



## BELOW THE RADAR

Factors that Steal Tons, Increase Costs and Prevent Change

### Stretching – Good for the Body, Not Always Good For The Budget

As Shortfall Coal, a subsidiary of Fictional Coal Inc., begins another year of operation, Shortfall's mine management team already doubts that it can achieve its improvement goals in the 2010 budget...

Every August, Fictional Coal's senior management team kicks off its budget process by setting high-level budget goals and identifying key drivers (coal prices, tonnage requirements for contract and spot coal, global targets for availability and utilization and prices to use for diesel and power). Mines then develop summarized estimates that are consolidated and reviewed by corporate. After this initial review, sites are asked to create zero-based budgets which include detailed cost projections, manning tables for production, maintenance and support departments (safety, purchasing, accounting, etc.), and wish lists for capital (sustaining and expansion). Budget models are populated by month for the coming year and five-year plan.

In 2009, Fictional's first set of budget review meetings took place in late September. After these meetings, corporate issued "stretch targets" for the mines. Each site was asked to increase production by 10% to take advantage of higher spot prices, reduce total costs by 10% despite increased tonnage, reduce capital by 25%, and prepare a list of improvement projects tied to goals for higher tons and lower costs. The sites were given three weeks to incorporate these changes into their budget models.

In October, the senior team reviewed the mines' revised projections; only minimal changes were required before final approval in November. After Thanksgiving, the mine managers met at corporate for a consolidated presentation and were congratulated on their efforts, but several of them (including Shortfall's manager) **left the room lacking confidence in their ability to achieve their site's goals** for the coming year. These same managers knew that quarterly performance bonuses would probably never be paid to their workforces because the targets were too high.

What is wrong with this scenario?

- If stretch targets are not carefully managed when they are integrated into a carefully constructed zero-based budget, cost detail becomes disconnected from business processes, muddying the pathway to future cost reduction.
- Applying one value for availability or utilization to all fleets ignores the impact of fleet-specific delays that must occur, making it impossible to achieve global ratios in some fleets and jeopardizing production goals before the year begins.
- Failing to openly discuss stretch target values with sites may lead to the **"unintentional approval of unachievable goals"**. These targets make the senior team happy...until the board begins asking questions about recurring budget shortfalls.
- If a mine manager has doubts in January about achieving annual budget goals, the budget process may have (unintentionally) positioned his/her site to fail, at least for that budget year. He/she also knows that employee morale will be negatively affected by failure to meet objectives that have already been communicated to the workforce.

Estimating the upside potential that can be captured in any budget year may be management's greatest challenge. Asking sites to revisit numbers and reflect additional improvements is part of the budget process, but targets must be linked to processes and capability. If senior management teams knew that site managers started the year believing that they had no chance to achieve the goals set before them, the team would not be happy. You may be thinking "Kay, this never happens." I assure you that it does happen, usually behind closed doors.

**The budget process is a key driver of management credibility.** Once budget goals are communicated to the board, senior managers become accountable for turning projections into reality, and they lose credibility when shortfalls occur during normal operations. Chronic over-estimation of budget projections undermines trust between departments and divisions and can actually change the culture. With the raised awareness about corporate ethics and shareholder value, it may even become an ethical issue for the board and senior team.

Adding a **budget reasonableness step to the budget process** mitigates these issues. Analyzing the achievability of budget goals **prior to final approval** improves management confidence and credibility by 1) **changing the questions asked** during a budget review, 2) **increasing the probability that improvements actually materialize** and 3) **preventing uncomfortable discussions with the board** about expected improvements that vaporize.

Here's the thought for January:

Budgets **create expectations** for performance and improvement, but  
**budgets must be executable** to deliver the expected result and maintain management credibility.

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Kay Sever is offering a **NEW Management Training Series** called "**Opportunity Fundamentals – Equipment, Cost and Culture**" to help management teams solve the kinds of problems discussed above and "**manage change like they manage operations**". She also implements improvement programs for mining and downstream processing facilities. Kay works with every organizational level and department to find the highest dollar opportunities and remove barriers that prevent sustainable change. She helps management teams lead improvement and better execute the budget, capital approvals, incentive plans, communications, etc. See [MiningOpportunity.com](http://MiningOpportunity.com) for details on her services and contact information. Look for the mining edition of her first book "**Building An Opportunity Culture – Addressing the Barriers That Steal Profits and Prevent Sustainable Change**", available on her website under Products/Books.