Marconi | Pacific

Consultants to Senior Management

STRATEGIC PROGRAM AND MINIMUM BASELINE (SPMB) BUDGETING

"Funding Strategic Programs while driving to a lower cost structure"

Investing in growth strategies while simultaneously reducing the cost of business as usual is a difficult task in healthy economic times. When, as now, the economy falters, this task becomes especially vital. **How can CFOs successfully integrate strategic funding with long-term cost reduction?** The *Strategic Program and Minimum Baseline* (SPMB) budgeting methodology enables corporations to balance strategic investment and cost reduction to ensure long-term growth and profitability.

"We don't have a tool to differentiate between strategy and cost reduction"

"Most of our executives argue strategy when the numbers don't work"

"Our production systems and our financial systems don't tie together; we measure everything in a vacuum and the business units use the data that serve them best"

- Marconi Pacific CFO/Exec. Survey comments Aug. '01

EXAMPLE STRATEGIC PROGRAMS

- Construction of a new "factory" for a new product
- Roll-out of a major new product with a multi-year payback
- Development of an e-commerce or direct distribution channel
- Investment in a strategic billing system

How should CFOs manage the funding of Strategic Programs? Strategic Programs are critical to the long-term growth and success of the corporation. These programs profitably grow revenue but, almost always, take multiple years to payback. Most strategic investments are also programmatic in that they cut across departments like Marketing, Manufacturing and Human Resources. Hence, SPMB budgets for them as Strategic Programs. During times of earnings squeezes, funding decisions for Strategic Programs often are made with a short-term focus. *Using SPMB, CFOs can help business units, across the company, fund the expense budgets and CapEx for the Strategic Programs that will truly maximize enterprise value over the payback term.*

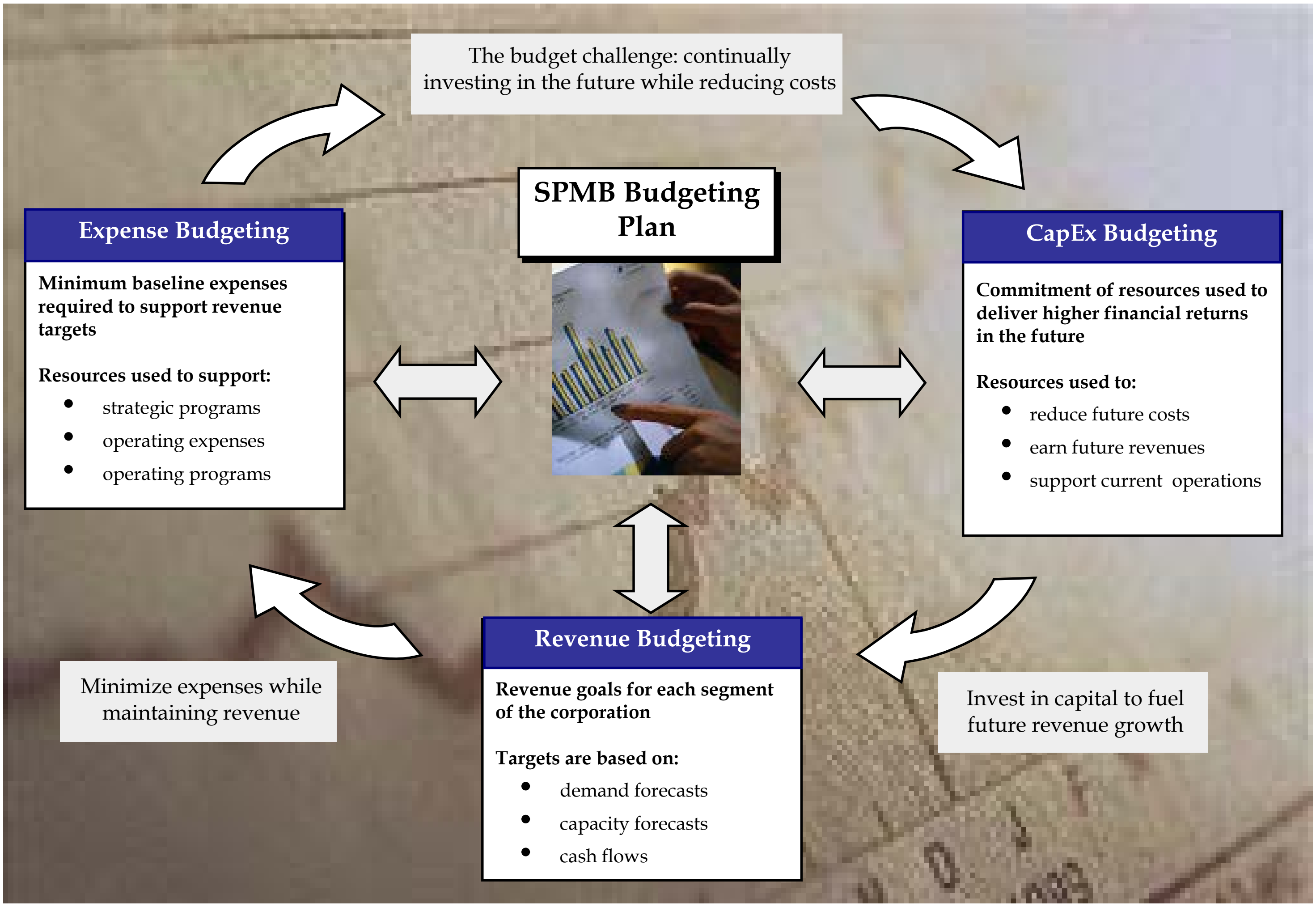
How should CFOs manage the funding of baseline expenses? Baseline expenses (core operating costs) are generally predictable and manageable. SPMB breaks baseline expenses into operating expenses (business-as-usual, minimum costs) and support programs (periodic discretionary costs). The goal of baseline expense reduction is to drive the operating expenses down to their lowest possible levels per unit of output, maximizing the unit productivity of the cost base. By establishing baseline costs and measurable metrics, corporations can drive year-over-year to a minimum baseline. *Only by focusing on long-term efficiency improvements can CFOs help set levels of expense reduction that drive to a long-term lower cost position while maintaining revenue and profit growth.*

EXAMPLE OPERATING EXPENSES

- Sales
- Marketing
- HR
- Manufacturing/Production
- Finance
- Billing
- Operations

EXAMPLE SUPPORT PROGRAMS

- IT replacement system
- Hardware upgrades/ refurbishment/ retooling
- Building maintenance
- Replacement vehicles



The SPMB budgeting plan unlocks the CFO dilemma of concurrently lowering the costs of business-as-usual while investing in the Strategic Programs that fuel business profitability and growth. When economic times get rocky, many business units shelve Strategic Programs in order to fund operating expenses. The effect is well understood by all... corporate growth will stall a few quarters out! SPMB demands the reevaluation of Strategic Programs but looks to long-term reduction of operating expenses for a significant amount of the cash to fuel growth. Long-term cost reduction per unit of output allows corporations to drive to a minimum baseline cost structure. It reduces the disruptions caused by episodic cost cutting exercises that have been so prevalent over the last 15 years. SPMB also requires linking the revenue, CapEx and expense budgets to allow effective and achievable budget adjustments across the enterprise.

How can CFOs implement SPMB? To ensure the success of implementation, CFOs should begin the transformation to SMPB budgeting soon after the completion of the prior budgeting cycle. The first phase establishes the SMPB budgeting foundation and should be completed in the 6 months prior to the start of the next budgeting cycle. This budgeting conversion phase consist of three steps: 1) Mapping the current budgeting process, 2) Recasting the current budgets into SPMB format, and 3) Developing minimum baseline starting points and metrics. Once the SPMB budgeting format is complete, the CFO is ready to create the first year's SPMB budgets and to monitor the financial and metric results, adjusting the Strategic Program and the Minimum Baseline components as necessary.