

Budget and Aggregate Metrics

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The Delta Model - The Complete Framework

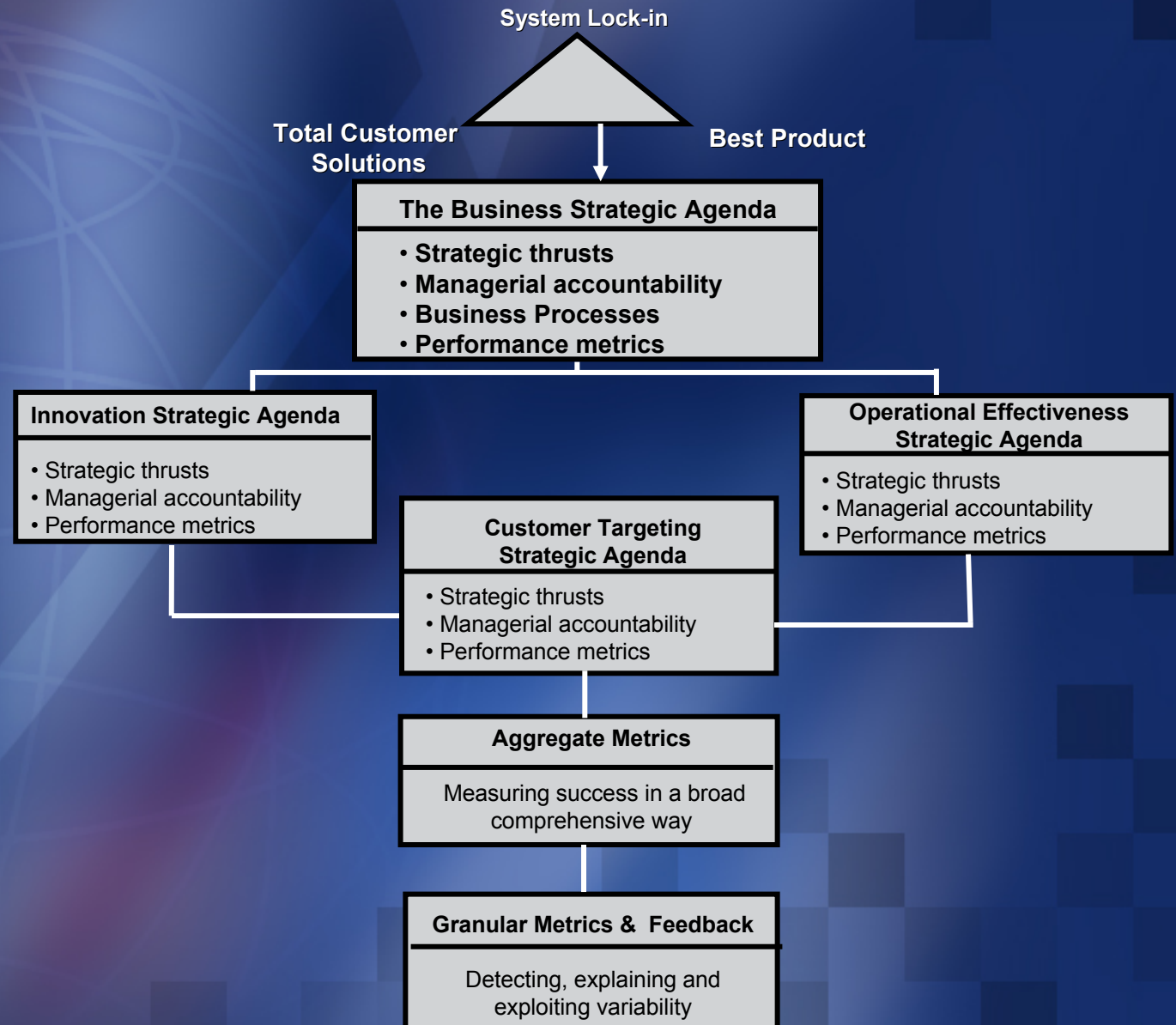
1. The Triangle- choosing the strategic position

2. The business Strategic Agenda-translating strategic positioning into execution

3. The Adaptive Processes- translating execution into concrete tasks

4. Aggregate Metric- the overall scorecard of business performance

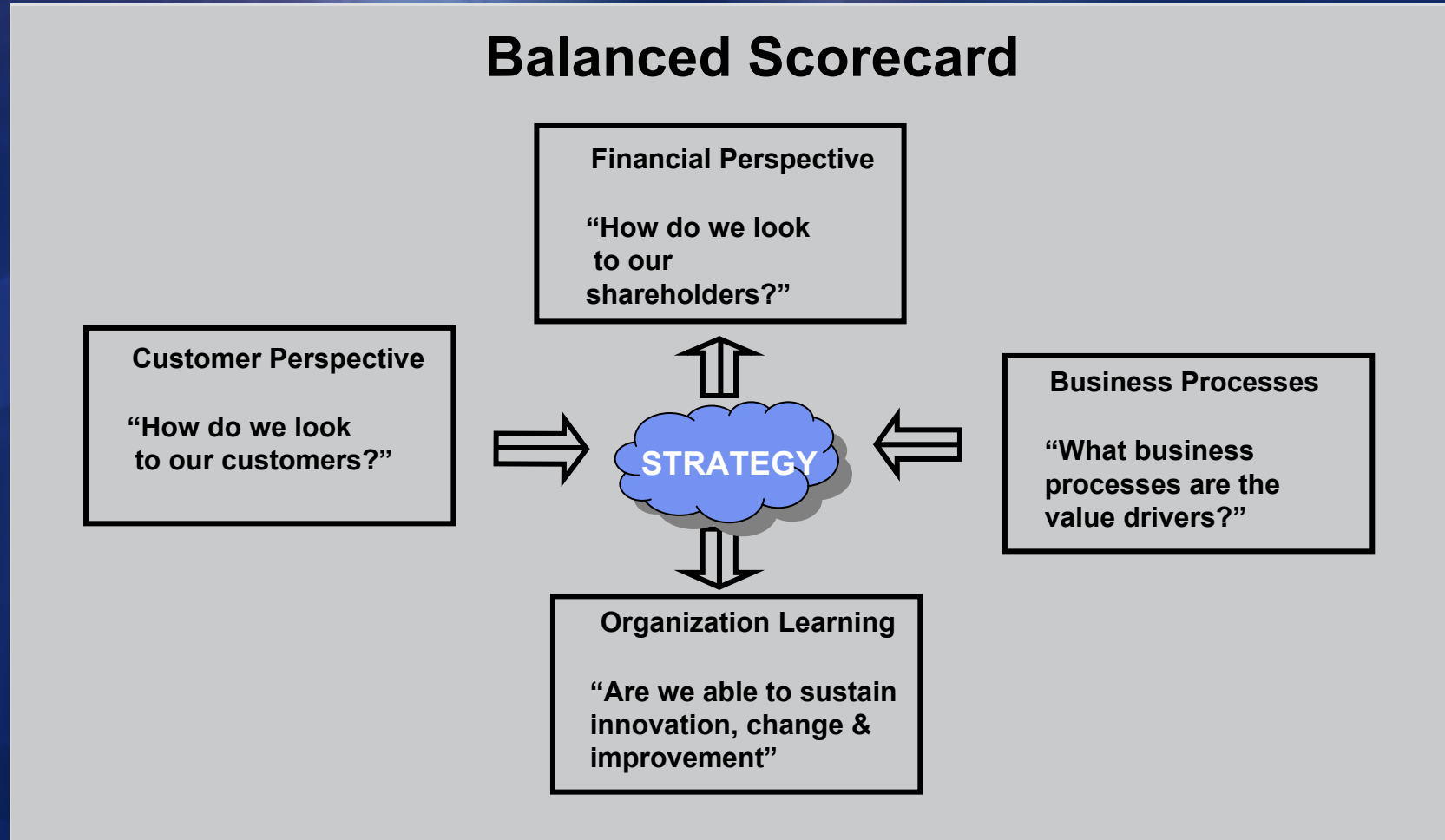
5. Granular Metrics- de-averaging, explaining and exploiting variability



Performance Metrics for the Business Drivers of the Delta Model

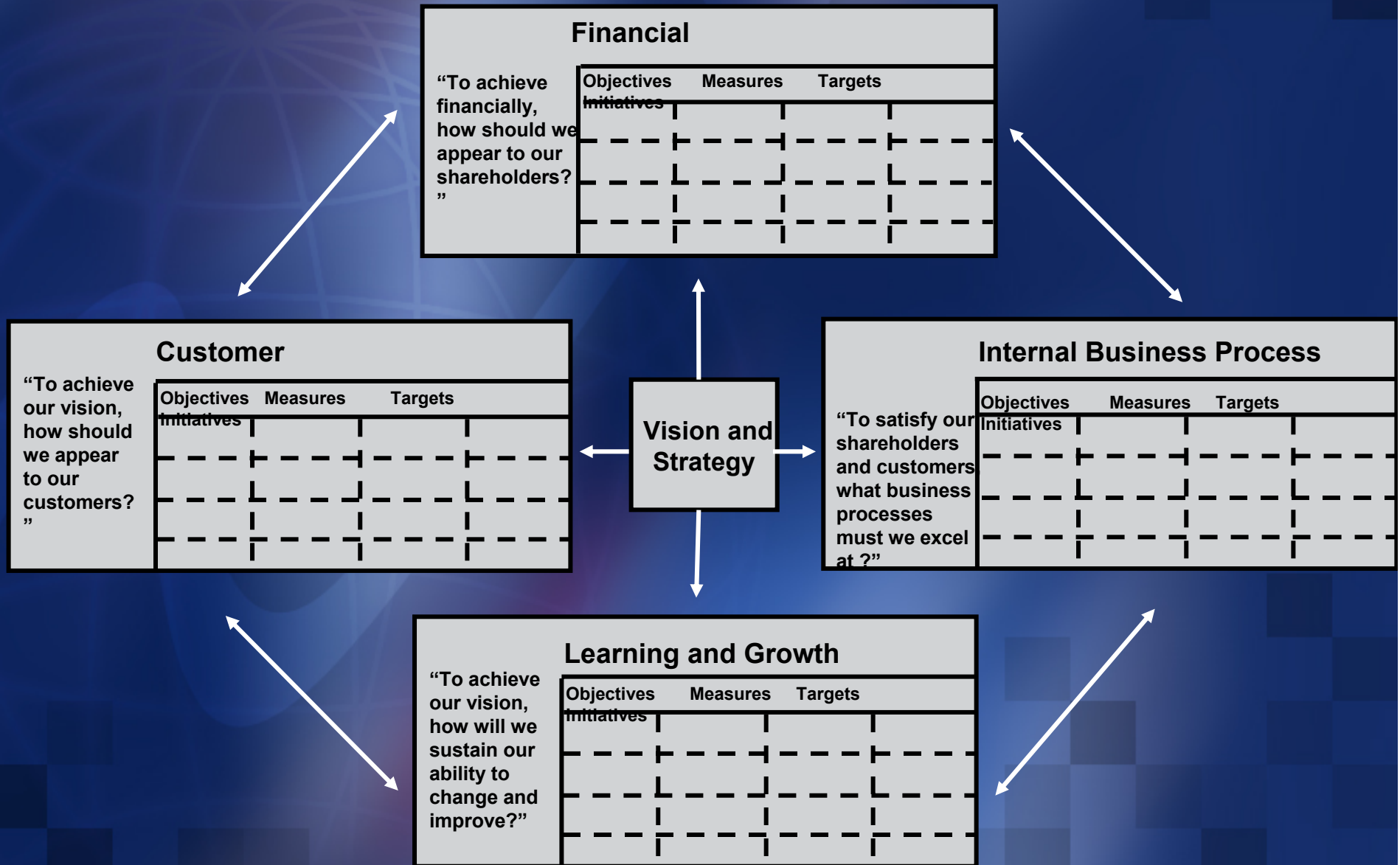
	Best Product	Total Customer Solutions	System Lock-In
Operational Effectiveness (Cost Drivers)	<ul style="list-style-type: none"> • Cost performance <ul style="list-style-type: none"> - Unit cost - Lifecycle cost - Variable and total cost • Cost drivers • Quality performance • Degree of differentiation 	<ul style="list-style-type: none"> • Customer value chain <ul style="list-style-type: none"> - Total cost - Total revenue and profit ▪ Customer economic drivers • Impact on customer profit due to our service vs. competitors 	<ul style="list-style-type: none"> • Description of system infrastructure ▪ Total system costs/revenues ▪ Complementor's investments and profits • Complementor costs of adhering to your standard • System performance drivers
Customer Targeting (Profit Drivers)	<ul style="list-style-type: none"> • Product market share • Channel cost • Product profit <ul style="list-style-type: none"> - By product type - By offer - By channel • Profit drivers 	<ul style="list-style-type: none"> • Customer share ▪ Customer retention ▪ Our profitability by customer <ul style="list-style-type: none"> - Individual and by segment • Customer bonding <ul style="list-style-type: none"> - Switching costs 	<ul style="list-style-type: none"> • System market share ▪ Our share of complementors <ul style="list-style-type: none"> - % of investments tied to our proprietary standard • Our profit by complementor
Innovation (Renewal Drivers)	<ul style="list-style-type: none"> • Rate of product introduction • Time to market • Percent of sales from new products • Cost of product development • R&D as % of sales 	<ul style="list-style-type: none"> • Relative involvement in customer value chain ▪ Percentage of product development <ul style="list-style-type: none"> - From joint development - Customized • Degree of product scope <ul style="list-style-type: none"> - Current vs. potential bundling 	<ul style="list-style-type: none"> • Switching costs for complementors and for customers ▪ Rate of product development • Cost of competitors to imitate standard

The Balanced Scorecard Provides A Framework To Translate A Strategy Into Actionable Terms



Kaplan and Norton's "Four Perspectives"

As a "Balanced Scorecard"²



Measures of Performance Related to the Financial Strategy

Capital Market Indices

- **Capital market indices** oriented at representing an external assessment of the economic performance of the firm in relation to key competitors, through a variety of popular and widely watched indicators such as: price earnings ratio (P/E), dividend yield (dividend-price ratio), earnings per share (EPS), market-to-book (M/B), and many others.

Profitability Measures

- **Profitability measures** being the most widely used: return on assets (ROA), return on equity (ROE), return on investments (ROI), and sales margin. It is important to observe the capability of the firm to earn a profit above its cost of capital. These measures can be contrasted with the firm's competitors to judge the firm's performance against its industry.

Risk

- **Risk** measured in terms of beta leverage (debt/equity) or bond rating, for example

Cost of Capital

- **Cost of capital** for both debt and equity, and other meaningful weighted average combinations of them

Growth

- **Growth** off assets, earnings, sales, investment opportunities, and whatever is considered relevant for the firm

The background is a dark blue gradient. On the left, there is a faint, light blue wireframe globe. A large, semi-transparent blue arrow points diagonally upwards from the bottom left towards the top right. In the bottom right corner, there is a faint, light blue bar chart with several bars of varying heights. The text 'THE BUDGET' is centered in the middle of the image.

THE BUDGET

Budgeting and Strategic Funds

Strategic funds are expense items required for the implementation of strategic action programs whose benefits are expected to be accrued in the long term, beyond the current budget period.

There are 3 major components of strategic funds:

1. Investment in tangible assets, such as new production capacity, new machinery and tools, new vehicles for distribution, new office space, new warehouse space, and new acquisitions.
2. Increases (or decreases) in working capital generated from strategic commitments, such as the impact of increases in inventories and receivables resulting from an increase in sales; the need to accumulate larger inventories to provide better services; increasing receivables resulting from a change in the policy of loans to customers, and so on.
3. Development expenses that are over and above the needs of existing business, such as advertising to introduce a new product or to reposition an existing one; R&D expenses of new products; major cost reduction programs for existing products; introductory discounts, sales promotion, and free samples to stimulate first purchases; development of management systems such as planning, control, and compensation; certain engineering studies, and so on.

Splitting the Profit and Loss Statement of a Division in Terms of Operational and Strategic Expenses

	Conventional Statement	Operational Expenses	Strategic* Expenses
Net sales	100	100	-
Less:			
Variable mfg. costs	30	30	-
Depreciation	20	20	-
Other fixed mfg. costs	<u>10</u>	<u>5</u>	<u>5</u>
Gross margin	40	45	-
Less:			
Marketing expenses	15	5	10
Admin. expenses	10	5	5
Research expenses	<u>5</u>	<u>0</u>	<u>5</u>
Division margin	10		
Operating margin		35	
Total strategic expenses			25

* Also called Development Expenses

Strategic Funds Programming and Operational Budgets — An Illustration

	History					Current Year		Projections			
	1988	1989	1990	1991	1992	Actual	Budget	1994	1995	1996	1997
Total Market	4,032	4,994	5,822	6,722	7,820	0	9,266	11,120	13,123	16,012	19,312
Market Share (%)	52	51	52	49.0	49	0	49	50	50	51	52
Company Sales	2,083	2,568	3,002	3,316	3,799	0	4,502	5,522	6,577	8,123	9,966
— Operating Cost of Goods Sold	1,789	2,138	2,499	2,771	3,165	0	3,760	4,612	5,492	6,789	8,336
Gross Operating Margin	294	430	503	545	634	0	742	910	1,085	1,334	1,630
— Operating SG&A	62	103	110	121	138	0	162	199	241	295	366
Operating Margin	232	327	393	424	496	0	580	711	844	1,039	1,264
— Strategic Expenses	130	165	204	213	251	0	321	396	497	626	789
SBU Margin	102	162	189	211	245	0	259	315	347	413	475
— Taxes	5	18	23	27	32	0	35	43	56	70	93
SBU Net Income	97	144	166	184	213	0	224	272	291	343	382
+ Depreciation	18	21	26	32	38	0	46	56	67	82	100
— Capital Investments	32	57	87	128	115	0	150	195	169	202	183
— Increases in Working Capital	0	0	0	0	0	0	0	0	0	0	0
Contribution/Request of Funds to the Corporation	83	108	105	88	136	0	120	133	189	223	299