dynamic and fluid conditions operating in the external environment, the assumptions will have to be reviewed from time to time and .also new strategies, tactics, and policies will have to be evaluated to maintain the desired level of

performance.

In the context of these requirements, two systemic responses are necessary:

- 1.** The formulation of contingency plans which will ensure that if certain assumptions originally made undergo change, the operating and executive management levels can determine for themselves, according to the pre-determined contingency plan, action to be taken. In this connection, the mode and mechanism of contingency planning adopted by a very large multi-product, multi-location unit in the United States is outlined in. What is particularly noteworthy in this context is that the contingency plan developed not only provides the "thermostat" mechanism for activating the contingency plan but also outlines specific guidelines relating to the areas which need to be reviewed for action in the event of such contingency plan coming into operation.
- 2.** The plan in quantitative terms needs to be backed up by action plans which specify activities to be undertaken, identify the manager responsible for taking such action, and the time period within which the action is to be completed. The basic point to be noted in this context is that the quantitative plans, unless they are backed up by action plans with respect to specific activities required to be undertaken to achieve the desired goals, do not register in the minds of most operating level managers coordinating the scheme for achieving the desired results.

In addition to the above process response, the recommended system requires specific structural response whereby those who were concerned with the formulation of the initial policy guidelines are continually involved in review of the original assumptions at quarterly intervals. For this purpose, it will be necessary to constitute a Policy Review Committee consisting of the members of the corporate management as well as those members of the executive management who were specifically charged with the responsibility of developing product group or regional policy guidelines at the time of initial planning. At quarterly intervals, the members of the Policy Review Committee need to re-examine the original assumptions and forecasts reflected in the working papers relating to internal and external environment as well as competitive trends to identify the policy shifts required to attain the targets and goals reflected in the annual plan.

The focus of the Policy Review Committee meeting will essentially be on strategic and policy matters based on the environmental and competitive data on the operations till the end of that quarter. The end-product of the Policy Review Committee meeting will be to identify shifts from strategies and policies identified in the policy guidelines, if such shifts are required and modifications of the action programmes originally formulated, and which are necessary in the light of the Policy Review Committee's deliberations. However, it is appropriate to note that:

- 1.** The Policy Review Committee is not concerned with the review of operational results which must be left to a different body, e.g., budget committee. It must essentially relate its deliberations to an examination of the environmental and competitive conditions operating with a view to identifying strategic and policy shifts.
- 2.** The Policy Review Committee has no authority to revise the targets originally

reflected in the annual plan. If the environmental and competitive conditions change, the revision of targets is not an option open to the Policy Review Committee. The committee must strive to identify what changes in strategies, tactics, and policies will achieve the original targets. It must not pursue the easy path of revision which will lead to substantial dilution in the credibility of the planning process.

Need for Tailoring Information Systems to Planning Data Needs

To make the deliberations of the Policy Review Committee purposive and worthwhile a quarterly environmental and competition scanning system must be designed which will lead to collection of all data required by the committee for its purposes. This scanning system must be semi structured in the sense that while the format will identify the relevant issues, it will leave the formulation of the qualitative assessment to the concerned members of the committee in their individual capacities. The concomitant requirement is to ensure that the ongoing management reporting system reflects some of the above environmental data in the reports to the executive management and corporate management.

Critical Variables for the System's Effectiveness

It might be worthwhile to examine the critical variables for success and effectiveness of the proposed system. It needs to be emphasized that what is desirable and necessary is not excessive sophistication but understanding of the budget linkages between the future environment and competition with past performance in formulating the annual plan. The ability to build in the linkages in a tailored fashion, keeping in view its operating characteristics in terms of marketplace situation, product characteristics, technology, financial structure, etc., is easily the most critical determinant of the success of the system. Again it is not a requirement that an esoteric model be developed for environmental and competitive trend analysis. However, it is necessary that the quality of the analysis should reflect a sustained attempt to probe and explore in a formal and structured manner all facets of environment and competition which have a bearing on the organization's operations.

Conclusion

It is contended that the suggested system, which has already been applied in several large multi-product, multi-location organizations¹⁰ in India (including large banking, high technology engineering, consumer goods, process engineering companies, etc.), is considerably superior to the traditional budgeting process on the following counts:

1. It explicitly responds in a formal and structured fashion to the environmental and competitive linkage requirements critical to successful annual planning.
2. It provides for a balance between quantitative determination of targets and qualitative and managerial determination of assumptions, strategies, and policies which are implicit in such targets.
3. It forces management to be explicit about their assumptions and requires them to develop estimates, targets, and policies on an open and mutually shared basis with lower levels of management, thereby ensuring their acceptance at the operating level.

4. It provides for a mechanism of continued assessment of environment and competition (given their fluid and dynamic nature in the current context) and development of remedial response in case the original assumptions change or are modified due to reasons beyond the organization's control.

5. It provides for a contingency plan and action programme which ensures that alternative plans are identified in terms of levels of activity and action programmes required to be under taken for achievement of the desired organizational objectives and goals are developed as back-up programmes for achievement of plans.

References

1. Andrews, Kenneth R. The Concept of Corporate Strategy, Homewood, III. : Dow Jones-/rwin, 1971.
2. Anthony, Robert N. Planning and Control Systems' A Framework for Analysis. Boston: Harvard University, 1965.
3. Bayer, Robert N. Profitability Accounting for Planning and Control. New York: The Ronald Press Co., 1963.
4. Bhattacharyya, S. K. "Translating Organizational Objectives into Programme Tasks and Operating Tasks." Economic and Political Weekly, 7(48), Nov. 25, 1972. Bhattacharyya,* S. K. "Management Control Systems and Conflicts," International Studies in Management and Organization; Planning and Control, winter 1973-74.
5. Camillus, J. C. "Evaluating the Benefits of Formal Planning System," Long Range Planning, 8(3), June 1975.
6. "Ophthiorro-Pronto Chemical Corporation Limited."Ahmedabad: Indian Institute of Management, 1972.
7. Welsch, Glenn A. Budgeting, Profit Planning and Control. New Jersey: Prentice-Hall Inc., 1971.