Beyond Budgeting Implementation Lessons

Mike De Luca
Lean Accounting Summit
October 21, 2014

Objectives

Discuss:
- Ways to align your financial planning processes and tools with your Lean initiatives and management system.
- The before/after story of Beyond Budgeting implementation illustrated with specific model examples.
- The importance of examining organizational readiness and the role of leadership commitment and understanding.
- Ways that the Finance function can enhance its effectiveness and relevance in supporting the Lean enterprise improve customer value.
The Story

- Three Chapters:
  1. Evolving the financial planning function in support of Lean operations
  2. Evolving the financial planning process
  3. Evolving the operation of the financial planning function to a Lean management system

- Today's focus is on Chapter 2

Background

- Group Health
  - Integrated care delivery & insurance
  - 600,000 insured
  - $3.5 billion annual revenue (mostly premium)
  - 9,000 FTE
  - 25 medical centers (multispecialty)
  - Began Lean implementation in early 2000s
Chapter 1 – Supporting Lean
The Case for Change

- Primary Care Lean Redesign
  - Required Finance collaboration and consultation:
    - Data/analysis for and participation in process improvement workshops
    - Measurement systems and visual management
    - Linked checking of frontline process to organizational results

Chapter 1 – Supporting Lean
Finance Response

- Created capacity to take on new work in support of Operations’ Lean redesign:
  - Employed customer value-focused tool to evaluate all recurring reports.
  - Eliminated, streamlined and in some cases enhanced reports; freed up 20% of department’s capacity.
  - Developed (in-house) and delivered training to Finance staff: “Finance in a Lean World”
    - Role of Finance (“Real Numbers” – Cunningham/Fiume)
    - Consulting skills (“Flawless Consulting” – Block)
    - See and measure process; linked checking of outcomes
    - Standards and standard work
Chapter 2 – Beyond Budgeting

Case for Change

Traditional planning (budgeting) process is out of synch with a Lean organization:
- Fixed calendar-year timeframe doesn’t support financial planning for ongoing process improvement and timing of results
- Inefficient, resource-intensive process
- Product of minimal value (budget variances vs. 5-why problem solving – root cause analysis – of process/outcome variances)

Beyond Budgeting provides alternatives that fit well with the Lean organization:
- Unbiased, driver-based rolling forecasts provide needed insight into magnitude and timing of process improvement impact
- Target setting is aligned with top-level financial goal – True North – vertically aligned through driver metrics, not disaggregation, and managed through linked checking
- Resource allocation aligns with Hoshin planning
- Tools support root cause analysis of variances
- Process is efficient and low resource intensity
## Chapter 2 – Success Rolling Forecasts

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<thead>
<tr>
<th>SITUATION</th>
<th>APPROACH</th>
<th>RESULTS</th>
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<tr>
<td>The annual budget process consumed thousands of hours of staff and manager time without providing a valuable management tool.</td>
<td>Eliminated the detailed calendar-year labor and expense budget. Replaced with driver-based rolling forecasts done (typically) on a quarterly basis.</td>
<td>Time spent: Thousands of hours of budget preparation time reduced to less than 40 hours per quarter. Accuracy: Accuracy of ±1% maintained. Level of detail: Lines of detail reduced from &gt;14,000 to 8.</td>
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## Chapter 2 – Forecasts “Mind your Ps and Qs”

- **Forecast = P × Q**, where
  - Q = quantity
  - P = price
- Examples:
  - Q: FTE, Rx fills, lab tests, surgeries
  - P: Cost per unit of Q

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Chapter 2 – Forecasts

Example

Notes

- Timeframe & frequency based on business requirements (not rigid)
- Inputs to drivers (some examples)
  - Improvements to throughput, staff mix, volume assumptions, changes in market conditions, new products/technologies
- Base case (status-quo) vs. scenarios
- Model back-testing and PDCA
Chapter 2 – Success
Target Setting

- Enterprise-level: margin, days cash
- Front line improvement measures (examples):
  - Pharmacy productivity (P, Q)
  - Clinical staff ratio and mix (P)
  - Operating room utilization/turnover (P, Q)
  - Lab test ordering (P, Q)
  - Defect reduction (P, Q)
- Link front-line outcomes to enterprise goals – unified daily management system

Chapter 2 – Target/Forecast Pitfalls
Beware the wolf in sheep’s clothing

- A target may still be a budget in disguise—Does it meet these three attributes?
  - Dynamic
  - Relative
  - Commonly accepted
- A forecast may simply be a budget re-framed and run more frequently
Chapter 2 – Forecast Pitfalls

- Divisional and enterprise forecasts are not clearly incorporated into checking and planning processes.
- In general, the roles and uses of the forecast are not clear.
- Forecasting processes and tools do not exist below the divisional level, or are not aligned with enterprise goals, or are not capable.
- The forecasting process does not have the flexibility to handle what-if scenarios or alternate timing as driven by business needs.

Chapter 2 – Success

Root Cause Analysis “5-why”

- Problem = Target/actual/gap
- Make problems visible through target setting that supports organizational goals
- Shift from traditional “budget variance” analysis to Lean 5-why problem solving
- Statistical tools (e.g. control charts) make problems visible in more complex systems
### Chapter 2 – Example 5-why

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<tr>
<th>SITUATION</th>
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<tbody>
<tr>
<td>Staffing levels were over-target on a sustained basis.</td>
<td>Root cause analysis of gap to target. Process walk the staffing process. Redesign the staffing process and adjust the staffing model.</td>
<td>Expense: Staffing expense consistently under target. Quality and safety: High quality maintained. Staff satisfaction: Staff felt more supported by the new staffing model.</td>
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<tr>
<td>Claims expense increased suddenly and dramatically. The annual impact, if sustained, would have been a $150 million increase.</td>
<td>Root Cause analysis (&quot;5-why&quot;) of the increase in expense using statistical tools and control charts. Identify causes at the process level where countermeasures or changes could be implemented.</td>
<td>Identified material causes for 90% of the observed increase in expense. Implemented countermeasures that immediately addressed the top 10%, and process changes for remaining material causes.</td>
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</table>
Chapter 2 – Pitfall

Performance Drivers

- Understanding of how processes and front-line performance drive organizational financial performance is inconsistent or lacking.
- Lean management system is not evolved to the point where it can support vertical alignment of drivers and financial outcomes.
- Operations management does not accept process measures such as productivity and unit cost as key drivers of enterprise financial results.

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Chapter 2 – Pitfall

Commitment, Communication, Accountability

- Commitment to implementation is uneven vertically or horizontally.
- Expectations are not clearly communicated at all levels and reinforced through Lean management system checking processes.
- Processes and tools to check accountability are not in place, or if they are in place, they are cumbersome, not commonly understood and not adjusted as necessary.
- Processes to check and assure understanding on an on-going basis do not exist (gemba walks).

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### Chapter 3 – Thumbnail
The Lean Finance Function

- Identify and improve key processes:
  - Production
  - Consulting
- Establish standards on training and development; create capacity for development and R&D

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### Chapter 3 – Thumbnail
Production Process

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<td>The Finance team needed to improve turn-around time on new requests and more effectively align daily work with company priorities.</td>
<td><strong>Process Map</strong> of the department production process. <strong>Improvement</strong> of each phase of the process: intake, prioritization, assignment, delivery. <strong>Visual management</strong> of all work and capacity in the department.</td>
<td><strong>Efficiency:</strong> Work across the department was levelled. Timeliness and quality of products improved. <strong>Prioritization:</strong> Work was prioritized based on company strategic goals and regularly checked with end-users. <strong>Staff satisfaction:</strong> Staff skills and talents were better utilized in their daily work.</td>
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Chapter 3 – Thumbnail Production Process

- Standard intake of all work
- Collaborative review of prioritization with clients
- Flexible assignment of work based on capacity, skill and interest
- Resource, capacity and progress management
- Peer review
- Example Outcomes:
  - Better alignment of work with skills and capacity
  - Increased efficiency – improved quality and timeliness of delivery
  - Improved staff engagement
  - Greater visibility of work-in-progress: status, capacity, roadblocks and alignment with enterprise priorities

Production Capacity Management Tool Example

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Chapter 3 – Thumbnail Consulting Process

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<th>FINANCE</th>
<th>OPERATIONS</th>
<th>CUSTOMER</th>
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<tbody>
<tr>
<td>Production</td>
<td>Consulting</td>
<td>Improve</td>
</tr>
<tr>
<td>Produce reports, tools, analyses, pro formas</td>
<td>Create clarity and understanding</td>
<td>Improve customer facing products and processes</td>
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Chapter 3 – Thumbnail Training and Development

- Peaks and Foothills Model
- Statistics
  - Statistical process control, control charts and outlier tests
  - Association and regression analysis
  - Populations, samples and measuring differences
  - Monte Carlo simulation
- Forecasting
- Root Cause Analysis/5-Why Thinking
- Business Case Analyses
  - Incremental cost/benefit analysis
  - Discounted cash flow
Conclusion

- Implementation of Lean as an improvement methodology as well as a planning process and corporate leadership philosophy sets the stage for an evolution of the Finance function.
- In a Lean organization, the role of Finance evolves. Along with the role of Finance, both processes and tools need to evolve as well, as do the capabilities and competencies of the individuals and teams in these functions.
- Beyond Budgeting is part of the evolution of Financial Processes and Tools to support the Lean or continuous improvement organization, not an end unto itself.

Questions?

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  206.465.9077
  www.torre-consulting.com
Selected Readings

- Better Thinking, Better Results: Case Study and Analysis of an Enterprise-Wide Lean Transformation, Bob Emiliani et al
- Flawless Consulting: A Guide to Getting Your Expertise Used, Peter Block
- Future Ready: How to Master Business Forecasting, Steve Morlidge and Steve Player
- Implementing Beyond Budgeting: Unlocking the Performance Potential, Bjarte Bogsnes
- The Leader's Dilemma: How to Build an Empowered and Adaptive Organization Without Losing Control, Jeremy Hope, Peter Bunce, Franz Rööslı
- Real Numbers: Management Accounting in a Lean Organization, Jean Cunningham and Orest Fiume

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