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by Robert A. Howell

Reprint F0407B

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When you think of forces that contribute to the long-term growth and prosperity of your company, you don't think of your budgeting process. Quite the opposite. Typical bottom-up budgeting, with its focus on earnings, its emphasis on making short-term numbers, and its death grip on performance measurement, control, and rewards, is one of the forces arrayed against you.

But I've seen a few companies where things are different—where budgeting is used as a tool to introduce and reinforce a growth mindset. In these companies, wise investments in people, R&D, market development, and plant and equipment don't suffer death by a thousand cuts. Instead, they live on to drive long-term revenue growth, cash flows, and shareholder-value creation. Your budgeting process can have the same effect. But only if you're willing to rethink it dramatically—and, in many respects, turn it upside down.

Institute Rolling Plans

The budgeting process should be understood as just the first phase of the rest of the life of the firm. To foster this attitude, some companies conduct their budget-planning process on a rolling basis, updating and extending the plan regularly (perhaps semiannually). Some set their short-term plans not according to the annual financial-reporting calendar but according to the full sweep of their company's normal business cycle. It's a common practice among Japanese firms like Toyota and deserves to be adopted more widely in other parts of the world. Rolling plans of two to three years' duration keep managers' eyes on a more distant horizon, and that has real implications for their investment decisions.

Restructure Your Planning Formats

Warren Buffett knows a company with growth potential when he sees it—and what he looks at is the company's "intrinsic value." What he means is that he focuses on cash flows rather than on accounting profits. The intrinsic value of any firm is simply the net present value of the future stream of cash flows it will generate. Most executives adopt the same perspective when they're considering acquisition candidates; if projected cash flows are insufficient to justify the proposed price, they know the deal should not be done. So why, when it comes to their own companies, do executives reduce cash flows to an afterthought?

At most companies, the formats of budgets and strategic-planning reports follow the basic structure of the financial statements. It's not hard to see why: Those formats are already understood and reconcilable with financial-reporting requirements. But the unfortunate result is that budgeting becomes infected by the financial statements' focus on earnings; cash is treated as a derivative of the effort rather than the focus. To avoid that problem, managers should reformat their planning and budgeting templates to highlight cash rather than accounting net income. These forms should zero in on investment (in working capital and fixed and other assets) and financing rather than assets, liabilities, and equity. And they should emphasize the level of free cash flows generated by the business available for lenders and shareholders.

Change Your Measurement and Reward Systems

Refocusing budgets on growth drivers would have a further benefit. Since budgets are so often used as the basis of a company's performance measurement, control, and reward systems, refocusing the budgets would make it easier to refocus those systems as well. Most managers implicitly understand that R&D investments, process improvements, new markets and customers, intellectual capital, and even property, plant, and equipment are what drive long-term growth, cash flows, and value

Budgeting in many organizations is negative, reactive, and depressing. But call it a "value-creating plan," and the process could be positive, proactive, and uplifting.

creation. However, like traditional budgeting processes, compensation and bonuses tend to be focused on earnings. The value of stock options, at least in the short run, is tied to earnings per share, P/E ratios, and stock prices. This mismatch drives managerial behavior in the direction of short-term responses and needs to be corrected.

Get Rid of the Word "Budget"

A new chairman was recently brought in at a small, start-up bank I know. He was eminently qualified for the post; his distinguished career had even included a stint as president of the American Bankers Association. The bank had yet to turn the corner on profitability, and he knew he needed to intensify his team's focus on that objective. How did he begin? One of his earliest steps was to ditch the word "budget" and start talking in terms of the bank's "profit plan."

Is this just semantics? Perhaps. But semantics can make a real difference. Many companies use the terms "strategic plan" and "long-range plan" when they're addressing the longer-term future, but when they start to put the numbers together for the next year, they revert to the term "budget." Not surprisingly, managers think expansively during the planning effort, but when the budgeting process begins, all that is pushed aside. Their focus narrows to achieving the desired annual net income and earnings-per-share objectives.

Words can be negative, backward oriented, reactive, and depressing. Alternatively, they can be positive, forward oriented, proactive, and uplifting. "Budgeting," in many organizations, has become the former. A new term—I would suggest "value-creating plan"—could be the latter.

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