Inpensa MasterClass

What is Inpensa MasterClass?

Inpensa MasterClass is a collection of resources from our subject matter experts that aims to provide best practices in the field of Capital Planning, CapEx Appropriation and Investment Performance Management. Our webinars, whitepapers and blogs together provide a wide range of information curated from industry experts, first-hand experience, along with tried and tested best practices.

<u>MasterClass Topic: The Next Generation of Capital Planning (4-part series)</u>

Part I: Setting up a Connected Capital Planning Framework
Part II: Systematic Annual Capital Planning
Part III: Capital Appropriation Request and Approval
Part IV: Capital Planning Performance Management

Part I: Setting up a Connected Capital Planning Framework

Whether you are just getting started or planning to update your existing process, a well-organized capital planning framework may seem complex and difficult to institutionalize. Mostly because it usually involves multiple business units or divisions, many people are involved in providing input and data collection is manual and untimely. Other drivers may be the lack of a system to manage the process, dependency on manual spreadsheets and lack of transparency in the reporting process. This blog provides a high level framework to get you started to enhance and improve your existing process.

Capital planning is an ongoing process of capturing capital expenditures over a defined period and aligning it to limited available capital. It also involves ensuring investments are aligned to strategies, mitigating company risk and managing cashflows. Some companies plan annually, while others plan continuously over multiple years. Whichever approach you take, you will find this framework applicable. The framework also allows for a crawl, walk, run approach so you can get started quickly and mature the process over time. Additionally, the various processes can be implemented separately and at different times depending on the most urgent need.

No surprise, our framework is designed around people, process and tools. All three are equally important to ensure a successful adoption.

People

Beginning with people, we recommend centralizing the process either at the corporate level or at the business unit level. Having one governing body to oversee the process ensures standardization and governance. It also provides a bird's eye view needed to catch anomalies and to programmatically make changes. At the corporate level we often see Corporate Planning or Financial Planning & Analysis (FP&A) functions take on these responsibilities. In divisions such as technology, we see the COO or business management office manage this process. Typical roles include executives such as business unit COO's, finance leaders and analysts, project managers, and business analysts. Before setting up this process we recommend developing a RACI to identify and assign roles. We always recommend strong executive sponsorship and consistent communication to all stakeholders.

Process

From a process perspective, we have outlined a best practice process that can apply to the most simple or complex organization. Below is a framework the outlines the various parts of the connected capital planning process. We will dive into these closer in Part II through IV of this series.

- **Annual or multi-year capital planning** – A process that aligns CapEx investments to budget targets and availability of capital

- **Capital appropriation request** – A process that manages the capture of new ideas, analyze the feasibility of the ideas, and workflow of the approval process

- **Performance management** – A process that tracks CapEx investments overall spend, including both financial and non-financial benefits

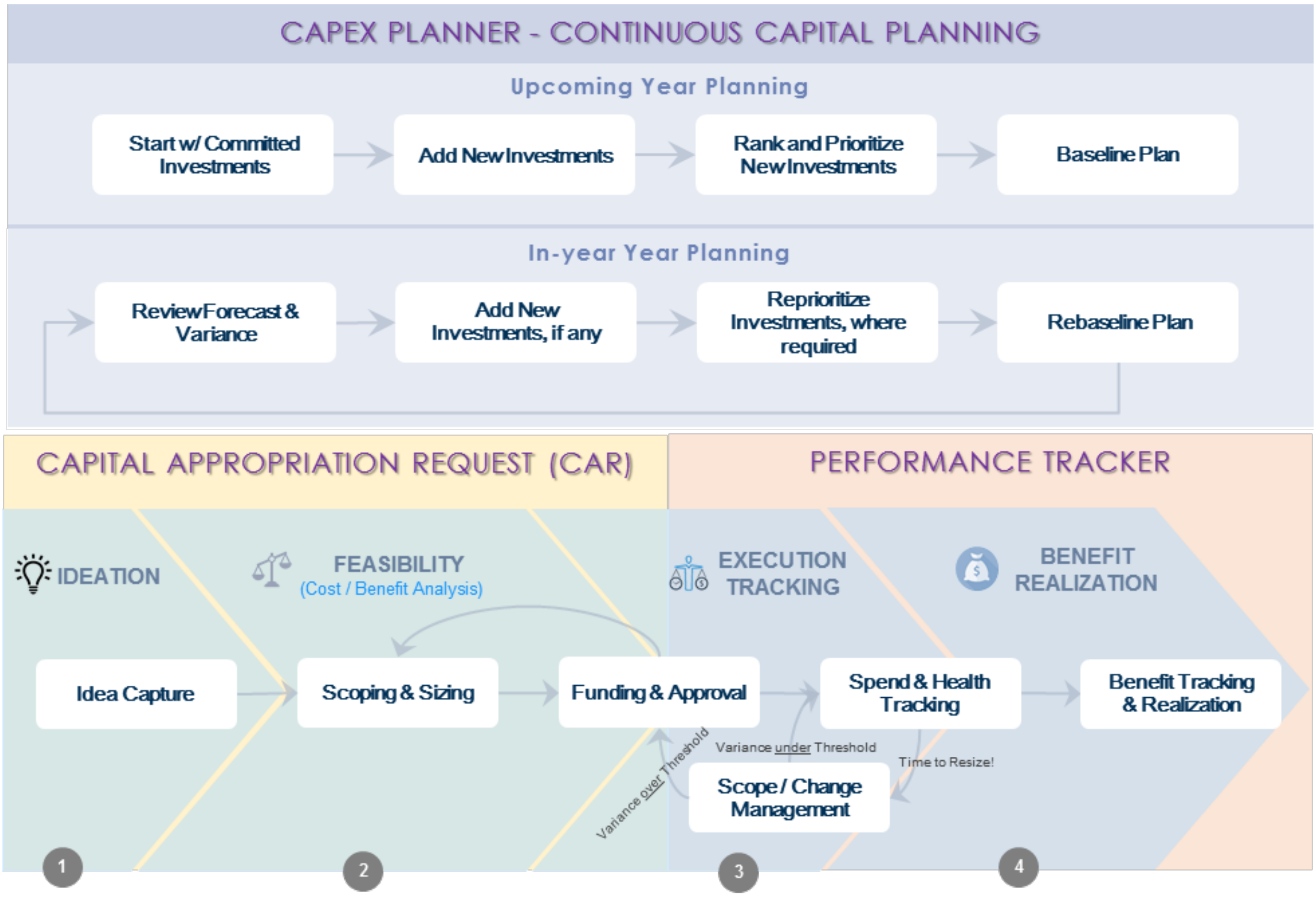

Figure 1: Connected Capital Planning Framework

Tools

Finally, from a tools perspective, we recommend a solution that can serve as a single source of truth for the entire CapEx process. There are many capital planning tools that are point solutions that only manage the high-level process. These tools depend on spreadsheets to fill the data gaps, run analysis and calculate business impact. Our view is to take a connected approach. At Inpensa our solution is designed to manage the entire process without dependency to other systems or spreadsheets. Our solution allows for direct data input. This is advantageous because it makes collecting data much faster, allows for standardization and consolidation and analysis is done with a few clicks. No more waiting for emails with spreadsheet templates to come back via email with potential errors.

Data analysis happens in real time as data in captured simultaneously through the company or business unit. Stage gating, which is common of capital planning processes, is managed by the system, allowing for opening and closing of the system, approval workflows and replanning to occur in an organized systematic way. Lastly, the system can feed data directly into ERP planning tools or other forecasting/budgeting solutions. This ultimately results in a frictionless process that is streamlined and produces more accurate results needed to run the business. Tools like these are necessary to facilitate and manage the overall process and ensure integrity in the data.

Part II: Systematic Annual Capital Planning

Annual capital planning is a systematic way of planning for capital expenditures (CapEx) around a specific target budget which includes identifying all required CapEx spend that are seeking funding. Most of our customers begin with a budget that is aligned with the company's capital availability and cashflow requirements. The following steps are required to develop a comprehensive capital planning process:

1. **Budget Target** - Develop a budget target by either analyzing historical spend or working closely with your finance teams to understand availability of capital and how much of it will be allocated to CapEx investments for the planning period. Usually, it's a combination of looking at historical spend and identifying the big ticket must have strategic investments that will determine the budget. At the divisional level, the budget targets may be passed down from the corporate level.

2. **Committed Investments** - Next, start with committed expenses. Most capital plans have about 40-50% multi-year initiatives. These are initiatives that are already committed and, in most cases, have already started. For example, if you are building a new data center or manufacturing plant that will take three years, the CapEx spend associated with this investment for years two and three will be carry-forward investments and will be part of the starting point of your new plan. Some companies have an agile budgeting process and will require justification to continue funding existing initiatives. This is common in more complex organizations and may apply to investments that exceed a funding threshold. Once you have captured all of your carry-forward investments and understand the financial impact you are ready for the next step.

3. **New Investments** - Create a list of new investments including estimated capital spend. Since you are in the planning phase these investments can be at the specific project, program or portfolio levels. Data capture should be standardized to prevent errors and provide the ability to quickly run analysis and reports. An important part of this process is to create a list of required information. For example, project/program name, business unit, CapEx spend, timing, business owner, etc. This will allow for easy aggregation and analysis.

4. **Prioritization** - It is very common to have investment funding requirements that exceed available funding. The demand for capital will almost always exceed the supply of capital. Developing a prioritization process to identify initiatives with the highest strategic value and lowest risk is very important. This should not be a politicized process that leads to a lot of pet projects that are not aligned to the overall strategy of the company. We suggest developing a strategic value scoring methodology that aligns investments to corporate strategies. We also suggest a risk assessment to identify investments that are very risky. This can be a high-level process during planning and a more detailed process during the capital appropriation request stage. Using a scoring methodology, create a prioritization ranking model and select initiatives that are most important to the company.

5. **Baseline Plan** - To create a baseline plan you will need to add your carry forward investments to your new investments. This provides visibility into the portfolio at an aggregate level and allows for further analysis. Compare the total spend to the budget target set in Step 1. In almost every case, the total capital plan will be higher than the budget. Continue to reprioritize the portfolio until you reach the desired mix of investments that align to the budget targets. Beyond eliminating investments, you can also adjust timing of investments and defer them into future years. This final process is usually managed in a stage-gate process. There are usually three stages or passes of the plan resulting in budget adjustments based on company performance and refinement until a final plan is approved.

Once the plan is complete and business impact is understood it is usually approved by an operating or steering committee. This committee will ask for quarterly updates (more frequent for smaller companies). The quarterly updates are captured in part IV of this series. Also, the plan is revisited at least twice a year and rebalanced as needed.

Part III: Capital Appropriation Request and Approval

Capital appropriation request (CAR) is an essential part of a connected capital planning process. Once the annual capital plan is complete (mostly viewed as capital allocation) there is a formal process for approval to spend. Some people also refer to this as the business case development and management process. The CAR process requires the capture of new investment ideas, the development of a formal business case to identify the ROI, NPV and other decision metrics of the investments and lastly, the approval of the investment.

In the process, identified in Part I, we outlined the three phases of the capital appropriation process.

1. Idea Capture
2. Feasibility Analysis (Business Case Development and Analysis)
3. Funding and Approval

All new CapEx investments should be initiated in the idea phase. Keep the data to a minimum and be careful not to make this an overburden process. Include a high-level description, high-level cost, identify high-level risk of doing nothing and include a statement of why the initiative is needed. Depending on your business unit you may want to include some additional information but keeping this part of the process simple will make it stickier and increase adoption. Allow for different stages of an idea and give people the freedom to openly jot down ideas. For example, ideas can have a T-shirt sizing stage, idea review and ready for feasibility (business case development) phases. In the T-shirt sizing stage, it is only viewable by the user and not by the wider group. This is as a sandbox where people can freely capture their ideas. Next is the idea review stage that allows your peers and managers to view and approve the idea for the feasibility stage (depending on configuration). See example below.

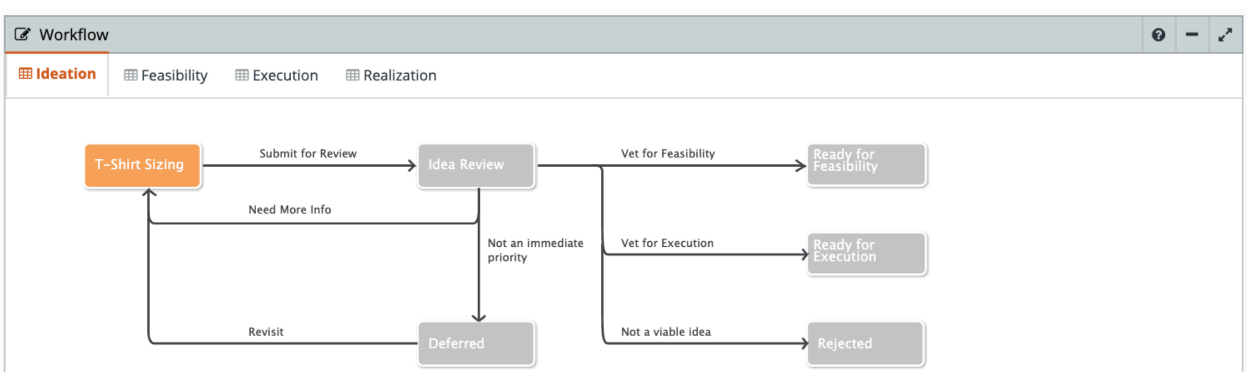

Figure 2: Example of ideation phase

Once the idea enters the feasibility stage it is ready for further evaluation and analysis. Companies will often have a funding threshold that requires a full business case to be created and presented to a committee for approval. Depending on the company size the threshold can be as little as fifty thousand to over one million dollars. Once an investment reaches this threshold it cannot receive funding without a formal business case.

The business case is a deeper dive of the idea and requires additional financial data and risk evaluation. Key components of the business case includes the data captured from the ideation phase with further elaboration of the following:

- Full description of the investment proposal
- Elaboration of financials including detailed costs and benefits

- Strategic alignment of investments to the company
- Risk evaluation both operational and financial
- Key metrics including NPV, IRR, Payback period and ROI

Note that there may be several versions of the business case which may include different scenarios. Scenarios can be alternative use of capital or the same scenario with multiple vendors. Establishing a framework that includes scenario modeling will speed up the decision process and increase time to market. Similar to the ideation phase, business cases will have a predefined workflow that includes feasibility review, management approval and ready for execution. The work flow can be very simple to complex including adding policy and rule-based decision trees. After full vetting of the business case the capital appropriation request is sent to management for approval and then ready for execution and performance management (Part IV of this series).

Part IV: Capital Planning Performance Management

So far, we have covered setting up the overall connected capital planning framework. The final step in the connected capital planning framework is execution, performance management and benefits realization referenced here as Capital Planning Performance Management.

Capital Planning Performance Management is a process that tracks capital spend over the lifecycle of the investment. For smaller investments, the capital may be a one-time purchase and for larger multi-year investments, it can be multiple purchases over a period of time. Understanding the cashflows and business impact over the investment period is important. Additionally, performance tracking also includes tracking the health of the investment and tracking benefits realization. We suggest tracking budget, benefit, on target to deliver, and overall health. This can be done in a simple RAG (Red, Amber, Green) status format.

Another key element of performance management is benefits tracking. Benefits are both financial benefits and non-financial benefits such as operational performance. Financial benefits are typically cost savings, cost avoidance, and revenue generation. CapEx projects can deliver on any one or a combination of these benefits. For example, replacing end of life machines can drive significant savings in ongoing maintenance and avoid expensive repair costs. Adding more capacity in a factory can double production and significantly increase revenues. These are assumption typically made in the CAR or business case proposal process and it is vital to test and monitor these assumptions over time.

Performance benefits are also important to consider in the decision process and equally important in the performance tracking process. For example, an investment that promised to increase production in a manufacturing plant or creates operational efficiencies should be monitored and tracked over time to ensure it is delivering on the intended benefit. This requires a purposeful approach that requires people, process and tools, strong executive management support, a well-defined process and tools to maintain the integrity and transparency of the data. Benefits often occur after the initial setup period which is why we created the "value period". The value period follows the setup period and is usually set from two to five years. The benefits identified in the investments are treated as a plan or target and actual results are tracked, monitored and recorded over time. The outcome of performance tracking is to be able to course correct if investments are not delivering as intended.

In Summary

If implemented and managed correctly, connected capital planning can deliver tremendous benefits to any organization. We heard the old saying, "better planning produces better results." This particularly holds true for capital planning. Some of our customers report an 8X ROI after using our solution for the first year. This is a result of better processes and more accurate planning data. ROI is also achieved by introducing objectivity to the analysis and decision process and driving accountability through performance management. Our suggestion is to get on a crawl, walk, run program. Identify the 20% of improvement you can make in your overall process that will have an 80% impact. If you are uncertain on how to get started let one of our professionals do a quick assessment and make recommendations.