Analyst Insight

Aberdeen Group
A Harte-Hanks Company

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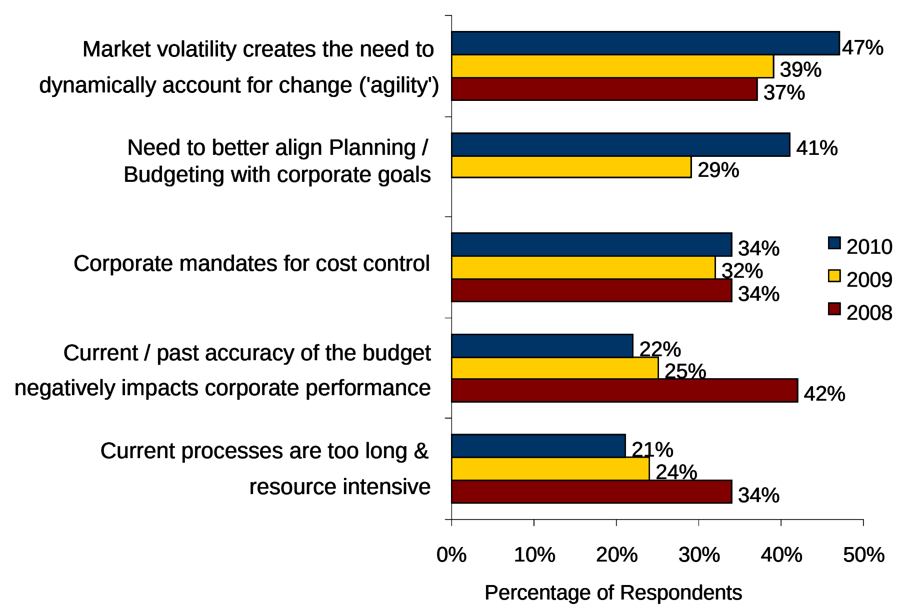
How Best-in-Class Plan, Budget and Forecast in Today's Dynamic World

At the start of 2010, prospects for the global economy remain precarious. But highly effective financial planning, budgeting, and forecasting can successfully enable decision making even in periods of unprecedented change. Dynamic financial planning enabled through five key elements — process, organization, knowledge management, technology, and performance management — can give business leaders the tools to take prompt action and emerge even stronger.

Making the Case for Dynamic Planning and Forecasting

Global economic conditions of the past few years drove businesses to become increasingly cautious about the near-term. Increased focus on improving flexibility to dynamically account for change, along with the need to better align planning / budgeting with corporate goals, and corporate mandates for cost control emerged as top pressures for companies. In 2010, with a renewed focus on strategic goals and corporate performance, organizations that hope to achieve Best-in-Class status must be armed with tools that provide visibility and flexibility to strike a balance between caution and driving changes to create a competitive advantage as the market improves.

Figure 1: "Top Two" Pressures Year over Year over Year



Analyst Insight

Aberdeen's Insights provide the analyst perspective of the research as drawn from an aggregated view of the research surveys, interviews, and data analysis

Definitions

For the purposes of clarity and consistency, Aberdeen defines the following terms as such:

√ **Financial Planning** is the process by which a business documents and communicates in financial terms. A financial planning exercise typically contains detailed plans and budgets, as well as analysis to show how the objectives are to be realized.

√ **Budgeting** is (typically) an annual process that often starts with the prior year's actual performance data, and includes the creation of detailed budgets showing expected future performance at a top-line and detailed level across the entire organization.

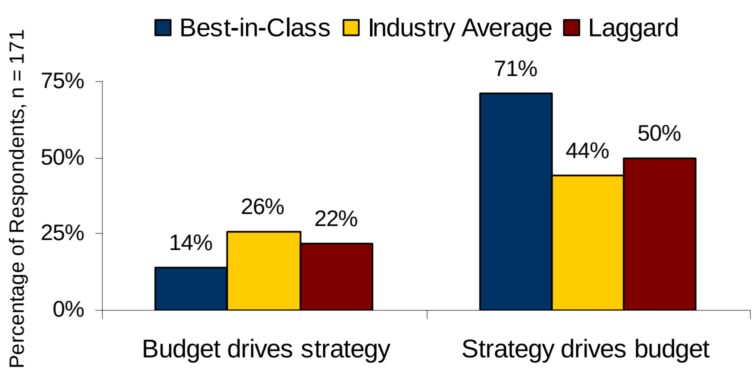
√ **Forecasting** is a process by which businesses adjust future expectations based on recent actual performance resulting in production of an updated forecast document. This can (but does not typically) include adjustments to the budget. Forecasting, re-forecasting, or "rolling-forecasting" can occur multiple times during a budget period, and can span time from one fiscal period to the next.

Source: Aberdeen Group, February 2010

With the economy in flux, adaptability and agility in financial planning, budgeting and forecasting continues to be at the top of the corporate agenda. While budget and plans are often fixed, in response to market volatility, the dynamically changing forecast has emerged as the dominant business driver.

A secondary pressure that emerged is the need to better align planning and budgeting with corporate goals. Best-in-Class are 55% more likely to use strategy to drive the budget (Figure 2). Indeed, in the case of the majority of top performing companies, strategy drives the budget (71%). Poor performance may force companies to budget-constrain strategies, weakening the link between the budgeting and forecasting and strategic objectives. Those not Best-in-Class are more likely to use the reverse approach and employ budget to drive strategy.

Figure 2: Companies' Approach to Financial Budgeting



Source: Aberdeen Group, February 2010

For a residual 30% of average and 28% of laggard businesses, operational and financial plans are developed independently of strategic goals. This reflects one of two scenarios. These companies may perceive, and therefore derive little value from the planning efforts. The planning and budgeting process is an exercise, perhaps imposed on a division or subsidiary of a larger enterprise by the parent company. The resulting budget is filed away until the next year when it is dusted off and revisited. This disconnect can also be indicative an absence of a well-defined strategy.

Strategies: Planning for Value

In benchmarking performance, Aberdeen focuses on the strategic actions of the top performers. In reviewing year over year trends Aberdeen observed a dramatic shift from 2009 to 2010 (Figure 3). The top strategy for Best-in-Class companies in 2009, improving data quality, moved to near bottom in terms of priorities. Best-in-Class appear to have made strides this year in improving data quality, resulting in improvements in overall accuracy and gains in profitability.

Best-in-Class Criteria

Aberdeen used four key performance criteria to distinguish the Best-in-Class (top 20%) from Industry Average (middle 50%) and Laggard organizations (bottom 30%). in financial planning, budgeting, and forecasting

- √ Overall budget accuracy (ratio of actual performance to budget)
- √ Forecast accuracy
- √ Improvement in profitability year over year
- √ Ability to finalize the budget prior to new fiscal period

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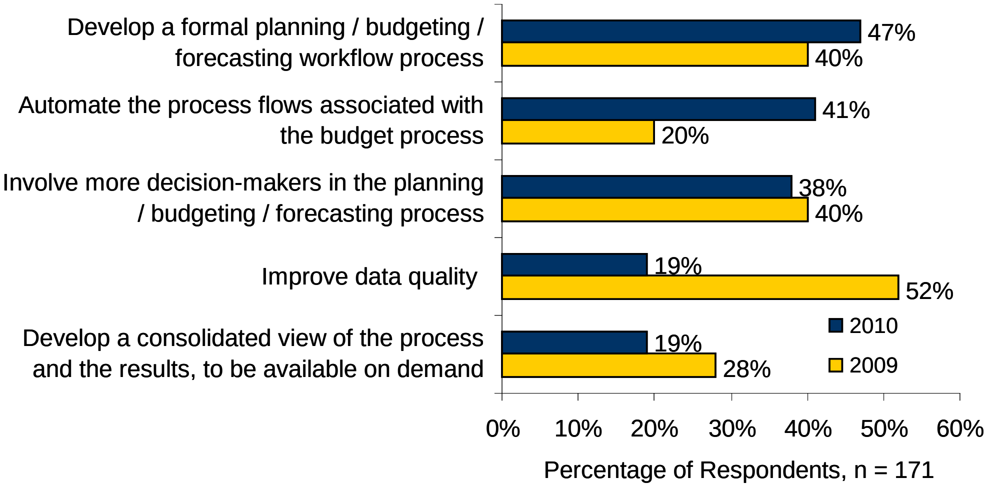
Figure 3: "Top Two" Strategic Actions of Best-in-Class



Source: Aberdeen Group, February 2010

Today the Best-in-Class are refocusing attention on process efficiency. This is reflective of the top two pressures – meeting the demands of an ever changing environment and a need to better align planning / budgeting with corporate goals. While Aberdeen found 94% of top performers do have a formalized process, they are now turning their attention to streamlining and automating the processes because agility is so important. The corresponding processes must be agile as well.

Enhancing Agility

Today's industry dynamics demand that corporate management execute new strategies rapidly. Companies are realizing the limitations of static annual plans and the shortcoming of limited horizons. Notably, 0% of companies desire to forecast just once a year (Figure 4). More companies are forecasting performance every quarter (32%), but businesses clearly have an appetite for improvement and seek to revise forecasts on a monthly basis (40%). A rolling forecast – revised monthly, quarterly, or at the very least semi-annually – can ensure that financial planning is continuous and dynamic.

Accuracy and Profitability Improvements Year over Year

Best-in-Class performance gains from 2009 to 2010

√ Overall budget accuracy improved by 6%

√ Gains in profitability improved by 18%

√ While Best-in-Class exceeded cost budgets by 6% in 2009, they were 3% under budget in 2010

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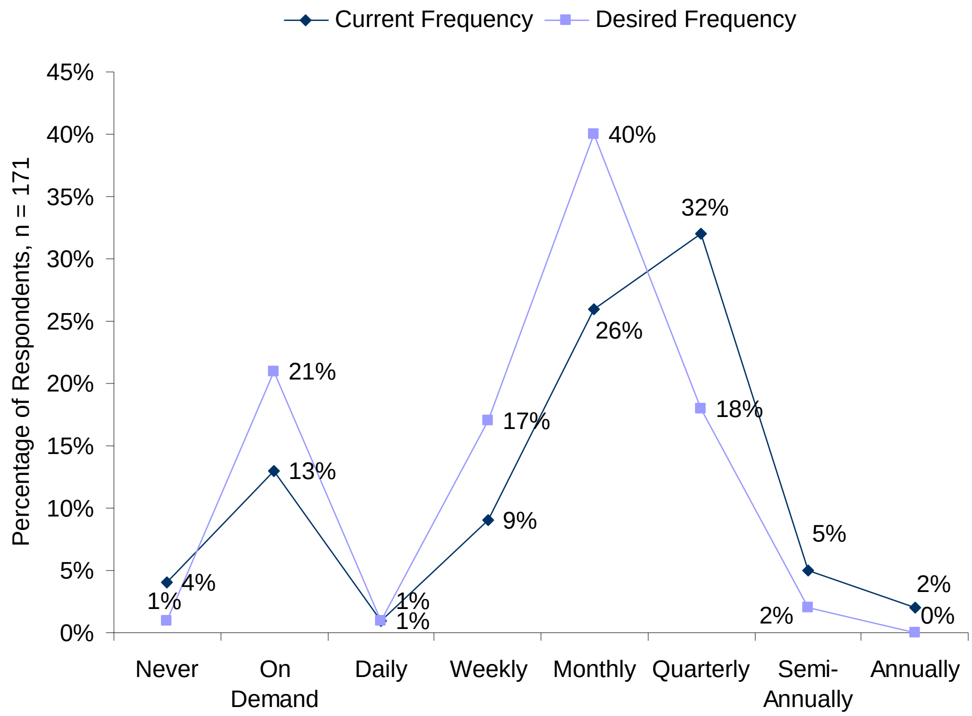
Figure 4: Re-forecast Frequency



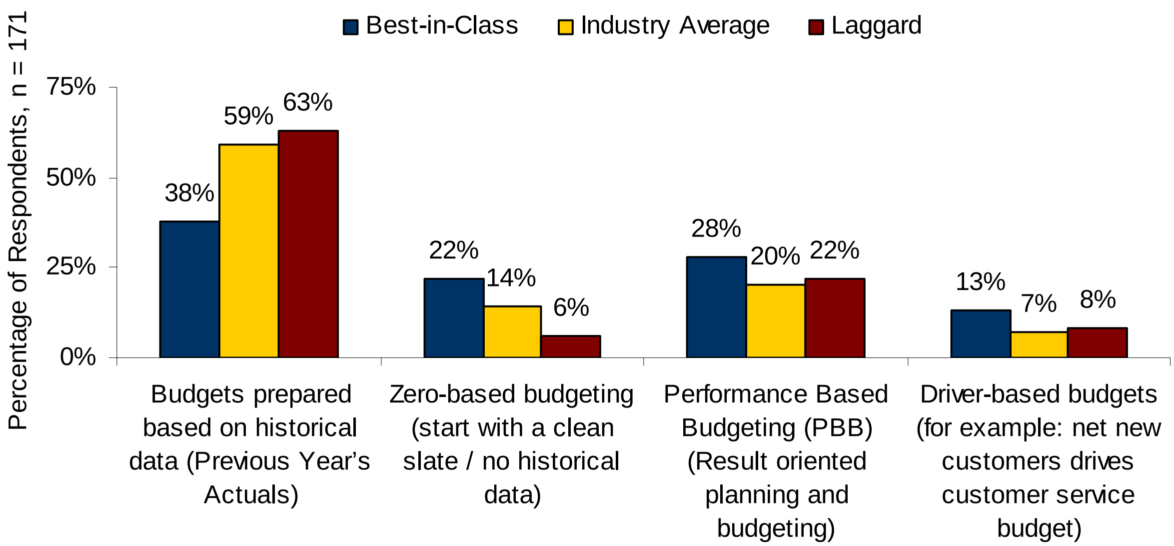
Source: Aberdeen Group, February 2010

Businesses that use traditional static budgeting and planning processes can miss opportunities and emerging risks may go unnoticed. The unprecedented financial crisis that started with the U.S. housing bust and subsequent disruptions in business plans of every sector of the economy have prompted more companies to develop contingency plans. To do so, finance departments are adopting processes and tools including rolling forecasts and scenario analysis modeling to help them provide better insight into future financial indicators and the risks and rewards of strategic actions.

Budget Methodologies Shifting

In the pursuit of more efficient and accurate processes Aberdeen has also observed a shift, although gradual, in budget methodologies. While the majority of participants are still basing budgets on historical data, Best-in-Class are breaking free of this approach and are more likely than their poorer performing counterparts to use alternative methods, including performance-based and driver-based budgeting (Figure 5) to drive better performance.

Figure 5: Budget Methodologies by Maturity Class



Source: Aberdeen Group, February 2010

Aberdeen recognizes that in certain circumstances multiple methodologies might come into play, but is interested in the one most commonly used by the organization. For this reason, participants were permitted to select only one of the methodologies presented to the survey question. The choice is more indicative of philosophical approach to the process than the mechanics. Many companies will use historical data from prior years in preparing for the planning process, regardless of the approach they will take in budgeting. Aberdeen delves deeper into technology use later in this report, and finds a high adoption rate of financial reporting and consolidation enterprise applications used in conjunction with planning and budgeting.

Managing the Process

One of the most challenging aspects of planning and budgeting is process mechanics. As noted, the top pressure facing companies is market volatility, and traditional static approaches to strategic planning, target setting, investment planning, budgeting and forecasting are proving to be inadequate. Instead, Best-in-Class are strategically focusing on making the process efficient and dynamic. One of the first steps is establishing and implementing corporate processes for budget revisions, roll-ups and approvals and making these processes agile enough to accommodate change. As business conditions change, including specific business drivers, it is important to be able to quickly assimilate those changes and to determine the impact on the overall plan and budget as well as the impact on the business itself. Figure 6 indicates top performers have more control over these processes.

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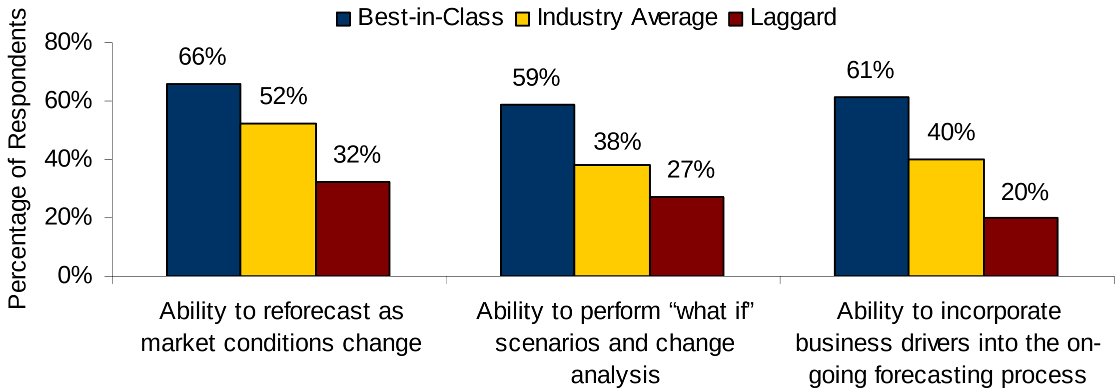
Figure 6: Dynamic Planning Capabilities

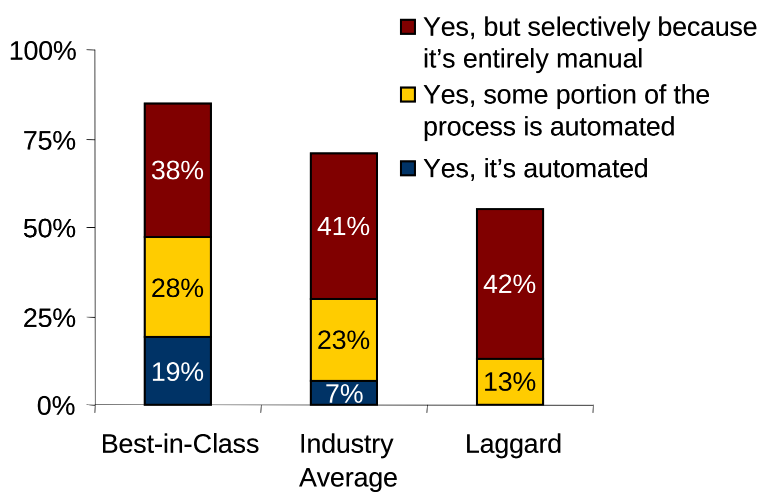


Source: Aberdeen Group, February 2010

As new developments and disruptions emerge, seldom is the impact isolated to a single facet of the business. The ability to make a change and evaluate its impact on the enterprise is contingent on the ability to perform "what if" scenario analyses to consider alternative strategies and allocation of budget. However, a key challenge to such analysis is lack of automation. Financial modeling whether quarterly, monthly, or ad hoc can be a cumbersome and a protracted process in a manual spreadsheet environment.

The level of automation can enable the ability to perform "what if" scenarios with agility and accuracy. While the ability to fully automate these scenarios is rare, Best-in-Class are significantly better equipped to fully or partially automate the process (Figure 7).

Figure 7: Ability to conduct "What if" Scenario Analysis

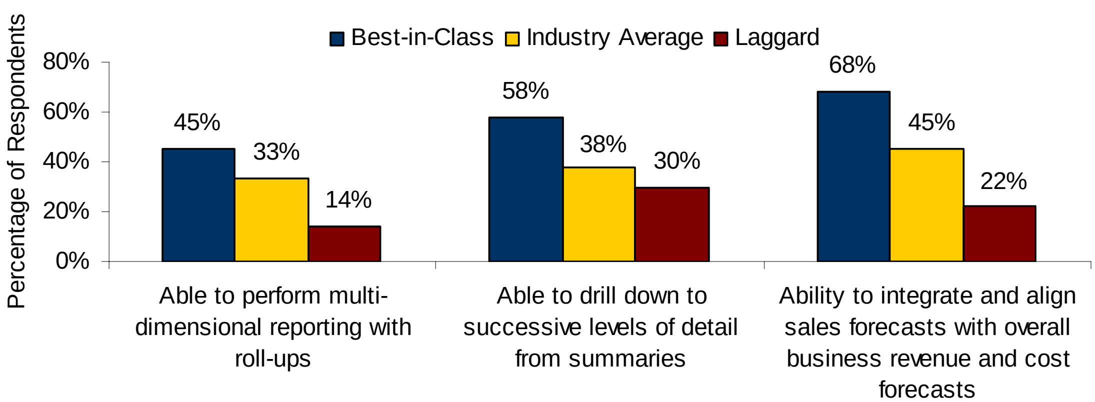


Source: Aberdeen Group, February 2010

Control and Visibility

Transparency and speed are key factors in enabling the planning and budgeting process to drive strategy and positively affect performance. In highly effective companies, strategic value delivered by the finance department is closely linked to visibility and timely response. Best-in-Class organizations are **66% more likely** to be able to drill down to successive levels of detail from summary position, than their peers (Figure 8). This level of detail can provide a holistic view of operations to drive successful execution of business strategies. Further, leading corporations are **3.2 times** as likely as Laggards to be able to perform multi-dimensional reporting – based on geographies, product lines, time periods, and other dimensions – which then roll-up to integrated financial statements (i.e. Profit & Loss (P&L), balance sheet, and cash flow) enabling transparency and collaboration across the organization.

Figure 8: Visibility Leads to Alignment of Goals



Source: Aberdeen Group, February 2010

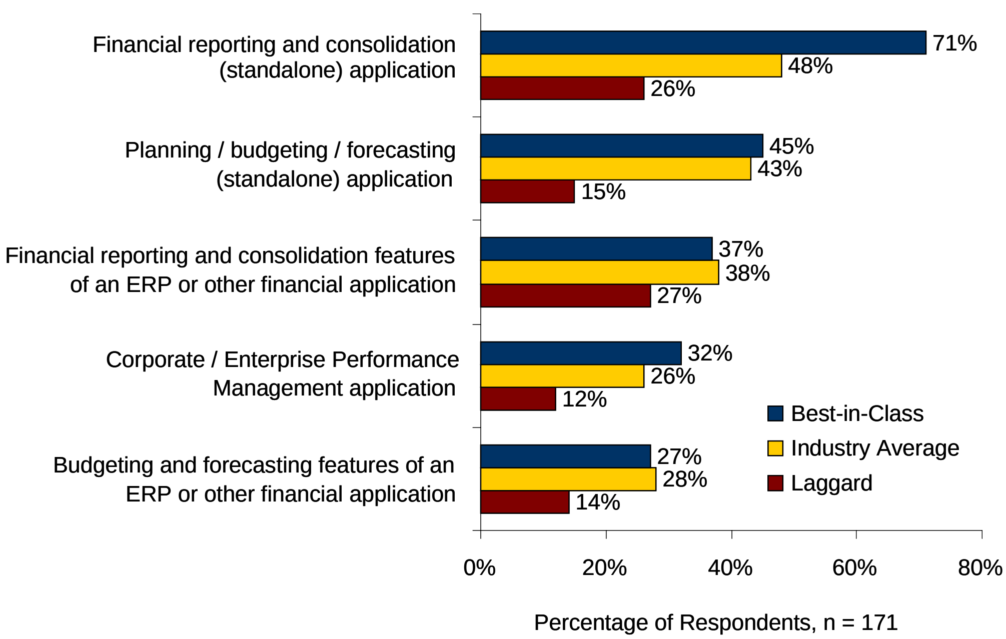
The net result is an improved ability to integrate and align forecasts (and re-forecasts) to the overall business revenue and cost forecasts to better produce the overall corporate results desired. Yet this level of visibility is virtually impossible to attain without the appropriate level of technology enablement. In spite of the perceived "attachment" to spreadsheets (88% of respondents still make use of spreadsheets at some point in the process), this pervasive tool simply cannot provide this level of visibility and control.

The Role of Planning / Budgeting / Forecasting Specialty Applications

A variety of different tools and technology can come into play. Financial reporting and consolidation applications, whether implemented as a standalone application or embedded within an ERP solution, are most effective in preparing for the budget process. Best-in-Class are almost twice as likely to have dedicated applications for this purpose as to simply rely on features of their ERP solutions (Figure 9). However, notably the percentage of Best-in-Class that rely on standalone or separate solutions and the percentage that use ERP is more than 100% implying that in some instances both are used.

The ability to satisfy the needs of the financial reporting needs of the enterprise will depend on the level of capabilities of the solutions implemented, their integration capabilities, and the specific needs of each company. Another factor is the size and structure of the enterprise itself. Smaller companies or those with a monolithic structure may not need industrial strength consolidation while this will be an important consideration for multi-national, multi-divisional enterprises.

Figure 9: Technologies Supporting the Process



Source: Aberdeen Group, February 2010

The majority of Aberdeen's survey population also prefers a specialty application for supporting the planning, budgeting and forecasting process itself. A quarter of both Best-in-Class and Industry Average companies simply rely on the features of their ERP solution or another general purpose financial application to support this process. Certainly the General Ledger module of most financial applications will have some rudimentary budgeting capabilities and will provide a repository for the budgets and the ability to compare actual results against budget. But seldom do these applications have the more advanced features that enable the planning process itself, including "what if" scenario analysis and the ability to incorporate forecasts and re-forecasts.

Software solution providers will often package financial planning, budgeting and forecasting applications as a subset of the more all-inclusive category of

Corporate or Enterprise Performance Management (CPM or EPM). However, Figure 8 implies that the adoption of the financial planning and budgeting functionality leads the adoption of the larger category, indicating the specific needs these applications provide are a top priority for many companies and perhaps a first step in a phased implementation of the broader software solution.

Results Achieved from Technology Enablers

Given there is often a choice made between using standalone applications and simply incorporating features and functions of an ERP or other financial application, Aberdeen sought to contrast the results from each against the results achieved by those still relying exclusively on spreadsheets. Table 1 illustrates a progression in performance, with the lowest performance achieved by those still persisting exclusively in the spreadsheet environment for the end-to-end financial planning, budgeting and forecasting process (including collecting information, data storage, and data analysis like "what if" scenarios), compared to those leveraging ERP and financial application functionality for automation and more robust analysis. The highest level of performance in terms of budget accuracy and profit improvement comes with the specialized functionality available in standalone applications.

Table 1: Specialty Applications Produce Top Performance

Enablers in Use	Performance
Financial Planning & Budgeting Stand-alone Specialty applications	▪ 93% Overall budget accuracy (ratio of actual performance to budget) ▪ 95% Cost budget accuracy ▪ 90% Revenue budget accuracy ▪ 91% Forecast accuracy ▪ 6% **improvement** in profitability year over year
Financial Planning & Budgeting as a feature of ERP or other financial applications	▪ 87% Overall budget accuracy ▪ 89% Cost budget accuracy ▪ 89% Revenue budget accuracy ▪ 88% Forecast accuracy ▪ 5% **improvement** in profitability year over year
Spreadsheets ONLY	▪ 82% Overall budget accuracy ▪ 86% Cost budget accuracy ▪ 84% Revenue budget accuracy ▪ 83% Forecast accuracy ▪ 3% **improvement** in profitability year over year

Source: Aberdeen Group, February 2010

The gains in performance achieved when companies move beyond spreadsheets comes as no surprise. Beyond the visibility and control afforded by these applications, there are certain approaches that are simply not adequately supported simply by distributing spreadsheets to those responsible for defining the budgets. One such perspective relates to the direction of collaboration between senior management and those line managers that have more direct involvement in delivering against the promises of the budget. Using a top-down approach, high level executives make the decisions handed down to the organization based on the strategic agenda they have developed. The strengths of this approach lie in the rapid ability of management to state corporate goals up-front, and lay the ground rules for limiting deviation from achieving these goals. Its weaknesses lie in the lack of organizational buy-in to the budgeting process, and potential for lower levels of belief that stated goals and financial targets can be attained.

In contrast, bottom-up budgeting provides employees the opportunity to be involved in setting their own goals and expectations for a given financial period, as well as create a more accurate picture of what each department / division needs in order to function effectively. The weakness of this approach lies in the potential risk of the budget not supporting the company's stated goals and financial targets.

As a result, leading companies are most likely to use a coordinated system of top-down and bottom-up planning and budgeting that links the performance of the business units to a company's strategic vision. Indeed, 58% of Best-in-Class take this approach. Laggards are most likely to simply take a top-down approach (44%). Why? While there may be many reasons for this, one of the most telling is the difficulty in managing a coordinated top-down and bottom-up approach without the assistance of solutions that help manage this process. Indeed 79% of Laggards use only file-naming conventions or other manual methods to manage version control through the planning and budgeting process, providing little or no assistance in coordination and collaboration.

A callout for a customer quote.

~ Customer Description

Key Takeaways and Recommendations

As companies face an unpredictable market, the firms that will be best positioned to navigate evolving market conditions are those companies that build strong and flexible business capabilities through the effective administration of process, organization, knowledge management and performance management. Supporting these business capabilities with enterprise applications that enable the planning, budgeting and forecasting process with streamlined workflows, support "what if" analysis, sustain flexible reporting and consolidation, along with integrated enterprise performance management are positioning themselves to survive the current troubling economic times and emerge stronger as the economic turmoil subsides and the world economy moves to recovery.

Some specific recommendations to help drive superior performance now and into the future:

- **Invest in financial and forecasting applications that provide flexibility to changing business conditions.** Spreadsheet-based budgeting and planning processes are manually intensive, error prone and tend to have longer cycle times. The effort expended in generating budgets and forecasts must be redirected to provide strategic value to help the company make rapid decisions and move quickly in the marketplace.

- **Employ both top-down and bottom-up approach in the planning and budgeting process.** Top performing companies are 28% more likely to use a balanced blend of the two approaches than Laggards. Using the combination of top-down and bottom-up approach helps to foster a closer link between finance and corporate strategy, ensuring corporate strategic goals are reflected in the plan and that managers who are held accountable have bought into the viability of the plan.
- **Implement processes to provide better insight into future financial indicators and shift reliance away from historical-based budgeting**. Today's unpredictable and fast-paced climate demands an adaptive system that is continually updated to reflect variances that arise due to changing business conditions. These include moving away from historical snapshots, developing multiple scenario analysis that demonstrate the risks and rewards of strategic actions, and integrating operational and financial planning processes.
- **Improve visibility with business analytic tools**. Even the Best-in-Class have yet to fully embrace the technological means to provide greater depth, accuracy, and agility in financial planning and forecasting. Providing visibility through data analytics with the use dashboards, performance management applications, and business intelligence tools, has shown to be a key competitive differentiator for Best-in-Class firms.

For more information on this or other research topics, please visit www.aberdeen.com

Related Research	
Financial Planning, Budgeting, and Forecasting: Achieving Agility and Adaptability in the SME; December 2009	*Financial Planning, Budgeting, and Forecasting: Managing in Uncertain Economic Times;* January 2009

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