



THE TRADE-OFF BETWEEN PLANNING OBJECTIVES AND PLANNING SUCCESS

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Abstract:

The aim of this paper is to analyse, why companies face difficulties in implementing modern planning concepts. For this the paper will discuss and define the terminology and goals of modern planning. Based on this, the article analyses how strategy orientation influences the willingness of companies to move from traditional budgeting to modern budgeting concepts. It will be outlined, why especially companies pursuing a cost leadership strategy are still reluctant to open themselves for modern budgeting concepts. The contribution of this paper is to analyse the influence of the strategy orientation on the readiness of organizations. Also it will be illustrated, how the overall value added of the corporate planning can be improved by prioritizing the most appropriate planning objectives.

Key words: *controlling, corporate planning, strategy orientation*

1. Introduction: The terminology “planning”, “forecast”, “budget” and “budgeting”

Planning, budget and forecast are terms which many actors involved understand to be very similar or even use as synonyms. It is also easy to mix up the terms “planning” and “budgeting” and the purpose of their usage. For a clearer understanding, the terms and their different purposes shall be defined and distinguished from each other:

Planning can be understood as the overall expression for structured processes to defining and setting targets. A plan bridges the current situation to the desired future one by specifying measures and actions. Depending of the time-horizon, the short and middle term operative planning can be distinguished from the long term strategic planning. The operative planning should be based on a defined strategy and a corresponding strategic long term planning (Rieg, 2015).

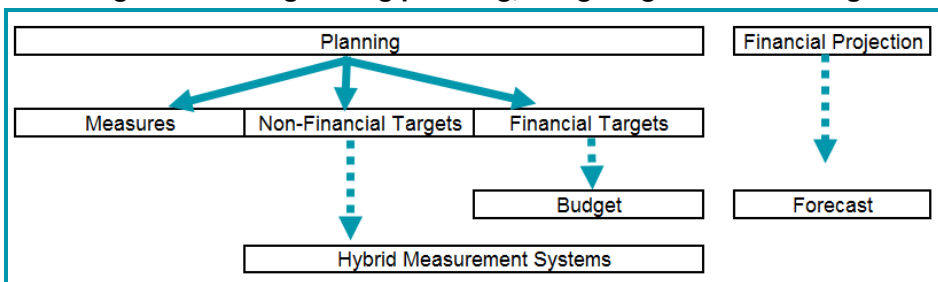
Budget can be one outcome of a planning process and normally includes standard financial reporting formats such as balance sheet, P&L and cash flow statement. The budget specifies which budget amounts can be spent or need to be

collected. Each budget amount is normally assigned to a person who is held responsible for this amount (International Group of Controlling, 2012; Zyder, 2007).

Beside budgets who by definition only describe financial performance figures, the so called Hybrid Measurement Systems (HMS) evaluate and monitor financial and in addition also nonfinancial performance figures. One of the most prominent HMS is the balanced scorecard (Gates & Germain, 2015; U. Schäffer, 2013).

A forecast is a financial projection of the future based on objective or subjective methods. Examples for objective methods are simple extrapolating past values or more complex forecast models. In comparison to these, subjective methods might involve guessing or gut feeling to prepare a forecast, however this is not a recommended approach. The forecast figures naturally deviate from the budget, which is a result of the planning process. The forecast deals with the question, to what extent the planned targets can be reached (Jessberger & Kappes, 2011). The discussed terms “planning”, “forecast” and “budget” can be separated from each other as illustrated below:

Figure 1: Distinguishing planning, budgeting and forecasting

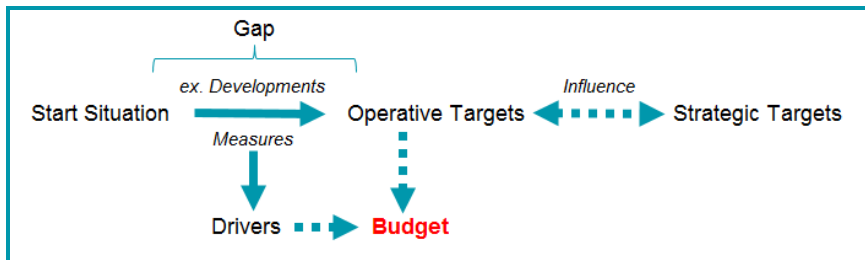


Source: Author's figure

The above figure summarizes and illustrates, that planning is defined as the target setting process which leads to financial and non-financial targets and to measures which are needed to reach those targets. The reflection of the financial targets is the budget. Hybrid measurement systems widen the target setting and include also non-financial targets. The forecast is not the result of a planning process but is the result of a financial projection into the future.

Based on the above definitions, each planning process should follow some key steps. The first step is to define a target meaning, a desired outcome which shall be achieved. Benchmarking is one often used and objective method to define such targets. It is common to distinguish operative targets, which are set for short and medium time spans, from strategic targets, which are basic decisions for indicating the direction the business shall be steered to and which are valid for a longer time span. In the best case both targets are related to each other. This means that the strategic plan determines the operative plan on the one hand but also that the operative steps lead consecutively to the realization of the strategic target.

Figure 2: Budget as one result of planning



Source: Author's figure

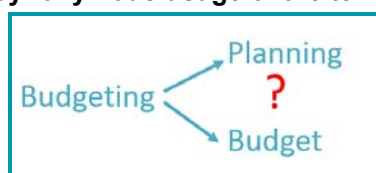
Between the start situation and the target situation there is normally a gap which needs to be bridged. For this bridging external induced developments as well as internal induced measures need to be considered. For example, the expectations towards the growth of the industry or the behaviour of competing companies have in the best case a beneficial or positive effect in times of economic growth. In the worst case such as in the case of a recession, it could increase the gap and hereby make it more difficult for the company to reach its target. Based on the remaining gap, internal measures need to be planned to close it. The measures will influence business drivers and business processes such as space, production capacity or marketing efforts which will reflect themselves in the budget figures. The budget can be seen as a financial reflection of the planned operative targets (Laval, 2015a, 2015c).

The planning of the consolidated corporate target consists in many cases of the addition of several sub-plans such as sales plan, production plan or investment planning. The planning process should in general start with the sub-plan which represents the bottle neck of the planning. The bottle neck is the factor which limit the company from reaching the target situation. In most competitive today's markets the achievable sales volume will be the bottle neck limiting the expansion. In this case it is recommendable to first start with the sales planning to follow by aligning the capacity planning to this sales plan.

The above leads to the following planning objectives "target setting", "coordination" and "performance measurement". In practice those planning objectives are interfered by competing objectives which will be discussed in a later paragraph.

In literature and business life the term "budgeting" is often used synonymously on the one hand with "planning" to describe the planning system in its total and on the other hand with the partial activity to prepare "budget" contents such as balance sheet, P&L and cash flow statement (Günther & Schomaker, 2012):

Figure 3: Synonymous usage of the term budgeting



Source: Author's figure

The synonymous usage of these terms makes a distinct analysis not easier and basically makes one of the terms obsolete (Zyder, 2007). The distinct usage of the terms “planning” and the noun “budget” would be beneficial to the opinion of the auditor. However, as the term “budgeting” is so well established in literature a usage with both meanings will be followed in this article; including budgeting as “planning” and budgeting as the process to prepare a “budget”.

From the point of view of a controller, the processes of setting up the budget are important tasks that need to be performed at the end of the year. The yearly routine is seen as financial exercise to come to a budget and it is accompanied by budget files and instructions to ensure that the controller fulfils this tasks in the manner and time the headquarter wants him to do. For this, the doing part of the budget seems normally clear for the controller. But to be precise and honest what many companies do is by above definition more preparing a forecast than a full corporate planning process. And it might be this misconception why many companies are deeply unsatisfied with the outcome of the “budgeting process”.

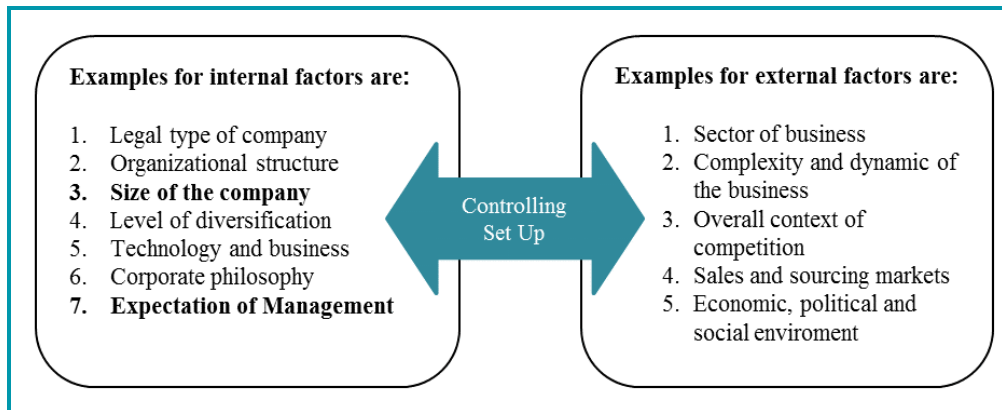
1. The influence of strategy orientation on corporate planning

Despite concepts in literature to modernize the planning for the companies it seems very difficult to find and implement a suitable modern planning concept (Rateike & Linder, 2010). A reason for that is that the planning is a management tool which needs to reflect the demands of the management and the nature of the business. Some questions to be answered are:

1. What degree and method of control do the top management or the owners wish?
2. How is the organizational structure? Who is responsible for what activities and their related costs?
3. What kind of motivation system and bonus system shall be followed?

The planning is only one aspect of the management system of a company and therefore it should not be seen isolated but should consider several internal and external context factors (Zyder, 2007). These context factors can change over time, e.g. a company can steadily grow in size and complexity which will impose a growing pressure to adapt the controlling organization correspondingly (Küpper, Möller, & Pampel, 2012).

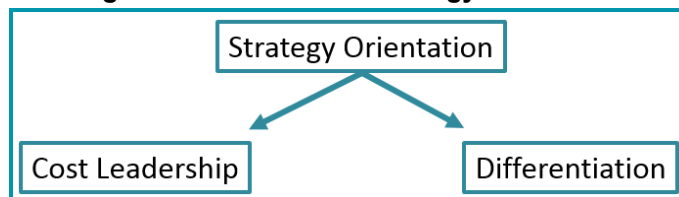
Figure 4: Context factors of planning



Source: Author's figure based on (Küpper et al., 2012)

For the further analysis of the planning concept, these context factors can be bundled in one significant trigger. The study made by (Gates & Germain, 2015) suggests that for the steering approach, the basic strategic orientation of the company significantly influences the management and control system and hereby the planning and budgeting process. For this, two basic orientations can be distinguished: first the cost leadership strategy and second the differentiation strategy.

Figure 5: Two forms of strategy orientation

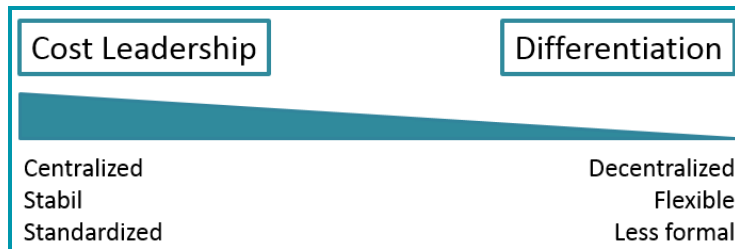


Source: Author's figure following (Gates & Germain, 2015)

Companies who pursue a cost leadership strategy normally follow a centralized, standardized and stable budgeting process. This tight and detailed budgeting process is important to realize a cost management and hereby a cost leadership. The focus on non-financial performance indicators for such companies is often seen as not helpful and kind of distracting from the cost control aspect (Gates & Germain, 2015).

Companies who follow a differentiation strategy prioritize a product / service leadership which requires a focus on activities such as research or product quality. Such companies often prefer a rather decentralized, flexible and less formal and detailed budgeting process with more sophisticated HMS systems (Gates & Germain, 2015):

Figure 6: Characteristics of strategy orientation



Source: Author's figure based on (Gates & Germain, 2015)

Centralized planning relates in many cases to a top down planning approach while decentralized planning considers more decentralized information in a bottom up planning. Bottom up planning often supports a planning input not aligned with the corporate strategy as well as budgetary slack avoiding ambitious targets (Epstein, Witzemann, & Witze-, 2015). A change to top down planning would support the connection between the strategic goals and the operative planning, but might lack the operative knowledge needed to set up realistic plans and hereby acceptance by the line managers. The setup of targets by the top management should consider market developments, benchmarks, investors' expectations. The top down approach of planning is especially beneficial, if the top management has the operative knowledge (like in operationally active parent company "Stammhauskonzern") (Epstein et al., 2015).

A high level of planning detail enables the headquarter to make a tight cost control and reduce the decentral level of decision freedom. The strategy orientation is therefore a strong determinant of the level of planning detail. But this increase of centralized control comes with some trade-offs which will be analysed in the following:

2. The trade-off between planning objectives

The desired results of the planning process determine the manner and the content of the planning. Vice versa the planning process determines the value added of its outcome. The planning can pursue those various goals which sometimes correlate but sometimes also exclude each other mutually. Following the planning principles introduced in paragraph two, the most important value added objectives of a planning would be:

1. Operative target setting following the strategic planning
2. Coordinating the actions of multiple groups inside the company towards this direction
3. Performance measurement to allow counter measures in case of unfavourable developments

According to the respondents of the survey from (V. U. Schäffer, Weber, & Mahlendorf, 2013), the planning in practice nowadays pursues a wide bundle of

objectives including the objectives mentioned above but also many goals which to some extent interfere with them:

Figure 7: Common planning objectives



Source: Based on (V. U. Schäffer et al., 2013)

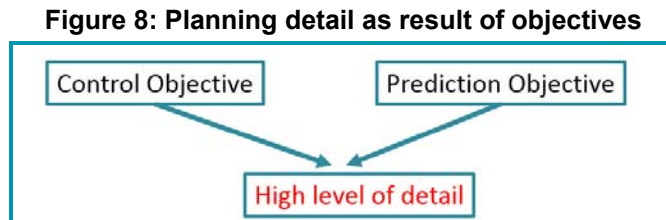
The above survey indicates the numerous objectives associated with the planning. Beside the planning objectives introduced before which are “target setting”, “coordination” and “performance measurement” in practice many additional planning objectives are pursued. The most prominent competing planning objectives are “control” and “prediction” and “motivation” which in the later will be referred to as traditional planning objectives.

There is a trade-off between the competing objectives meaning that not all objectives can be maximized at the same time. For example, the goal to control or predict with a high level of details can exclude the goal to plan fast and flexible. Also too many details can make it difficult to connect the operative planning with strategy because one might “lose the wood for the trees”. Because of such conflicts of interest, the objectives should be sorted in a reasonable hierarchy to ensure the positive effects for the company’s success.

The prioritization of planning goals is one core factor of the planning success. The paper will outline why and how the focus should be moved from the traditional goals towards the value added objectives in order to increase the value added of the

budgeting for multinational companies. In the following the three traditional objectives “control”, “prediction” and “motivation” will be further analysed.

The balancing out depends on the preference of the individual company and its top management. The influence of the objective control and prediction on the planning process is illustrated below:



Source: Author's figure

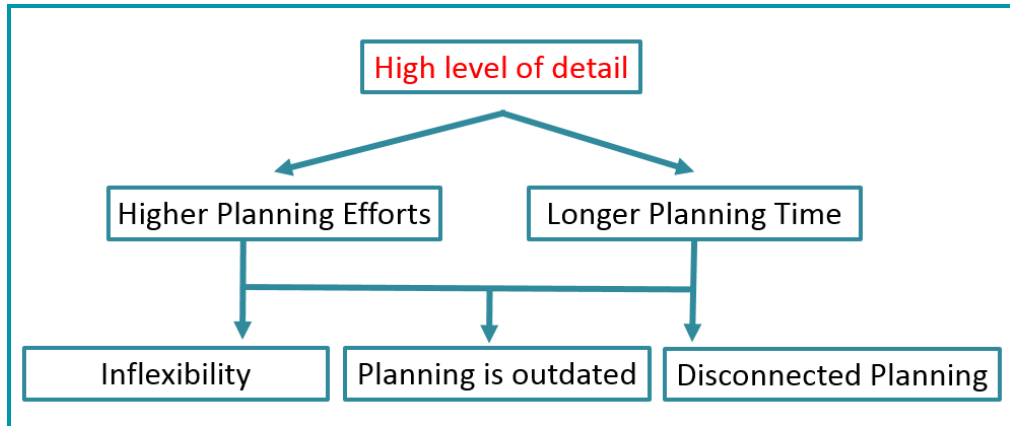
To **control** the spending behaviour of management by assigning fixed budgets is the top ranked goal of planning. This control aspect can lead the management to introduce cost savings when they would better spend some money on additional opportunities to drive the business further on the one hand side. On the other hand, it can indicate too much spending in the case the cost budgets are not fully used at year end. If the control aspect is overweighed, the management tries to increase the amount of budget reserves which might end in tough budget negotiation rounds. If the budget is seen as a negotiation result made by different functional heads who are struggling for the same money (McCoanty, 2014), the allocation of funds depends mostly on political influence and negotiation skills. This would additionally lead to longer iterations needed to fix the budget figures as well as it would lead to a dilution of the operative and strategic targets and also ignoring the drivers of financial performance.

The control approach further leads to tough negotiation processes using existing information asymmetries and can lead to conflicts of interests between the subordinates and the superiors (Arnold, 2015). 56% of the participants from big companies responded in the study of (V. U. Schäffer et al., 2013) that reaching the budget had a high relevancy for the remuneration of the managers. To relate the management bonuses to the budget figures can lead to bonuses not related to the individual performance but to windfall profit out of external factors such as general economic development.

The **prediction** of the financial figures is a second ranked goal in the current business environment which unfortunately dominates the planning process and outcome in many companies. To increase the forecasting quality, companies increase the level of planning detail and hereby increase the complexity of the process and hinder flexibility and ownership of management. In general the goal of a planning should not be to generate an exact forecast as projection of the financial future but to set up a consistent approach to be prepared for the future (Eisl et al., 2011; Rieg, 2015).

Both objectives “control” and “prediction” in practice often lead to an increasing level of detail in the planning package which has several unfavourable consequences:

Figure 9: Consequences of high level of planning detail



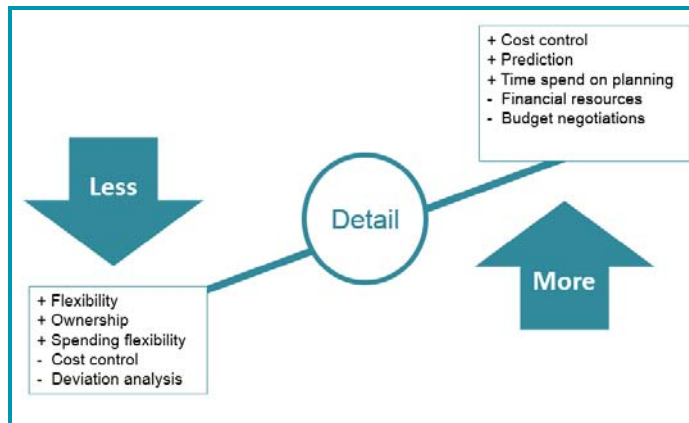
Source: Author’s figure

A major part of the working time in controlling departments is consumed with the budgeting process. Considering the long time span, budgets are in many cases technically almost impossible to be adapted during the business year to new information. In case of major external shocks or change of assumptions, a fast reallocation of budget amounts is needed in order to keep the budget usable. As the adaption cannot be done within the year, in many companies just recognize that the budget becomes irrelevant and that they “drive by sight”. 56% of respondents from the survey of (V. U. Schäffer et al., 2013) answered not to update the budget during the year. Most of the important planning assumptions may be outdated during the time the planning process is finished. In some companies the budget is not finalized until the beginning of the planned year.

The more the controllers focus on planning detail the easier it is to miss the wood for the trees. This means that the controllers might focus so much on details that they lose the bigger strategic picture out of sight. This leads to a disconnection between the operative and the strategic planning.

As an interim conclusion we can summarize, that the specification of planning level leads to a trade-off. To include more details in the planning supports the planning objectives “control” and “prediction”. This advantages are offset by disadvantages such as less flexibility, and a high resource consumption in the planning process. Especially companies following a cost leadership tent to include to many details in the planning process. The following graph illustrates the trade-off:

Figure 10: The trade-off of planning detail



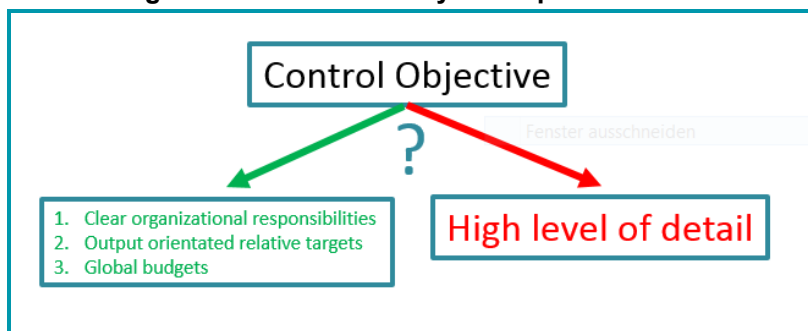
Source: Author's figure

3. Solving the trade-off between the planning objectives

The top three objectives "control", "prediction" and "operative planning" have high importance for a company's top management. The idea of a trade-off makes companies understand that it is an "either-or" situation. If they prioritize "control" and "prediction", they have to sacrifice something else. The trade-off will be further analysed by reviewing, if the budget is the appropriate management tool to pursue control and prediction.

The control objective in modern companies is challenged a lot by multi-dimensional matrix organizations. In many companies, overlapping responsibilities such as local responsibilities, regional responsibilities, divisional responsibilities and functional responsibilities lead detail budget control ad absurdum. This organizational set-up makes it hard if not impossible to assign clear responsibilities. And control without responsibilities is worth not much. After clear responsibilities have been assigned, the control objective can be further enhanced by assigning clear output orientated relative targets as far as possible.

Figure 11: Alternative ways to improve control



Source: Author's figure

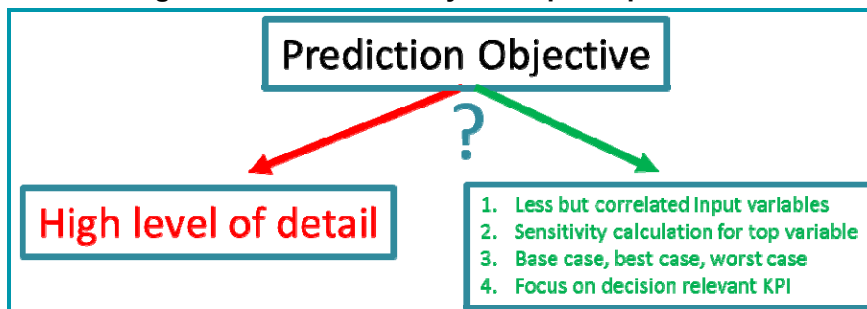
Assigning clear organizational responsibilities for measures and budgets is mandatory to ensure that one person has the operative power to influence these measures and budgets. This principle is also referred to as the “controllability principle” (Rieg, 2015). Organizational overlapping of responsibilities and unclear responsibilities contradict the idea of budget control. If responsibilities are unclear which in many matrix organizations nowadays is observable, the bottleneck for efficient cost control however cannot be found by increasing the detail level of planning. Budget control without responsibilities remains meaningless.

The usage of output orientated relative budget targets, also referred to as “performance based budgeting”, allocates budget by considering output oriented performance targets allocated to the budget holder. These performance targets should be in line with the overall company strategy (McCoanty, 2014). A problem with output oriented techniques however can be, that some functions do not create a quantifiable output which can be measured.

When the planning is too detailed, it can occur that the management needs to justify a budget shift between cost centres or different kind of costs. Rather than being held responsible to spend each budget amount exactly as planned managers should be responsible to reach a fixed target with a global budget.

The prediction objective of the budget is also not the most appropriate tool. High-level of fluctuations make the cumbersome budget process too slow and inflexible to adjust. Instead of detailed budget, the rolling forecast needs to be implemented. This works with fewer but correlated input variables. The most important input variables should be subject to most important scenarios which most likely are sales volume and possibly exchange rates.

Figure 12: Alternative ways to improve prediction



Source: Author’s figure

The prediction objective can be reached by definition less but correlated input variables. For this external and internal input variables need to be distinguished. External input factors are factors which cannot be influenced by the company such as currency exchange rates raw material prices. Internal factors can be influenced by the company such as production volumes or efficiency KPI’s (Epstein et al., 2015). The

KPI should be of high significance for the planning on the one hand side and influential by the management.

For sensitivity calculations, the budget should be seen as the result of business drivers. In driver based planning models, the budget is the result of a mathematical linked relationships between operational drivers such as output units or number of employees or production utilization rates. Hereby the number of input variable is lower than in traditional budgeting models and by this it is much more easy to calculate different scenarios. Different scenarios in this would mean changing certain operational drivers to add to the base case complementary worst case and best case scenarios (McCoanty, 2014).

A high level of details during the planning process often does not lead to higher plan precision. Too many details hinder a focused discussion about the driver for future success (Epstein et al., 2015). Therefore, it is recommended to limit the discussion to the most relevant success factors of the business. The usage of relative KPI's enables the usage of internal and external benchmarks (Epstein et al., 2015).

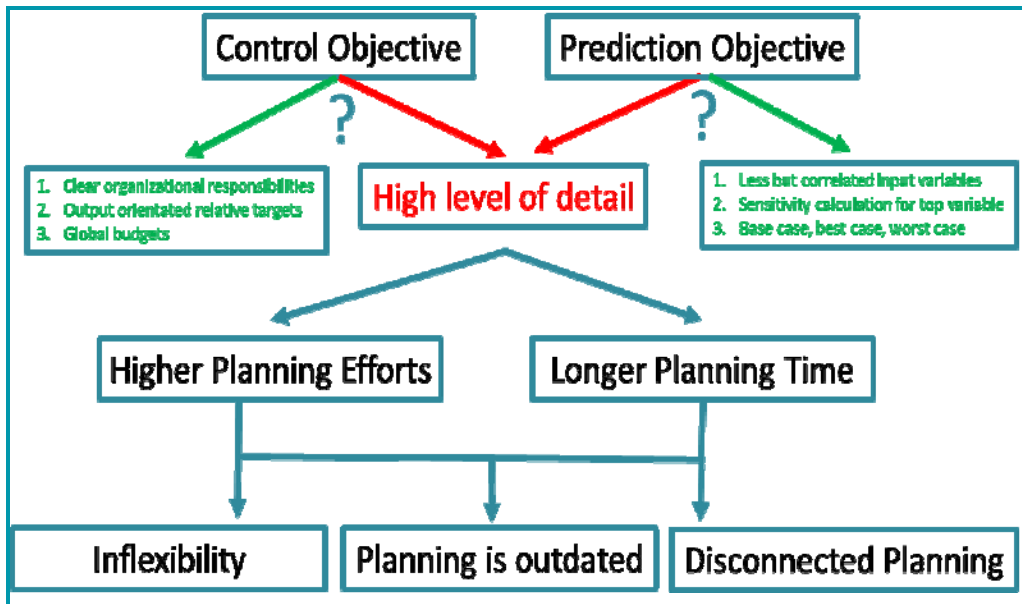
The planning detail should be focused on the decision relevant KPI. Increasing the level of planning details might make it difficult to see the wood for the trees. Meaning that focusing the planning on the most important operative KPI's might make it easier to have the strategic goals in mind.

The planning should be reviewed regularly if it is in line with the key drivers of the business and if the reporting addresses the right content to the right people (Laval, 2015b). The following figure summarizes the consequences of traditional planning objectives and how they can be overcome:

4. Conclusion and outlook

The contribution of this paper is to clarify the terminology and goals of the planning process. Based on this the trade-off between planning objective and planning success could be demonstrated. It was explained why especially companies prioritizing traditional budgeting objectives might invest high planning efforts but getting only insignificant decision support out of the planning process. Following the argumentation of this paper, those problems can be tracked back to influence of strategy orientation on the budgeting system. The following figure illustrates this conclusion:

Figure 13: Consequences of traditional planning objectives



Source: Author's figure

Especially companies with a cost leadership strategy should evaluate, how to address the traditional budgeting objectives “control” and “prediction” with other management tools than the budget. The paper concludes, that the overall value added of the corporate planning can be improved by prioritizing the most appropriate planning objectives.

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