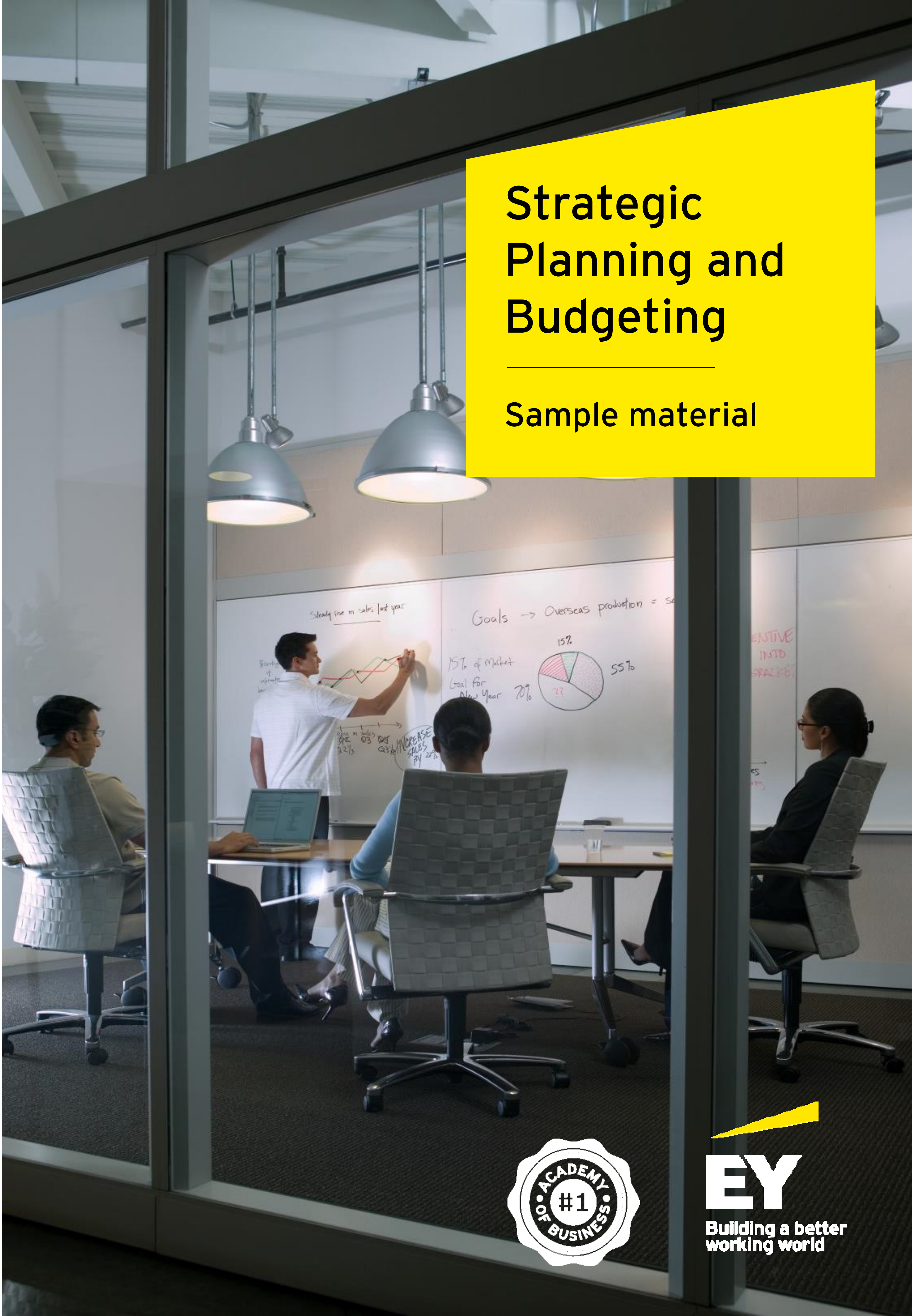

Strategic Planning and Budgeting

Sample material

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OBJECTIVES, STRATEGY AND PLANNING

CHAPTER CONTENTS

- **Definition of terms**
- **Objectives**
- **The links between strategies and organisational structure**
- **The planning process**
- **The main techniques used in the planning and decision process**
- **The basic elements of a management control system**
- **Methods for monitoring and control against objectives and plans**
- **Illustrations of the need for monitoring and evaluation**

DEFINITIONS

Objectives represent milestones in achieving the long-term purposes of the organisation.

Strategies are general programmes of action and deployment of resources to attain comprehensive objectives.

Values are the standards of social and ethical behaviour that management is expected to adopt.

Policies are the statements or understandings which guide the thinking of decision-makers.

This chapter describes the link between objectives, strategies and planning, and then goes on to show how forming plans, whether strategic, tactical or operational, will have little effect within an organisation unless performance is first monitored and then evaluated. Evaluation will lead to feedback whereby management will attempt to alter performance or may have to change plans. Accountants have an important role in providing much of the information needed for this process.

OBJECTIVES

By the time you have finished this chapter you should be able to:

- define the terms 'objectives' and 'strategy'
- describe the different objectives for different types of organisations
- illustrate the links between strategy and organisational structure
- explain how the objectives and strategy of an organisation impact upon its plans
- describe the planning process
- describe the main techniques used in the planning and decision-making process for various types of organisation
- explain the difference between strategic, tactical and operational planning
- describe the basic elements of and purpose of a management control system
- illustrate the need for monitoring and evaluation
- describe methods for monitoring and controlling against objectives and plans.

1 DEFINITION OF TERMS

First, we need to establish some definitions for certain key terms for this chapter. These are as follows.

Objectives represent milestones in achieving the long-term purposes of the organisation. Whether or not objectives are attained will represent a measure of success or failure for the organisation.

Strategies are general programmes of action and deployment of resources to attain comprehensive objectives.

Values are the standards of social and ethical behaviour that management is expected to adopt. They may also be defined as standards that management seeks to incorporate into the organisation's culture. In that sense an organisation's values will be similar to what is known as its mission.

Policies are the statements or understandings which guide the thinking of decision-makers.

Diagrams and key points make your learning easier and faster

KEY POINT

Two main planning approaches:

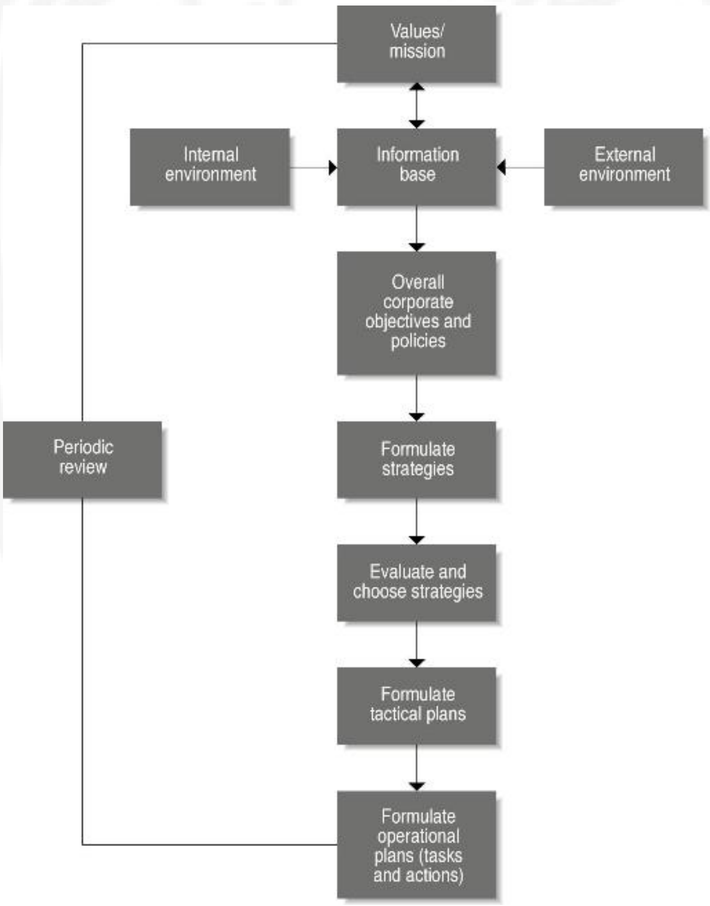
- **the right-hand approach: the organisation defines what it wants to attain**
- **the left-hand approach: the organisation seeks to understand the market and its environment.**

The first method, also called the accountancy-led approach, can be criticised because it may not be sufficiently sensitive to environmental changes. If a company has enjoyed 20% profit growth for a decade it is difficult for it to believe that that may ever end.

The left-hand approach, sometimes called marketing-led, starts with an environmental awareness and works forward from there. Certainly this is a necessary approach in organisations that are subject to intense competition or rapid market and technological changes.

4.1 A description of the planning process

It is not possible to establish a set of strategic planning guidelines to stand as a definitive list suitable for all organisations in all situations. However, by drawing on the published and researched experiences of many different companies it is possible to weld their distinctive features and characteristics into a set of common principles which can be loosely classified as a strategic planning system. There are many views on the logical sequence of the tasks involved although very little disagreement about their necessity. The following diagram is comprehensive yet relatively simple.



Because it starts with environmental appraisals, this diagram essentially describes the marketing-led approach to planning. Note the two-headed arrow between values/mission and information base; the environmental appraisal may lead an organisation to change its values.

Practical examples and rich descriptions make definitions easy to understand and remember

SAMPLE

6 THE BASIC ELEMENTS OF A MANAGEMENT CONTROL SYSTEM

6.1 Introduction – the purposes of management control systems

O'Shaughnessy claims that organisational control systems provide the following benefits:

- motivate and encourage desirable behaviour
- foster delegation and facilitate decentralisation
- save management time – management by exception
- provide feedback for planning
- emphasise performance accountability.

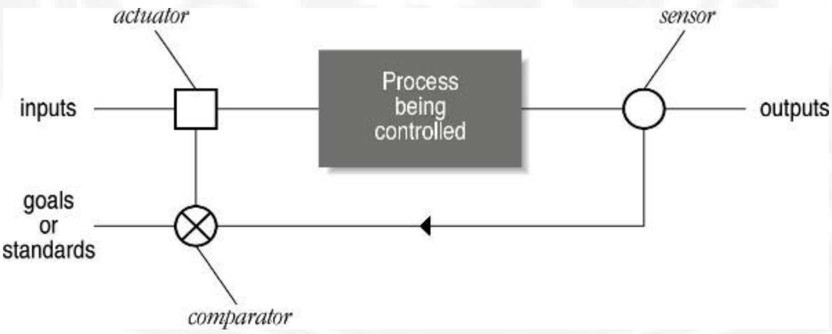
DEFINITION

'**Organisational control** is that phase of the managerial decision system that monitors performance and provides feedback information which can be used in adjusting both ends and means.'

6.2 According to Kast and Rosenzweig:

Organisational control is that phase of the managerial decision system that monitors performance and provides feedback information which can be used in adjusting both ends and means. Given certain objectives and plans for achieving them, the control function involves measuring actual conditions, comparing them to standards and initiating feedback which can be used to co-ordinate organisational activity, focus it in the right direction, and facilitate the achievement of a dynamic equilibrium'.

A schematic representation of a control system is as follows:



If we consider a central heating control system the input to the process is heat from the boiler whilst the output is warm air in the house. The goal is some target temperature, or more normally a band of temperature, which is pre-set on a thermostat. This thermostat incorporates a sensor which measures the actual air temperature in the house. Within the thermostat the pre-set temperature is compared to the sensed temperature, so that the device also includes the feedback path and the comparator. If there is a mismatch between the actual temperature and the goal, then a signal is sent to the boiler which acts as an actuator – a device which acts on the inputs and takes action to control the process. It must be remembered that the goals of any system can be altered, in this case by altering the setting on the thermostat – in the long run the system thus becomes an open one.

The extension of the above model to a stock control system is an easy step; its application to organisational behaviour is more complex but can be very useful.

With correctly functioning automatic control systems feedback would always be negative, i.e. the errors would be reduced, but in human systems feedback could be positive and the error aggravated.

Examples, Activities and Case Studies with full solutions support and motivate learning

Example

ABC Ltd makes and sells two products, X and Y. Both products are manufactured through two consecutive processes – assembly and finishing. Raw material is input at the commencement of the assembly process. An activity based costing approach is used in the absorption of product specific conversion costs.

The following estimated information is available for the period ending 31 December 20X5.

	Product X	*Product Y*
Production/sales (units)	12,000	7,200
Selling price per unit	$75	$90
Direct material cost per unit	$20	$20
ABC variable conversion cost per unit		
- assembly	$20	$28
- finishing	$12	$24
Product specific fixed costs	$170,000	$90,000
Company fixed costs	$50,000	

ABC Ltd uses a minimum Contribution/Sales (C/S) ratio target of 25% when assessing the viability of a product. In addition, management wish to achieve an overall net profit margin of 12% on sales in this period in order to meet return on capital targets.

Explain how target costing may be used in achieving the required returns and suggest specific areas of investigation.

Solution

The information given will give the following estimated product and company results:

	Product X		*Product Y*		*Company*
Per unit	$	$	$	$	$
Selling price		75		90	
Less/variable costs					
materials	20		20		
conversion costs	32		52		

	Product X		*Product Y*		*Company*
Per unit	$	$	$	$	$
Contribution		(52)		(72)	
Contribution: sales ratio		23		18	
Total for period		30.7%		20%	
Sales		900,000		648,000	1,548,000
Contribution (sales x cont/unit)		276,000		129,600	
Product specific fixed costs		(170,000)		(90,000)	
Contribution		106,000		39,600	145,600
Company fixed costs					(50,000)
Net profit					95,600
Net profit margin on sales					6,2%