

Effective decision making

Topic Gateway Series No. 40



About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

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The Chartered Institute of Management Accountants

26 Chapter Street
London SW1P 4NP
United Kingdom

T. +44 (0)20 7663 5441

F. +44 (0)20 7663 5442

E. tis@cimaglobal.com

www.cimaglobal.com



Effective decision making

Definition and concept

Organisations are constantly making decisions at every level. Decision making ranges from strategic decisions through to managerial decisions and routine operational decisions. Decision making in business is about selecting choices or compromises in order to meet business objectives.

However, decision making is not just about selecting the right choices or compromises. 'Unless a decision has 'degenerated into work', it is not a decision. It is at best a good intention' [Drucker, 1967].

Effective decision making is defined here as the process through which alternatives are selected and then managed through implementation to achieve business objectives.

'Effective decisions result from a systematic process, with clearly defined elements, that is handled in a distinct sequence of steps' [Drucker, 1967]. Management accountants have key roles to play throughout the effective decision making process.

Context

Global markets give companies access to similar resources and competition causes many business processes to converge on similar standards. Decision making is becoming the remaining basis of competitive advantage that can generate superior returns for shareholders.

Meanwhile, many leading companies have taken the opportunities presented by developments in systems and globalisation to transform their finance and accounting (F&A) functions. These opportunities have enabled companies to be both more efficient in their operations and more effective in how they support decision making across the business.

Traditionally, the role of the accountant in business may have been to provide management information to support decision making or to flex the budget after a decision had been made to allow implementation. However, the role of the management accountant is relevant throughout the process of effective decision making. For a definition of the role of the management accountant, please refer to *CIMA's Official Terminology 2005*.

Management accountants can be engaged to contribute at each stage of the effective decision making process. They can be involved in:

- setting the context and framing the issue to be considered
- performance and risk management during implementation
- the financial and narrative reporting of outcomes.

In the current syllabus, effective decision making is implicit in the entire syllabus of the professional qualification as it is central to the role of the management accountant.

Students must understand decision making and will be examined on it in Paper 2, Management Accounting Decision Management, Paper 6, Management Accounting Business Strategy and Paper 10, the Test of Professional Competence in Management Accounting.

In the CIMA Professional Development Framework, decision making is inherent in the Management Accounting and Strategic Management competences. Decision making features specifically in Business Skills Analysis and Making Decisions.

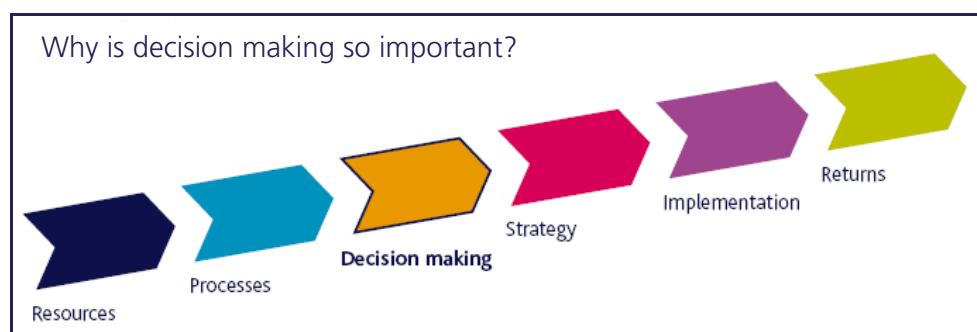
Related concepts

Finance transformation; finance/business partnering; CIMA Strategic Scorecard™.

Overview

Decision making is becoming the basis of competitive advantage and value creation for organisations. Improving decision making could be the key to superior business performance if global markets give all organisations access to similar resources and competition causes many business processes to converge on world-class standards. The quality of decision making could become the key differentiator and link in the value chain as illustrated below.

The importance of decision making



Source: CIMA, September 2007

Many companies have a formalised strategic planning process and a governance process at board level. However, the planning process can often generate reports rather than decisions. The board's role in decision making is often just to oversee or ratify. Usually only routine operational decisions, for example, credit management, have fully documented processes. Many decisions are taken by line management outside formal processes.

The decision making process can be illustrated as a proposal considered by decision makers in the context of the organisation and its strategic position. Alternatives, risks and potential outcomes are considered and then a decision is reached. There may also be a post audit and a feedback loop. The decision making process is subject to human error as the decision makers have personalities, prejudices and a self-interest bias. Importantly, they have different attitudes to and appetites for risk.

There is an opportunity here for management accountants to improve decision making through their role as finance/business partners. Finance must be able to provide timely and accurate management information to achieve impact. However, an effective decision making process and increased shareholder value also depend on finance to:

- communicate this information effectively
- have an understanding of its relevance to the business
- share insights
- influence the decision
- manage the performance and risk effectively.

Improving decision making



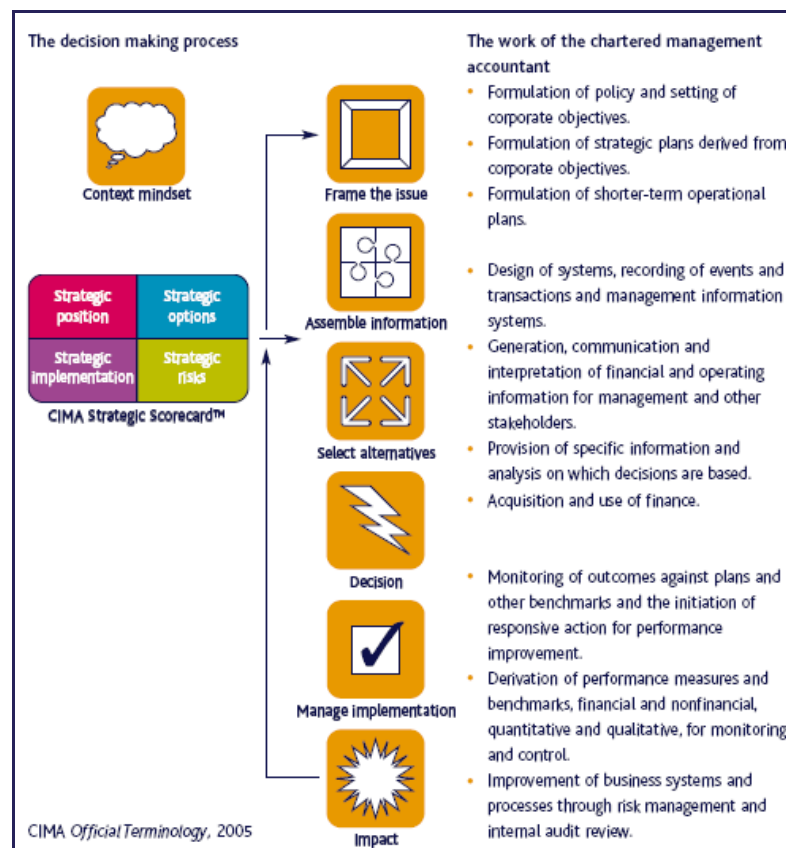
Application

Effective decisions result from a systematic process

Effective decision making can be achieved by following a step-by-step process.

In reality, this process is unlikely to be documented or followed systematically. However, when the CIMA Improving Decision Making in Organisations Forum considered the steps implicit in an effective decision making process, it became clear that the management accountant has a key role to play in improving decision making (see Overview).

The decision making process and the work of the chartered management accountant



An effective decision making process includes the following steps:

Enterprise Governance

The board provides the overall enterprise governance of the organisation. This means that it exercises effective oversight of both the conformance and performance aspects of the organisation. The formal planning process provides the strategic context, brand values and budgetary constraints in which decisions are made.

Enterprise Governance is represented by the CIMA Strategic Scorecard™ to illustrate the overall governance context in which strategic decisions are taken. The CIMA Strategic Scorecard™ is a tool developed by CIMA to help the board of any organisation to engage effectively in the strategic process. For more information, refer to the CIMA Strategic Scorecard™ topic gateway.

Context/mindset

Decisions are taken in the general context of the organisation's overall strategic direction, ethics and culture by individuals with their own prejudices and attitudes in the context of the issue being considered. The potential impact of prejudice in the organisational culture and people's attitudes and behaviour cannot be underestimated. Management accountants can help to ensure that alternatives are considered properly and decision making is evidence based.

Frame the issue

This is a key step. Issues must be properly framed to balance a broad view with efficient focus. Appropriate parties must be engaged. Stakeholders' interests are taken into account in determining the objectives at this stage. In businesses that are managed for value, the main criterion will be the impact on shareholder value.

Assemble information

This involves the provision of insightful information to describe the business's current financial and competitive position. Information is also assembled for a business proposal(s), the value for customers and the impact on the organisation's value chain. The risks involved require close co-operation or partnering with the business.

Select alternatives

Alternatives should be selected on the basis of evidence and analysis rather than personal opinions. Risks must be identified as either 'deal-breakers' or issues to be managed. Management accountants can facilitate unbiased, evidence based decision making. They can provide consistent quantitative and qualitative analysis of the situation and proposals.

Decisions

The decision maker(s) should have the authority to take the decision. Role clarity and understanding is important here so that decisions are reached efficiently and not delayed or swayed by other interested parties.

Manage implementation and impact

Managing implementation through to impact requires that the decision should be clearly communicated and the expected outcomes reflected in performance management metrics. Quantifying or describing potential outcomes and, if appropriate, the potential next steps after each outcome, will enable implementation to be managed and appropriate action taken promptly. This will ensure that goals are achieved.

Feedback

Trial and error may be allowed as tactical experiments within acceptable risk parameters, but repeating past mistakes should be inexcusable. The decision and matters considered should be properly documented for post audit or learning purposes. The outcome of past decisions should be captured as part of the corporate memory to ensure that lessons are learned.

The role of the management accountant

For decision making to be effective, management accountants must become finance/business partners. In order for this to happen, the finance and accounting partners must overcome the following challenges.

1. To provide useful management information more efficiently.
2. To work closely with the business to combine their financial expertise with the business' expertise to help achieve impact.

Finance/business partners can apply financial disciplines such as managing for value, performance management, risk management or analytics to support the business to make more effective decisions. However, this is not just about supplying financial information, or a performance measure or other management information but it is about:

- sharing insights based on an understanding of the value drivers in the business
- challenging views and assumptions constructively
- using intuitive logic to provide an opinion
- providing metrics and analysis to support evidence based decision making
- managing performance and risk through to achieving impact.

Key developments in effective decision making

Over recent years, many leading organisations have transformed their F&A functions so that they support the business and improve decision making. These functions have the people, systems, processes and structure to provide timely and accurate financial and management information in a user friendly format. Their finance people are business literate as well as financial experts. They operate within a culture that values their contribution to evidence based decision making.

The first step in a change programme to improve managerial decision making should be determining a shared vision for the F&A function's role. This shared vision should be developed and communicated by the CEO and CFO to the wider business so that it is expected that finance/business partners will improve decision making. A change agenda should look at both the efficiency and effectiveness of the F&A's vision, people, systems, processes and structure.

Case studies/examples

CIMA's Executive Report, *Improving decision making in organisations: the opportunity to transform finance*, provides case studies, examples and experiences from leading organisations.

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Performance measurement and benchmarking. To book via www.cimamastercourses.com please go to Find and key in the course code PMCI. [Accessed 7 February 2008]

Enterprise risk management. To book via www.cimamastercourses.com please go to Find and key in the course code ENRM.
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Contracting out the finance function
Enterprise risk management
Future of finance
Performance measurement and management

Websites

The Foundation for Performance Measurement

This website has a number of resources on performance management.

www.fpm.com

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Stern Stewart

A consulting firm that specialises in the measurement and creation of shareholder wealth. www.sternstewart.com

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The Hackett Group

A global strategic advisory firm in business transformation and associated services. The website has a number of resources and case studies on areas such as risk, performance management, business processes, etc. www.thehackettgroup.com

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**The Chartered Institute of
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26 Chapter Street
London SW1P 4NP
United Kingdom

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