Aligning Strategy and Finance

by Thomas E. Ambler

Year-after-year Bain & Company's survey of decision tools and analytical techniques being used by major companies shows that Strategic Planning ranks highest in terms of preference and successful usage. Formulating a sound, crisply defined strategy for the future clearly contributes to your company's long-term success. A strategy cannot be sound unless it is aligned with reality, which means it must have solid input. But even the perfect, "sound" strategy will be next to worthless if it is not implemented. Successful implementation requires organizational alignment with the strategy. In an ideal world, every person in the organization, from the boardroom to the backroom, would understand the strategy, be fully committed to its vision, and know how his or her individual actions support the "big picture." Strategic Alignment makes winners.

Every function in an organization impacts Strategic Alignment. However, in this article we will limit ourselves to the Financial Function. We will explore how it can maximize its contribution to Strategic Alignment. Then, when we finish, we will ask the impertinent question — "after the Financial Function has done all it can do to facilitate implementation and provide solid input, is its contribution really all that important?"

Before we launch into the thick of it, let's define a few terms. First, when we say we want our organization to be aligned with our strategy, what do we mean by "strategy"? For our purposes, "strategy" means the "course and direction" that we intend to follow over the next several years. It includes specific intentions about our core business, new opportunities, competencies, infrastructure, organizational development, financial and ownership issues and size.

The ideal planning process involves 4 major phases —

1. External and Internal Situational Analysis,
2. Strategy Formulation,
3. Implementation Planning and
4. Execution.

This ideal process should produce several major "deliverables" —

a. A Strategies document that captures all of the facets of strategy listed above,
b. A set of long-term Goals, which are qualitative criteria defining our concept of success, accompanied and supported by key metrics (comparable to the methodology promoted by Robert Kaplan and David Norton in their book *The Balanced Scorecard*) and
c. A set of specific and measurable Action Plans and Other Key Strategic Initiatives for the next year.

The Strategies and Goals provide ongoing general guidance and focus to the conduct of the organization for the next several years. The Action Plans and Other Key Strategic Initiatives are the step-by-step marching orders from top management to the organization as to what is to be accomplished over the next 12 months. They generally cut across functional boundaries and are, by their very definition, strategically aligned. This means that everyone involved in these initiatives and the organizational functions they represent are also at least somewhat strategically aligned. Full strategic alignment requires behavior that is consistent and supportive of all 3 of these major deliverables.

Most strategic planning practitioners, including Norton and Kaplan, recognize the following four primary Barriers to Strategic Implementation/Alignment:

1. Vision and strategy not actionable.
2. Strategy not linked to departmental, team and individual goals.
3. Strategy not linked to resource allocation.
4. Feedback only tactical, not strategic.

The Simplified Strategic Planning Process, as presented by Robert Bradford and Peter Duncan in their book, *Simplified Strategic Planning*, addresses and largely overcomes all four of these barriers. Barriers 3 and 4 relate most directly to the Financial Function and will be addressed further in this article.

Let's define one more term, the "Financial Function" (henceforth referred to as just "Finance"). Table 1 lists the activities that we will consider to be part of the Finance responsibility.

**TABLE 1 — FINANCE ACTIVITIES**

*Group I — Significantly affect other functions*

A. **Keeps score.** Generates budgets, reports routine financial status and provides management reports focused on performance and highlighting fruitful areas for management action.
   - Generates basic financial reports (e.g., P&L, Balance Sheet, etc.)
   - Provides management with financial and operational information at appropriate summary levels to spot trends and gauge performance relative to prior actual, budget and other benchmarks
   - Prepares next-year's operating budgets
   - Defines key performance metrics and targets with the management team
B. Provides usable, building block data to support analysis.
   - Analyzes variances from expectations, prior performance and budgets and makes recommendations for operating improvements
   - Provides databases of sales, purchase and production data at the detail transaction level to facilitate flexible, user-friendly, ad hoc report generation for multiple years

C. Assures cash availability and rations capital.
   - Manages cash flow
   - Manages operational risk
   - Arranges and maintains relationships with sources of capital
   - Performs credit function with customers and suppliers
   - Prepares next-year's capital budgets and rations capital

D. Provides financial analysis of new possibilities
   - Evaluates major investment projects
   - Performs financial analysis of new opportunities and decision alternatives

E. Contributes general analytical and financial perspective to the planning and ongoing management processes
   - Stays abreast of economic and business news
   - Participates on multi-discipline teams such as Strategic Planning, Innovation etc.
   - "Eats, sleeps and breathes" the short and long-term Cash Flow Equation
   - Educates non-financial management in financial concepts
   - Synthesizes information and both hypothesizes and validates cause-and-effect relationships that influence success

Group II — Activities primarily contained within Finance

- Performs general accounting functions including payroll, accounts payable etc.
- Keeps business in compliance with fiduciary regulations and reporting requirements
- Conducts the routine banking function
- Participates in financial and operations audits
- Works with financial stakeholders and auditors

The financial function defined here is not necessarily synonymous with the way you define the boundaries of your Finance Department. Some of the functions included in this definition may organizationally be located in the IT Department or be fulfilled by another position such as the CEO or Operations Executive.

Most companies know what it takes to have a strong short-term Financial Function. The question is, "what else does it take to have a "strategically aligned" Financial Function — one that can (a) contribute solid input to the development of strategy and (b) be a major force in motivating its execution?"
Strategic alignment for Finance does not require adding new functions. It does require deepening and broadening each of the traditional functions we outlined above. This extension is predicated on 8 strategic management principles:

1. If you expect it, you must inspect it.
2. If you can't measure it, you can't manage it.
3. Much of management is symbolic — measurements are symbols.
4. Measurements are intended to provide positive motivation — communication of the expectation itself and the satisfaction of achieving it.
5. The "main thing" is to keep the "main things" the "main things." (The "main things" are our strategies and goals.)
6. Strategic resources like top management time are easily squandered if not focused on the "main things." Measurement systems should communicate the "main things."
7. Execution of the "main things" will not occur until the "main things" becomes urgent or automatic.
8. Aligning strategy with reality requires upward flow of the realities of all levels of the organization combined with information from monitoring the external environment.

When we combine these principles with our list of major Finance Activities, we see some very interesting and important suggestions emerge for shaping the role of Finance to achieve better strategic alignment. Let's consider these suggestions one Activity at a time.

A. Keeps score. Generates budgets, reports routine financial status and provides management reports focused on performance and highlighting fruitful areas for management action.

In the formal planning process, senior management will typically identify a list of key measurements and target values that represent the "main things." In Simplified Strategic Planning this is the combination of "Goals" and "Measures of Success." Norton and Kaplan call it a Balanced Scorecard, because it deals with key measures (fewer than 25) for all functional perspectives, including customer, operational, financial and learning/growth. To quote from their book, "the balanced scorecard is not a replacement for an organization's day-to-day measurement system. The scorecard measures are chosen to direct the attention of managers and employees to those factors expected to lead to competitive breakthroughs for an organization."

"A good balanced scorecard should have an appropriate mix of outcome measures (lagging indicators) like Return on Capital Employed or Economic Value Added and performance drivers (leading indicators). {specific measures will be different in district environments} The outcome measures without performance drivers do not communicate how the outcomes are to be achieved. They also do not provide an early indication about whether the strategy is being implemented successfully."

Finance is responsible for completing what we will label the "Main Things" Scorecard with careful selection of the critical few measures and their long-term targets.
outdated measures can be as important as selecting the right new ones. Finance is also responsible for generating scorekeeping data to facilitate monitoring organizational progress toward those targets.

Action Plans and Other Key Strategic Initiatives have two intentions. The first is to avoid Implementation/Alignment Barrier #3, "strategy not linked to resource allocation," by requiring that all Action Plans be scheduled at the same time and specifically recognize organizational constraints such as management time and cash flow. Where organizations have separate processes for long-term strategic planning and annual budgeting, short-term discretionary funding and capital allocations are often unrelated to strategic priorities. Major initiatives — like IT system replacements — are undertaken with little sense of priority or strategic impact.

The second intention is to be the most important organizational drivers of strategic alignment/implementation. This happens when Action Plans are monitored monthly. Monitoring requires organizational discipline and attention to detail, behaviors often more natural to those in Finance than in certain other functions. As a result, Finance can make a major contribution to strategic alignment by promoting and supporting the monitoring process. Finance must also be alert to its need to provide the scorekeeping necessary to monitor attainment of these initiatives.

In most organizations the most prominent, but not necessarily the most important, mechanism for controlling and motivating managerial action is the annual operating budget. All too often, the development process and the tactical basis of the operating budget have a life of their own, independent of strategy. Strategic alignment demands a strong linkage between the multi-year strategy and the commitments that operating management make in their annual operating budget. Finance is in the driver's seat to assure that these linkages are made. Budgets should reflect the costs/benefits and scheduled timelines of the Action Plans and Other Key Strategic Initiatives. The implications of near-term targets for measures on the "Main Things" Scorecard should also be incorporated into the operating budget. Budgets should reflect the cause-and-effect relationships between drivers (both internal and external) and outcomes learned in strategic planning and vice versa.

If you ensure this linkage between strategy and operating budgets, then your normal periodic actual vs. budget reviews automatically become strategic reviews. That's powerful stuff! Combine this with Action Plan monitoring and you have just eliminated Alignment/Implementation Barrier #4, "feedback only tactical, not strategic."

Finally, forge a link between a strategy-aligned budgetary and reporting process and Open Book Management, where financials are shared with all employees. Such a linkage would give you, at least in theory, complete top-down strategic alignment and the possibility of genuine bottom-up flow of strategic input.

B. Provides usable, building block data to support analysis.
This Financial Function takes place in the deep recesses of the "backroom." Nevertheless, it is vital to both the short and long-term health of the organization. In today's competitive environment, if you don't know your costs, where you are making your profits and what your investments are at a detail level, you are flirting with disaster and will fall short of your potential. Good strategy starts with a solid understanding of your Core Business. Much of that understanding must be built on internally generated data. If the basic building blocks exist at a transaction detail level, they can be combined in an infinite number of ways and become valuable information, not just reams of data. This information can lead to (a) identification of opportunities for improvement, (b) development of key cause-and-effect relationships that mold strategic thinking and (c) support of strategic decision-making — all of which translate into strategic alignment.

Here are a couple of strong suggestions related to the nitty-gritty of strategic alignment:

- Sharpen profit determination by incorporating into your cost accounting system some Activity-Based Costing concepts for dealing with overhead allocations \( \text{e.g. central vs school based costs} \).
- Implement coding structure changes indicated by your strategy. Strategy always involves drawing distinctions between this and that "chunk of something." For example, once market segments are defined, they need to become part of the coding structure that gets carried into transaction detail. Or, if a strategy involves growth beyond current core business and a metric like "% of total profit from non-core business growth" is added to the "Main Things" Scorecard, then Finance needs to find a way of implementing that distinction in the basic computer system. Often these distinctions will dictate changes in the Chart of Accounts. \( \text{What changes could you make to measure strategic use of district and school resources?} \)

Finance has a role early in the implementation phase of a new strategy to systematically identify and execute all such changes either as part of its own strategic initiative or as steps in corporate-wide initiatives.

| C. Assures cash availability and rations capital. |

Finance has a function of assuring long-term cash availability that is essentially just an extension of its short-term function. Successful development of strategy requires a clear understanding by the strategic planning team of future capital limitations perceived by Finance. If the strategy being formulated exceeds those limitations, the need for additional sources of capital becomes itself a strategic issue and an iterative process of considering strategic alternatives begins. Finance must be prepared to offer reasonable assumptions for these alternatives based on prior understanding and investigation of potential sources of capital.

Finance may need to provide a forecast of short-term cash flow for scheduling a feasible first-year strategic implementation plan. Multi-year cash flow forecasting under various economic
scenarios and related capital rationing are ongoing processes not only necessary for strategic alignment but also mandatory fiduciary responsibilities of Finance. Private and thinly held public companies have the additional dimension of ownership succession and exit strategies to consider. Hopefully, Finance is able to manage estate and income tax liabilities so that they do not become the proverbial "tail that wags the strategic dog."

D. Provides financial analysis of new possibilities

Strategy is concerned with defining direction for the next several years. It involves broad-brush consideration of new product and market opportunities and new internal capabilities. Normally, the strategy formulation phase ends with only directional commitments to certain types of opportunities that make sense strategically. Further pursuit of these opportunities is part of the implementation plan. Where investment is involved or multiple alternatives exist, Finance will exercise its normal evaluation role, which should consider not only the project's financial return but also its alignment with the overall strategy.

{How do you make sure finance is involved early enough in the process when districts are looking at instructional strategy investments? What analysis can you bring to bear?}

New venture innovation is likely to be crucial to your strategy. Finance should view the innovation process as a portfolio of opportunities at various stages of development and diverse probabilities of success. A step-wise "option" evaluation technique for early stage developments is called for rather than premature use of a traditional investment project ROI approach. For strategic alignment, Finance may need to "change its stripes" and do its part in fostering a nurturing culture where innovation is encouraged by the recognition that the ultimate failure is to never fail.

E. Contributes general analytical and financial perspective to the planning and ongoing management processes

Kaplan and Norton state that "a strategy is a set of hypotheses about cause and effect."

In order to contribute to alignment on either the input or the output side of strategy, you must have a firm grasp of the major, time-lagged, cause-and-effect relationships that link strategic drivers and Critical Success Factors to strategic outcomes. These relationships largely result from a somewhat subconscious process that simply occurs when one has a synthesizing mind and chooses to become immersed in both the action and the data. Covey would categorize this process as continuous "sharpening of the saw." No other function has a greater responsibility for this never-ending process than Finance.

Sharpening of the saw also applies to simple accumulation of information without the expressed purpose of establishing linkages. Formulation of strategy is a creative process that requires information from everyone involved as its primary raw material. For Finance this requires intentional participation with customers {Schools and academic side leaders} and
other outside stakeholders to break out of its natural, internally focused comfort zone.

Dropping to a less esoteric level, here are some final strategic alignment suggestions for Finance:

- Train Finance personnel to be positive, strategic thinkers. This is the best way to overcome any "bean-counter" stigma that may linger in your organization and undermine Finance's strategic contribution.
- Know where the return on investment is being made — which customers, products, applications, markets, locations etc. — and share that knowledge.
- Recognizing that strategy is cross-functional, use measures that do not perpetuate "silo" perspectives.
- Promote incentives, both financial and non-financial, that motivate alignment with strategy and, then, generate quality information to make them work.
- Exercise the boldness to respectfully "tell the Emperor he has no clothes." ("The Emperor" may just as likely be a concept or a paradigm as a person.) In other words, find tactful, team-building ways of being intellectually honest.

We have now covered all of the activities of the Financial Function.

So, what are your answers to our original questions? "Can Finance contribute solid input to the development of strategy?" And "can Finance be a major force in the execution of strategy?" Your answer to each question has to be a resounding "YES!" Then, what is your answer to the impertinent question we posed as well — "is Finance's contribution to strategic alignment all that important?" Your proper answer must be "IT IS INDISPENSABLE!" (If you disagree, you are sentenced to reread this article — several times!)

And finally, if you are part of the Financial Function, consider this writer's belief that the single most crucial contribution you can make toward Strategic Alignment in your organization is to —

Set the example — know your organization's strategy, then live it by performing each of your functions, whether routine or strategic, in a highly ethical, competent and proactive manner, so that others are enabled and encouraged to do the same.

Tom Ambler is a consultant with the Center for Simplified Strategic Planning, Inc. He can be reached via e-mail at ambler@cssp.com

© Copyright 2012 Center for Simplified Strategic Planning

http://www.strategyletter.com/CD0503/featured_article.php