The Strategic Importance of Asset-based Planning

Introduction

Building value-driven planning and budgeting processes is an essential aspect of the finance department's evolution from 'policeman' to strategic business partner. Effective planning and budgeting provide the foundation for finance activities such as governance, risk management, compliance, and corporate-wide performance management. Furthermore, planning is a critical component in Finance's expanded responsibility for creating value, achieved by providing guidance to the organization and supporting the optimal allocation of resources.

Energy companies and utilities have unique requirements for planning and budgeting. Being asset-intensive, a large portion of spending is directed at the construction, operation, and maintenance of physical infrastructure, and long-term performance is a direct result of asset investment. Utility decisions are constantly under the scrutiny of regulatory agencies, thereby increasing the need for rigor and transparency. Moreover, utilities are often held to especially high environmental and safety standards, making the evaluation of non-financial aspects of performance very important.

Asset Investment Planning is an approach whereby the current condition and long-term value and costs of the asset base are made central to the planning and budgeting processes. This is essential to optimizing the allocation of resources for long-term performance, while also meeting more immediate stakeholder needs. Incorporating asset-based planning into corporate planning processes increases forecast accuracy and aids the optimal allocation of spending to enhance value and manage risks. It also increases the levels of rigor and consistency in planning processes, thereby improving governance and transparency.

Asset Investment Planning: Creating Value and Strengthening Governance

In a recent survey, CFOs identified value creation and performance management as top priorities for finance. The survey further indicated that finance executives recognize value and performance as more than quarterly financial results; they must be understood and managed as long-term variables that are increasingly related to non-financial aspects of performance. [1] [2] This requires clear corporate strategy and multi-year plans from which to manage and monitor progress. Planning and budgeting are also critical aspects to how stakeholders perceive the organization. For example:

- A survey of analysts found that 85% believed an organization's planning and budgeting systems have an impact on share valuations and price. Planning supports what the analysts viewed as the three most influential factors in share price: actual performance, predictability, and management credibility[3];
- Bondholders and rating agencies need long-term financial plans to be assured debt covenants will be met; and
- Utility Commissions or other rate approval bodies (e.g., city council for municipal utilities) require accurate, multi-year views of financial performance before approving revenue requirements. Often, this approval is tied to non-financial, operational performance metrics such as reliability, safety, and environmental compliance.

To meet these needs, plans must accurately forecast long-term spending and performance, and provide sufficient business intelligence to manage risks and make strategic decisions. Planning processes that are entirely 'top-down' may not truly reflect spending requirements and performance expectations across the organization.

These gaps can be closed by integrating bottom-up, asset-based plans into top-down corporate forecasts. This "hybrid" type of budgeting process increases buy-in and forecast accuracy while maintaining strategic alignment and executive

[1] IBM Institute for Business Value, CFO Survey: Current State and Future Direction, (2003).

[2] IBM Institute for Business Value, Future Finance: A CFO vision for creating value through e-business on demand, (2003).

[3] Cranfield School of Management and Accenture, Driving Value Through Strategic Planning and Budgeting, (2001)

control.[4] Hybrid budgets also strengthen the link between asset condition and corporate performance, a key issue for most utilities as their infrastructure nears end-of-life and requires significant re-investment.

The challenge in hybrid budgeting is blending top-down and bottom-up elements to create a meaningful and understandable plan that addresses multiple needs. This is particularly difficult in technically focused environments like utilities, in which operations and finance staff use different terminology and criteria for justifying investments.

Asset Investment Planning, an asset-based approach to planning, supports hybrid budgeting by establishing a decision and data framework that addresses the needs of both finance and operations. This allows financial and operational factors to be used collectively in decision-making. Asset Investment Planning forces asset managers to look beyond technical requirements and to develop plans that address corporate objectives and asset value, over time. Finance staff are equipped to make plans that respect the asset condition realities, avoiding unanticipated expenditures or spikes in spending and rates. By viewing investments as portfolios rather than individual decisions, the organization can make informed trade-offs and support a more optimal allocation of resources.

Asset Investment Planning also improves the organization's governance and risk management. The common decision framework ensures that investment and risk analysis are consistent. The team approach to planning allows risks and opportunities to be clearly identified, which is a necessary first step in building open and transparent decision-making processes. Ultimately, this produces improved stakeholder confidence and trust.

ESP: Enabling Asset Investment Planning

ESP is a purpose-built, enterprise-wide, Asset Investment Planning and Reporting package that supports an asset-based approach to budgeting and planning. Organizations gain control over asset planning and forecasting by capturing future spending requirements and opportunities in a multi-year, multi-user database. With greater knowledge of spending plans, organizations can then develop asset-based investment portfolios that create value, manage risks, and achieve required levels of operating performance. Features and analysis capabilities include:

- Pro forma analysis of long-term financial performance, with roll-up throughout the organization;
- Dynamic modeling of portfolio impacts on production or delivery capability, revenues, costs, and risk;
- Budget development and optimization; and
- Sensitivity and scenario analysis, to evaluate the robustness of decisions relative to changing input assumptions.

ESP fills the strategic planning gaps in ERP and EAM systems, and integrates with these systems to ensure data consistency and maximize user efficiency. As a multi-user, database-driven system, **ESP** avoids the inherent pitfalls of spreadsheet-based planning and budgeting, such as security, consistency of data, and integration.
With **ESP**, finance executives are provided with comprehensive, asset-based spending and performance plans that reflect executive and stakeholder perspectives. By integrating an asset-based perspective with top-down corporate strategic planning, organizations can improve the quality of their decisions and enhance communications, directly affecting their ability to create value, strengthen governance, manage risks, and gain stakeholder confidence.

CopperLeaf Technologies

CopperLeaf Technologies provides thought leadership and the enabling technologies to improve the performance of energy companies and utilities. CopperLeaf's **ESP** is a leading Asset Investment Planning and Reporting software package that is specifically designed to support long-term, asset-based planning.

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