PERSONNEL NOTEBOOK
For Your Most Important Resource — The Human Resource
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The Skills of Top Managers
Part VI

In Parts I through V of this subject, we reviewed the first 12 of what *Harvard Business Review* (HBR) identifies as the 13 skills that set top managers apart from others. Those 12 skills were:

1. **Setting Goals That Inspire Others**
2. **Hiring the Best**
3. **Keeping the Best**
4. **Delegating With Confidence**
5. **Managing Your Time**
6. **Managing Teams**
7. **Appraising and Coaching**
8. **Handling Problem Employees**
9. **Dealing With Crisis**
10. **Developing Your Career**
11. **Becoming a Leader**
12. **Strategy**

In this, part VI, we will focus on skill number 13, Mastering Financial Tools.

13. Mastering Financial Tools

Finance can be the major stumbling block for many developing managers. While most managers focus on the art and craft of managing, delegating, goal setting, strategy, and leadership, the discipline and exactness of numbers make finance what many consider to be the only element of management to be a stand-alone, full profession all by itself.

Finance can also be an art and a science. And although “creative accounting” is a subject for many detective movies, the financial professional must often be very creative. As such, this subject could fill four years of college textbooks. We’re not going to reach for that, but we will spend a few issues of ***Personnel Notebook*** on outlining it. If you intend to be a top manager you will at least have to learn to speak this basic language of business.

HBR considers these four topics to be the financial skills of top managers.

1. **Budgeting**
2. **Financial Statements**
3. **Net Value and Rate of Return**
4. **Break-Even Analysis and Operating Leverage**

1. Budgeting

If you are the owner of a small business with few cash resources, a good budget can be the difference between financial success, struggling from week-to-week, or closing the doors. A good budget lets you see in advance whether or not you have the assets to meet your goals. It forces you to realistically plan and set goals and to determine in advance your ability to provide the assets you need to make them happen.

<u>Let's define a budget:</u>

- A budget is the interpretation of your strategic plans into measurable quantities that identify the expected resources required and anticipated returns over a certain period.
- A budget also functions as an action plan.
- In many cases it may actually be the estimated future financial statement of the organization.

<u>What are the functions of a budget?</u>
Budgets perform four basic functions:

A. Planning
B. Coordinating
C. Communicating
D. Monitoring Progress
E. Evaluating Performance

Planning
Planning is a three-step process that consists of:

<u>Choosing Goals</u> — Your goal might be to "Provide the most efficient and creative services in the industry to our clients," or "Increase our revenues by 10 percent in the coming year," Or, they may be as specific as, "To capture the Acme Gigantus Corporation as our client within 12 months."

<u>Reviewing Options and Predicting Results</u> — Once goals are established, you need to determine the costs and benefits of each goal. Then, explore all the options you might use for attaining the goal. You will also want to predict the most likely and realistic outcome of each option. For example, if your goal were to increase revenues by 10 percent next year, you might consider raising your prices. So consider how much and on which products and what the total gain will be. Then predict the likely loss, if any, of losing some of your customers as a result.

<u>Deciding on Options</u> — Once the goals have been determined and the options have been weighed, the next step is to decide which of the options considered, will be used. When that has been decided, your budget must be aligned to produce those options.

Coordinating
The various activities, marketing, research, design, production, purchases, materials, etc. must all individually be identified and budgeted. Each element of the budget must then be brought together. This will be your master budget. And it will also be the organizations overall strategic plan.

Communicating
Communication is essential! Upper management needs to communicate the company's strategic plan to all levels of the organization. This includes departmental as well as individual goals. Each department must know its budget. Each individual should know the part he/she plays in the strategic plan.

Monitoring Progress
Once the plan has been set in motion, the budget becomes a tool that managers can use to regularly monitor the progress. By comparing the actual results with the budget expenditures and timetables the company and each team can be prepared to take timely corrective action if things seem to be straying. For example, if raising your prices causes customer resistance, knowing this in time might allow you to offer customers bonus packages.

Evaluating Performance
Each section of the company will have someone in charge of that specific part of the budget and the results. Managers who make planning and action decisions should be held accountable for their progress. This is how the goals are achieved, by monitoring the progress incrementally, letting everyone know how they are doing, and making adjustments as needed.

These performance evaluations serve many purposes:

- They motivate employees through reward systems based on performance.
- They provide the basis for compensation decisions, future assignments, and career advancement.
- They create a basis for future financial allocations.

There are many who feel that the traditional one-dimensional budget no longer serves the needs of a modern, growing organization. Critics complain that budgets are either for too long or too short a period or that they do not set realistic measurements, are too simplistic, or not very challenging. Some feel that the bar is set too low so that managers can hit their targets easier for bonuses. Here are some of the various types of budgets developed to address some of these difficult issues:

Types of Budgets

- Short-Term Versus Long-Term
- Fixed Versus Rolling
- Incremental Versus Zero-Based
- Kaizen

Short-Term Versus Long-Term Budget
Budgets are generally for a one-year period. But in many circumstances, such as a company attempting to develop a new product over a five-year period, it may be better to assign a five-year budget to it. If, on the other hand, a company is living hand-to-mouth, which is often the case with a start-up company, a month-by-month budget that focuses on immediate cash flow, may be more useful.

Fixed Versus Rolling Budget
This interesting concept begins with a typical annual budget, but at the end of every month, the managers update the results and adjust the budget accordingly, creating a new budget for the next month. This way they always keep a 12 month budget ahead of them.

The advantage is that it requires managers to re-evaluate actions as the conditions or markets change. Practitioners state that the budgets are more accurate and produce better results. The disadvantage is that the process can become too time consuming. Critics also say that even on a one-year budget, a quarterly review done properly will bring out needed changes, and the budget variances can be put in place.

Incremental Versus Zero-Based Budget
Incremental budgeting is most often used in large corporations and particularly in governments where the size of the budget and its increase is a measure of power and authority. The manager merely takes last year's budget and increases it by a percentage large enough to accommodate pay increases. The advantage is that the original planning has already been done and this is the most efficient method to do next year's budget. The disadvantage is

that it's a guarantee of an ever-increasing budget with no consideration for higher productivity or efficiency resulting from more experience and/or technology. It also tends to make the entire process somewhat more bureaucratic.

Zero-Based budgeting is a method where each new cycle (fiscal year or period), begins anew by starting over from zero. Each expenditure must be validated and critiqued and possibly altered or deleted. Each goal and assumption is re-evaluated.

The advantage to Zero-Based budgeting is that it requires managers to perform a much more in-depth analysis of each goal, expenditure, and line item. It keeps the strategic plans current with changing events and opportunities and also keeps the ideas fresh and updated in everyone's mind. The disadvantage is that although it is much more analytical and thorough, it can be repetitive and time consuming.

Kaizen Budgeting

Kaizen budgeting is a Japanese term meaning "continuous improvement." It is focused on cost reduction on a scheduled basis. For example, if a manufacturing process costs $2,400 each month, the Kaizen budgeter might determine that the process should be reduced to $1,200 by the end of the year. So the amount allocated (budgeted) will begin in the first month at $2,400 and be reduced in the second month to $2,300 and in the third month to $2,200 and so on, until after the twelfth month the cost is expected to be down to the budgeted $1,200 per month.

In our next issue of ***Personnel Notebook*** we will look at preparing the Master Budget as we continue to review skill number 13 "Mastering Financial Tools."

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