The Problem

I found a way to save a million dollars by spending only $10,000.

The $10,000 would come out of my budget but the savings would go into someone else's budget. It's not feasible.

Our stockholders might disagree.

That's why they aren't invited to meetings.
Not About Replacing Budgets with Forecasts

Alternative Financial Planning and Management Approach
# Two Visions for Improving Finance

<table>
<thead>
<tr>
<th>Vision A</th>
<th>Vision B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase targets, measures, controls</td>
<td>Reduce targets, measures, controls</td>
</tr>
<tr>
<td>Improve financial and accounting expertise</td>
<td>Improve business analysis skills</td>
</tr>
<tr>
<td>Tighten top-down planning and control</td>
<td>Enable local managers to respond to events</td>
</tr>
<tr>
<td>Manage costs through tighter budgets</td>
<td>Eliminate costs that add no value</td>
</tr>
<tr>
<td>Measure to tighten accountability</td>
<td>Measure to learn and improve</td>
</tr>
<tr>
<td>Manage risk through better procedures</td>
<td>Manage risk by raising competences</td>
</tr>
</tbody>
</table>

(Hope & Fraser, 2000)
Beyond Budgeting Framework

1. Targets relative to competition
2. Rolling forecasts
3. Rewards on relative performance
4. Up to date/transparent information
5. Give managers freedom to act
6. Adaptive to changing environment

- A new management model, not just financial control structure

(Hope & Fraser, 2000)
A Foundational Change

- Reduce targets, measures, controls
  - Single measure rather detailed line item budgets
  - Consistency of measure between cost per and productivity per
- Enable local managers to respond to events
  - Manage within targeted costs per UOS
- Eliminate costs that add little value
  - Resources spent on improving performance versus negotiating budget
- Measure to learn and improve
  - Continuous feedback loop on performance
  - Action plans to improve current performance
- Focus is on responding to customer demand vs. anticipating demand
Ideal Environment

- Rapidly changing business climate
- Organizational self-confidence
- Cultural readiness to manage differently
- Desire to encourage front-line decision making
- Lean management may facilitate transition
Budget Wasteful

Filling In For The Pointy-Haired Boss

Does your department need its entire budget this year?

No, we'll waste most of it on empire building and appearing to work on trendy things.

All in favor of cutting this guy's budget in half?

I call do-over! do-over!
Desire: A Better Financial Management System

- Eliminated a “waste” of resources
- Emphasized performance improvement
- Clear accountability
- Better communication across functional teams
- Empowered front-line managers to run the business
  - Right information, right time for daily management
- Facilitated organizational nimbleness to changing business climate
Board Involvement

Board approved four targets

• Operating margin
• Capital
• Days cash on hand
• Charge master increase

• Targets primarily driven based on capital plan and rating agency expectations
• Focus discussions become more future orientated
• Hold management accountable for outcomes
Forecast Process

• Best estimate of what will happen in the future, given what we know today
• Forecast 18 months into the future (6 quarters)
  • High-level, not at a department level
  • Quarterly process, two weeks post quarter close
  • Evaluate accuracy
• Leverage past quarterly results as baseline
  • Adjusted for known projects
  • Utilized a few KPIs
  • No plugs
• Results discussed
  • Senior leadership team (on track, modify)
  • Finance Committee (with senior leadership team conclusion)
  • All management/Medical Staff
Management Reports

Metric Driven
  • Cost per unit of service
  • Productivity (worked hours per unit of service)
  • Revenue (unit driven) per FTEs (medical practices)

Monthly Reporting
  • Actual compared to run rate (past three month average)

Future Development
  • Daily productivity reporting
  • Improved financial reporting

Accounting Changes
  • Eliminated accruals at departmental level
Retained Aspects of Budgets

• Capital
  • Amount available to spend driven by forecasts
  • Managed under a “budget” approach

• Consider excluding specific subsidiary operations
  • Foundations, other decentralized operations
  • Stable business models
  • Incorporated into new approach once stable with largest operation
Semi-Annual Business Plan Reviews

• Major business lines
• Finance, quality, service, & people key metrics
• Presented to senior leadership team
• Key accomplishments, plans for improvement, & barriers to achieving targets
Outcomes

Positive
• Management more focused on results versus budgets
• Discussion became more future orientated
• Operating results significantly improved

Negative
• Managers wanted to know what they could “spend”
• Reporting wasn’t adequate to support change
• Change in leadership impacts sustained practice

Continued Challenges with Accountability Regardless of System
## Comparisons

<table>
<thead>
<tr>
<th><strong>Budget</strong></th>
<th><strong>New Planning Model</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Board approved detailed budgets</td>
<td>Board approved organizational targets</td>
</tr>
<tr>
<td>Annual</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Cumbersome, wasteful process</td>
<td>Nimble, focused process</td>
</tr>
<tr>
<td>Slow to respond</td>
<td>Quarterly discussion &amp; course correction</td>
</tr>
<tr>
<td>Very detailed</td>
<td>Focus on the significant few</td>
</tr>
<tr>
<td>Silo accountability</td>
<td>System view / accountability</td>
</tr>
<tr>
<td>Significant resources to “balance”</td>
<td>All hours redeployed to daily management and quarterly forecasting</td>
</tr>
<tr>
<td>Variance analysis to “budget”</td>
<td>Variance analysis to continuous improvement from previous period</td>
</tr>
<tr>
<td>Static Dollar Focus</td>
<td>Metric Driven</td>
</tr>
</tbody>
</table>
What is the risk?

- Lack of plan to achieve results
  - Revisited quarterly through forecast
  - Clear improvement plans based on current performance
- Lack of accountability
  - Every manager will have a clear target on performance
  - Targets linked to productivity
- Lack of understanding
  - Consistent with Lean Management
  - Finance data is similar to quality data
- You can always create a budget
Avoiding the Inflexibility of Budgets

I made a typo in my annual budget request, but don’t worry.

There are only two things you can’t buy for the test lab this year.

Hardware and software.
Take the Leap!
References


