

# Meaningful managerial action planning: The financial component

J.G. Kotzé

School of Business Leadership, University of South Africa, Pretoria

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An innovative orientation is a highly desirable characteristic of senior-middle and top management teams in business organizations. The formalized expression of such entrepreneurial flair may be developed in the form of action plans. Such plans consist of five elements, of which one, namely the financial component, is of prime importance. Three categories of action plans are distinguished and the evaluation of the anticipated financial impact of action plans within each category discussed. Finally, the integration of the anticipated financial results of action plans in the formal long- and short-term plans of an organization is described.

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'n Innoverende oriëntasie is 'n baie gesogte eienskap van senior-middel- en topbestuurspanne in 'n bedryfsorganisasie. Die formalisering van sodanige entrepreneurskap mag in die vorm van aksieplanne geskied. Hierdie planne bestaan uit vyf elemente, waarvan een, naamlik die finansiële komponent, van die aller grootste belang is. Drie kategorieë van aksieplanne word onderskei en die evaluasie van die verwagte finansiële impak van aksieplanne wat binne elke kategorie ressorteer, bespreek. Laastens word die integrasie van die verwagte finansiële resultate van aksieplanne in die formele lang- en korttermynplanne van 'n organisasie beskryf.

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## Introduction

In recent years several management theorists<sup>1,2,3</sup> have emphasized the importance of innovative entrepreneurial action thinking in any organization. Although such an orientation is tacitly expected from every member of an organization, it is rapidly becoming a formal requirement of all senior-middle- and top-managerial positions. The intellectual, entrepreneurial ability of these executives to initiate present action aimed at capitalizing on predicted favourable trends and to minimize the impact of unfavourable trends; to improve on an existing situation, whether favourable or unfavourable; and to timeously adjust organizational operations to deal with unanticipated environmental changes constitute important elements of their performance.

Undirected entrepreneurial action can, obviously, be dysfunctional. The process should, therefore, be continuously triggered by and directed and co-ordinated within a formal framework of planning and control systems. For an exposition of such a framework, the interested reader is referred to Schutte.<sup>4</sup>

This article illustrates the formal expression of innovation action in the format of an action plan. One element, namely the financial component, is analysed in greater detail and the integration of the anticipated financial results of approved action plans in the formal long- and short-term plans of the organization is described.

## Format of action plans

An action plan should encompass the following five major elements:

- the objective of the planned action should be stated in operational terms;
- the successive steps to be taken to ensure achievement of the objective should be detailed;
- the responsibility structure involved in the execution of the steps must be stated;
- the target dates for the completion of every step must be determined;
- the estimated financial impact of the proposed action must be evaluated.<sup>5</sup>

These elements can be combined in the general format as depicted in Table 1.

The financial component is vitally important as this instills the discipline of thinking a proposed course of action through in a logical sequence. It is, also, normally the most difficult element in formal action planning. This component is therefore analysed in greater detail in the remainder of this article.

This analysis can be carried through more meaningfully in

J.G. Kotzé

School of Business Leadership, University of South Africa,  
P.O. Box 392, Pretoria 0001, Republic of South Africa

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**Table 1**

Action plan no.: .....		
Objective: .....		
.....		
Steps	Responsibility	Completion dates
.....	.....	.....
.....	.....	.....
.....	.....	.....
Anticipated financial impact		R .....
.....		.....
.....		.....
Net financial impact		R .....

a framework of the major classes of action plans. Accordingly, a classification of the different types of action plans which might be encountered in an organization is developed in the next section.

### Classification of action plans

The objective of action plans may be to improve on the anticipated results of the financial year in which the entrepreneurial action is being instituted. In this case, the predicted financial impact of the action plan is not expected to extend beyond the financial year end. The anticipated financial impact of other action plans may affect the results of several future financial periods. Some action plans require an operating expenditure while others necessitate a capital investment.

In Table 2, action plans are classified utilizing the concepts of short versus long term and operating expenditure versus capital investment.

**Table 2**

	Operating expenditure	Capital investment
Present financial year	A	C
Present and future financial years	B	

### Category A

Action plans in this category normally require a relatively small operating expenditure with the objective of achieving some level of cost savings and/or some increase in revenue in the remaining portion of the financial year.

The approval level of these action plans is usually relatively low in the organizational hierarchy.

The extent of financial analysis required for the approval decision is limited.

### Category B

Action plans in this category normally require relatively large operating expenditures with the objective of achieving cost savings and/or increases in revenue in the remaining portion of the financial year as well as in succeeding financial years.

The approval level of these action plans is typically higher in the hierarchy than the Category A levels due to the larger

amounts of expense involved.

As the financial impact is expected to extend over several financial years, more sophisticated financial analysis than in the case of the Category A plans is required for the approval decision.

### Category C

Action plans in this category require a capital investment outlay. Additional land, buildings, equipment and/or vehicles have to be obtained to meet the objectives of these plans. The amounts required might be relatively small (for example, the purchase of a delivery vehicle) or quite large (for example, extensions to productive capacity).

The anticipated financial impact of action plans in this category always extend over more than one financial year. The approval level of the majority of action plans in this category is usually high in the organizational hierarchy. In the case of major capital investments, the approval level is usually the board of directors.

Very comprehensive financial analysis is usually required for Category C action plan proposals.

The quantification of the expected financial results of these three classes of action plans may differ in the degree of detail required as well as in the appropriate method of analysis to be employed.

### Quantifying the anticipated financial result

In Table 3, an action plan developed in an automotive component company,<sup>6</sup> illustrates the required format of a Category A action plan.

The financial analysis required is a simple accounting calculation of the incremental increase/decrease in cash inflow and the incremental increase/decrease in cash outflow resulting from the successful implementation of the action programme during the remainder of the financial year.

**Table 3** Objective: To increase the marginal contribution of sales through selective price increases by R40 000 to the end of the financial year

Steps	By whom	By when
- Issue instructions to market research	Marketing manager D. McDuff	30 June
- Test the market for elasticity of demand at increased prices of product A B C and alternatives, D & E	Market research B. Smith	31 July - within 4 weeks
- Analyse results, select products for increase and implement increase	Marketing manager D. McDuff	7 August - within 1 week
Profit impact		
Increased marginal contribution		
Product A	10% increase in turnover 80 000	R8 000
Product B	6% increase in turnover 300 000	R18 000
Product C	4% increase in turnover 400 000	R16 000
		R42 000
Less additional promotion in support of Product B		(2 000)
		R40 000

In Table 4, an action plan developed in an electrical appliance manufacturing company, illustrates the required format of a Category C action plan.

**Table 4** Objective: Introduce low manufacturing-cost cooker to combat imports by November 1981. Dealer price to be R250,00. Features as per schedule AWHK/LAB 1019. To achieve budgeted increase in sales 15% p.a.

1. Programme:	Facility	Responsible	Date
(a) Finalize marketing features price and size	MKTG.	D.J.S.	Complete
(b) Tentative costing of mock-up	COSTING	M.W.G.S.	30.10.80
(c) Working prototype for testing	ENG.	F.M.C.	01.11.80
(d) Engineering drawings complete	ENG.	F.M.C.	10.12.80
(e) Final costing complete	COSTING	M.W.G.S.	03.01.81
(f) Capital required signed off	FINANCE	T.B.	15.01.81
(g) Tooling and tool trials complete	MNFG.	H.S.G.	15.07.81
(h) Pre-production pilot run complete	MNFG.	H.S.G.	15.08.81
(i) Sample to marketing for advertising copy and sales literature	ENG.	F.M.C.	01.09.81
(j) Service specifications and catalogues complete	SERVICE	N.R.W.	01.10.81
(k) Job 1 production	MNFC.	H.S.G.	01.11.81
(l) Distribution to regional warehouses	DISTR(N)	M.L.M.	23.11.81

## 2. Profit impact

Using cost savings as previously tabled which result in 10% saving in variable costs and allowing 5% reduction in sales prices, profit impact for 12 months as follows:

	Year 1	Year 2	Year 3
Increased sales contribution	100	130	170
Variable manufacturing expenses	72,3	96,5	128
Factory var. margin	27,7	33,5	42
Warranty & distribution	6,9	7,5	9
Variable margin	20,8	26	33
Factory fixed expenses	9,8	11	13
Net profit:	11,0	15,0	20,0

the required format of a Category B action plan.

The financial impact analysis extends over more than one financial year. The probable impact of inflation, accordingly, has to be considered. In the illustrative action plan, it is tacitly assumed that inflation will have exactly the same impact on all the major items of cash inflow as well as cash outflow. If this is not the case, the predicted inflow and outflow calculations for every financial year have to be adjusted to reflect the anticipated impact of inflation.

Finally, in Table 5, a hypothetical action plan serves as illustration of the required format of a Category C action plan.

The financial analysis required for Category C action plans necessitates careful consideration of the following factors:

- the time value of money;
- the discounting factor to be used in the present value calculations;
- the predicted salvage value of any capital assets;

- the impact on the existing working capital level of the proposed capital acquisition and the subsequent recovery of the working capital at the end of the economic life of the capital asset;
- the impact of inflation on the anticipated cash inflows and outflows;
- the taxation effect of the proposed capital acquisition in the form of initial and investment allowances; the depreciation tax allowance and the tax effect of the predicted salvage value of the capital asset.

For a detailed discussion of the above matters, the interested reader is referred to Clark, Hindelang and Pritchard.<sup>8</sup>

## Integration into the financial planning and control processes

The large, well-managed business organization will probably use all or most of the following formal planning and control documents:

- a strategic plan;
- a capital budget;
- a long range business plan: this document normally takes the form of an operating budget which covers a future period of three to five financial years;
- a short range business plan: this document is normally the annual operating budget;
- a planning 'bridge of performance' statement;
- a control 'bridge of performance' statement.<sup>9</sup>

The anticipated financial results of the three categories of action plans will be reflected in Table 6.

Category A action plans are developed on a recurring basis with the objective of improving the anticipated financial results of the current accounting period. The development of these action plans is a reaction to almost continuous pressure to adjust favourably to changing circumstances. These are, accordingly, 'control' or 'replanning' action plans and the anticipated financial impact does not affect any formal planning or control document, except the control bridge of performance statement which should be developed on a regular (monthly or quarterly) basis. This document is, in essence, an updated forecast of year-end results incorporating the anticipated results of approved 'replanning' action plans.

Category B action plans are developed on the same basis as Category A plans but the anticipated financial results will affect multiple accounting periods. They are, therefore, analysed and allocated to these periods as follows: The total impact of such an action plan is taken up in the long range business plan; the forecasted impact on the financial year following the accounting period in which such an action plan is developed, is included in the short range business plan as well as in the planning bridge of performance statement. (The latter is the most important working paper from which the short range business plan is developed.) Finally, any impact anticipated in the year in which the action plan is developed is, as is the case with Category B plans, included in the control bridge of performance statement.

The integration of Category C action plans differs from that of Category B in as much as the entire cash inflow and outflow associated with the action plan are also included in the capital budget of the organization. Furthermore, the strategic plan of the organization is affected as well. In the formulation of a strategy, as far as the financial component is concerned, two stages may be identified. The allocation of financial resources and the releasing of such resources. The allocation of resources required for an approved strategy is taken up in the format

**Table 5** Objective: To extend productive capacity by the purchasing of a new grinding machine, No. Mx 1930, with an expected economic life of 5 years and costing R100 000

Steps	Responsibility	Completion dates
a. Prepare memorandum for board approval	Industrial Engineer Operations Manager	31.03.1983
b. Obtain board approval	Operations Manager	30.04.1983
c. Supply specification to procurement division	Industrial Engineer	05.05.1983
d. Oversee installation of machine	Engineering Division	30.06.1983
e. Commissioning of machine	Supplier Industrial Engineer	04.07.1983

Anticipated financial impact

	Present	Year 1	Year 2	Year 3	Year 4	Year 5
Initial investment:						
– Machine	R(100 000)					
– Working capital	(20 000)					
Operations:						
– Cash inflow		R120 000	R120 000	R120 000	R120 000	R120 000
– Cash outflow		80 000	80 000	80 000	80 000	80 000
Operating cash flows		40 000	40 000	40 000	40 000	40 000
Income tax		3 333	6 666	10 000	13 333	16 667
Cash flows after tax		36 667	33 334	30 000	26 667	23 333
Present value of R1 @ 0,12 <sup>a</sup>		0,8929	0,7972	0,7118	0,6355	0,5674
Present value:						
Cash inflows		32 740	26 574	21 354	16 947	13 239

Calculation of taxation effect<sup>b</sup>

	Year 1	Year 2	Year 3	Year 4	Year 5
Operating cash flows	40 000	40 000	40 000	40 000	40 000
Sum-of-years digits depreciation	33 334	26 667	19 999	13 334	6 666
Taxable income	R6 666	R13 333	R20 001	R26 666	R33 334
Income tax @ 50%	R3 333	R6 666	R10 000	R13 333	R16 667
Present value: Cash inflows			R110 854		
Present value of working capital recovery: 20 000 × 0,5674			11 348		
			122 202		
Less: Investment			120 000		
Net Present Value			2 202		

<sup>a</sup>A 12% investment hurdle rate (cost of capital) is assumed.

<sup>b</sup>It is assumed that this investment does not qualify for initial and investment tax allowances, and that the machine has no salvage value.

**Table 6** Action plan impacts in the planning and control process

	Category A	Category B	Category C
Strategic plan			X
Capital budget			X
Business plan: long range		X	X
Business plan: short range		X	X
Bridge of performance: planning		X	X
Bridge of performance: control	X	X	X

of an action plan and forms part of the strategic plan. The second stage, the releasing of resources, is implemented on the

strength of a financial analysis as illustrated in Table 5.

### Conclusion

In this article an extremely important prerequisite to the success of a business organization, namely, directed entrepreneurial flair, has been defined and formalized in the format of an action plan. One component of such a plan — the anticipated financial impact — was analysed and described in greater detail.

Practical results in organizations which have implemented the concept of formalized entrepreneurial action as an integral element of excellent performance on the senior-middle to top management levels, attest to the value of this orientation.

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