The plan ahead: Creating an effective financial planning process
All businesses, irrespective of their size and maturity, need financial plans—a decision-making process and tool that enable management and investors to assess results and set targets for growth. Just as a pilot would never fly from New York to Los Angeles without a flight plan, a business needs a clear, delineated guide to get to its destination.

Because each company has its own route—a set of goals and a unique market presence and opportunity—no two financial plans are alike. A company, thus, either needs to create one of its own or tailor a generic plan to fit its needs. In doing so, a company faces a challenge in determining the key elements that will make up its specific financial plan and then in setting a systematic process to monitor and follow that plan. A large or more diverse company will face an additional challenge in needing to consolidate disparate financial plans and present a consolidated view to headquarters.

Companies can benefit from taking a measured, systematic approach to creating a financial plan. The first step involves setting goals. Next, companies must consider and evaluate external factors—including the regulatory and competitive landscape—and identify and analyze pertinent metrics. A key part of the plan involves creating a budget, a systematic process that encompasses all functions and is flexible so that managers can adjust it during the year to adapt to internal and external changes. Budgets quantify future expectations and actions, and provide benchmarks against which managers can compare results and develop corrective measures. This process is critical to the success of any organization. It provides rigor and confirms that a company’s objectives are achievable from a financial point of view. It also helps management guide the company and provides detailed financial information to investors and creditors.
The role of a financial plan
Financial plans can be a critical tool for any company. They help link a company’s daily operations to its mission and both its short- and long-term goals. These plans help management define the steps needed to attain benchmarks that will enable it to reach those goals. At the same time, financial plans provide investors with a roadmap for how companies will grow and mature. Financial plans can be motivating, a mechanism for rallying employees to hit targets and benchmarks. They also can be sobering, revealing if a goal is not attainable or providing insight into what adjustments companies have to make—cost-cutting, divestment, and so forth—to reach specified targets.

While large businesses need financial plans to inform management and investors, these plans are not solely for large companies. Private enterprises on the cusp of going public need financial plans to provide investors with visibility of both their financial rigor and goals. Even small companies—family businesses as well as the so-called mom-and-pop operators—can benefit from having a structured, measured approach to running and growing their businesses.

Some companies—such as GE—have more than one financial plan. Some are long-term growth playbooks, complete with specific tollgates, where managers can measure if and when a business unit will hit a specified target. Other financial plans are shorter term, such as GE’s annual operating plan. Without such plans, any business would not be able to measure accurately whether they have failed or succeeded in running their business—or whether venturing into a new area was productive or destructive.

The result of a financial plan may mandate that a company change its capital structure. For example, a financial plan might underscore that a company needs to reduce its debt and raise equity, or take on more debt to fuel expansion. It also will provide management with guidance on whether it needs to generate more cash. In addition, a financial plan will provide insight into whether a company will be compliant with its debt agreements.

Establishing a plan
Financial plans start from the ground up. Management begins the planning process by setting goals. The next step involves gathering insights and information from all areas of the business to understand its competitive position in its particular market segment. Management then can focus on internal and external factors, enabling it to create a base from which to forecast revenue and profits. The results will enable management to create a budget as well as to think strategically about matters from cutting costs to penetrating new markets.

Setting goals
The financial planning process typically kicks off with a company establishing its goals. These goals may be numeric—such as profit, return on investment, net income, and so forth—or they may be qualitative—such as achieving a leadership position in a particular market segment, gaining market share, or increasing brand awareness. Setting clear, measurable goals is crucial to the success of a financial plan.

GE’s annual strategic and financial planning process takes both a long-term and a short-term view in setting direction, including periodic checkpoints to assess progress against targets.
market share. They also can be abstract, such as product leadership or product diversification. For some companies a viable goal may be to double profits; for others a goal may be returning to the black. For some, survival, or simply staying in business, is the goal. Typically, companies first set general goals, which are directional in nature and include training managers, maintaining product quality, or being the low-cost producer. Then, companies set more specific goals.

Larger companies typically develop a hierarchy of goals—starting at the corporate level and cascading to the strategic business unit level and then the functional level. For example, a company might set goals in which the chief executive is responsible for a 25 percent ROI and growing earnings per share by 12 to 15 percent a year. Meanwhile, at that same company, a strategic business unit manager might be in charge of increasing market share by 2 percent and introducing five new products. At the functional level a production manager might be looking to reduce absenteeism, reduce spoilage by 2 percent and meet production quotas. All subgoals come from upper-level goals and help all employees stay on track and recognize how their work contributes to the company’s success.

**Internal performance metrics**

In the next step of creating a financial plan, management can use its goals to set revenue and profitability targets. In setting these targets, managers can consider not only the company’s goals, but also its market opportunity—how much revenue it can expect to generate. Then it can focus on setting expenses—and making sure expenses are in sync with revenue. This is critical, as many businesses fail when expenses are not in line with revenue.

As a result, management should take a deep dive into an analysis of operating expenses, calculating granular details that are pertinent to the business. For example, companies need to analyze headcount, SG&A as a percentage of revenue or the use of temporary workers. Depending on the business, the analysis could dig even deeper, measuring, for example, platform costs, or cost per headcount. A comprehensive financial plan at a large company may contain thousands of factors and pages of analysis. Ideally, management will want a set of metrics that measure overall business performance and a second set that digs deeper and provides transparency and insight into the efficiency of resources, personnel and business entities.

**External factors**

While internal metrics are somewhat predictable and, thus, can be controlled or adjusted, there are many factors that management cannot plan for, ranging from changes in the competitive and regulatory landscape to financial factors from consumer spending to interest rates. But management cannot ignore these factors because they may have a large impact on their business. As a result, companies need either to designate internal resources to scan for meaningful external developments in these areas or engage outside providers (accounting firms, for example) who specialize in these areas to keep them informed.

Companies also need to perform competitive analyses and benchmarking against leading competitors for insight into how efficiently their own business is functioning. In addition, companies need to deepen their understanding of customer dynamics—including sensitivity to price, shifts in demand for products and services and general spending habits. Finally, in large companies, such as at GE Capital, managers can compare their division’s results with those of other divisions to ensure that their units are operating within a range of acceptable efficiency.
Because small businesses may not have a strong financial history, financial planning and budgeting helps investors or banks thoroughly review the business.

Management may need to update budgets and financial plans regularly to account for unanticipated events.

Though some view budgets with dread and feel that they impose constraints that are hard to live with, a budget is an integral part of a financial plan. Budgets allow managers to provide investors and creditors with forward-looking guidance, and though they do not guarantee success, they certainly can help avoid costly mistakes or failure.

Conclusion
Companies will have varying needs for financial planning and budgeting depending on the type of business and its size. Some will need detailed financial plans, with hierarchical goals and a rigid budgeting process that is established and monitored frequently. Small, independent businesses may need just a bare-bones plan of where they hope to go and how they plan to manage expenses to continue to stay in business.

Regardless of their complexity or size, any business needs a game plan, an articulated step-by-step process of what it hopes to accomplish, how it will manage its resources to get there, and how it can react to factors that it may not be able to control. These plans will provide transparency and detail to owners, investors, and managers—and enable employees to work together to attain targets.

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