Agile Budgeting

Needs another nudge

White Paper

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Introduction

Budgeting – a more balanced view

Budgeting has come under a lot of scrutiny lately, and quite rightly, in part driven by the Beyond Budgeting Institute. Some early movers have made a successful break with rolling forecasts, but it feels like the rest of the world has been left behind with the same old budget thinking and processes. The budgeting process has taken on the nature of a comfort blanket, management expect it and so it's delivered. Not that a budget itself is necessarily a bad thing for most businesses in their evolution of processes, but its limitations and "use by date" have to be better understood.

The resources and processes used to deliver the budget need to be appropriate to the nature of the task and its value to the business alongside other forecasts. Don't ever forget that it is just an estimate that will in time reduce in value and be replaced by another estimate. The debate has engendered a greater frequency of forecasting subsequent to the budget but another nudge is now required to have a more balanced view of the budget in the whole planning landscape.

Budgeting Problems

Let's look at some of the many issues that Finance teams encounter when preparing budgets:-

The process gives management the illusion of control, and some finance teams exacerbate this with wholly ill-conceived ideas that vast volumes of data and complexity will increase accuracy.

Time

The scarcest resource in any business is usually not capital or ingenuity but time. This is admirably covered in a Harvard Business Review May 2014 paper "Your Scarcest Resource", detailing how organisations squander time. It would not be so inexcusable if the outcome of all that time spent was useful, but in many cases there appears to be an inverse relationship between the time spent on the budget and the usefulness of the output. A recent study calculated it took an average of 110 working days to complete a budget. So what is going wrong here?

Devil *is* the detail

There was a time was when budgeting was limited by the number of columns on analysis paper or the number of rows available in early spreadsheets. Such constraints have been swept away by an army of analysts pivoting and pirouetting data, no bad thing in itself, but spreadsheets now offer few constraints. Parkinson's law has been wonderfully applied, and data has flooded into the available space. The budget is built at a more summarised level of detail than that in the GL or ERP for a very good reason, but is being driven closer by many.

Businesses need to stand back from this volume, because while in theory the spreadsheets can take the load, in practice huge numbers of man hours are being burned feeding the spreadsheets, and the complexity is not helping budget value. A budget is, after all, an estimate with a limited shelf life – we will come later to how limited – we need to understand what its value is to the business, and then we can more clearly determine how much effort to invest in it.

Inadequate Processes

There have been structured budgeting applications around since the early 90's, a quarter of a century ago, yet still the budgeting tool of choice for many is a spreadsheet. This has to some extent been driven by the cost and complexity of the early choice of on-premise solutions such as Hyperion, Cognos and SAP which concentrated on enterprise level organisations and missed the mid-sized and below market.

Cloud solutions have made the entry point much more attainable for all and equally appropriate to large and small organisations, but many are still dragging their heels when it comes to switching out of spreadsheets. Even those businesses that have had structured solutions for a few years in reality only partially adopted it due to the expense and complexity of pushing it down to the roots of the business.

In this world where everything can be measured and evaluated in the finest detail, people rarely add up the whole cost of the time invested in budgeting processes. Why? Because it is easier to assume it is an absolute necessity, and a cost that the business just has to bear. It is worth challenging this assumption to see if it stands up to scrutiny, or if it allows lazy thinking to prevail.

Convoluted Modelling

The corollary to using spreadsheets is convoluted modelling. This has led to the logic that supports the growth of models each successive year until it really becomes both unmanageable and dangerous to health and wellbeing. I suspect we have all seen it and been party to it, but few properly question if it is either sustainable or fit for purpose.

Let's take the example of significant venture capital businesses who manage a stable of high growth businesses. They are operating in a fast moving, high growth environment, where most are focused on investment risk and re turn, so you don't want spreadsheet errors undermining your assumptions. Yet it isn't common practice to step into their portfolio and insist on better standards. Maybe the answer is that the complexity of models these days means many of us just don't know the extent of errors inherent in spreadsheets.

Big systems integration businesses still have teams pedalling complex business models based on spreadsheets, allegedly to demonstrate their prowess in understanding that particular industry. Every few months there is a big news story about some spreadsheet error, but we seem to be slow learners. My favourite slide quote from the ACCA is still:

> "More than 90% of spreadsheets contain serious errors, while more than 90% of spreadsheet users are convinced that their models are error-free."

Accountants wryly smile when confronted with this statistic. Such processes and resulting errors devour corporate time, and ultimately undermine informed analysis and decision making.

Lack of Collaboration

Planning is all about collaboration. It's more than just manipulating data it's about having engaging processes that encourage participants to willingly contribute, exchange ideas and thoughts for simultaneous consumption. Well-conceived planning applications in-corporate collaborative tools alongside all the other wonderful means of handling data. Spreadsheets totally fail at collaboration. There is nothing shareable about them. They proliferate because they just seem easier, low cost and everyone understands them. More concerning is that most users are self-taught and regularly skirt the perimeter of their capability. Lack of collaboration results in missed opportunities to work in unison, adding risk and lengthening the task. As well as frustrating everyone in the process.

Budget Half Life

What is the useful life of a budget? Its usually driven by the cadence of your business or whenever it has been out-stripped by reality. In a fast moving business it is not going to last long. If you have growth in excess of, say, 30% per annum you may only be able to plan in six month segments. There are no rules, you just have to do what is useful to move the needle. If a budget has passed its useful life why waste time comparing performance to it? Re-forecast and give yourself a new star to steer by. Similarly a lot of time is wasted on prior year comparisons which don't actually help anything except they more often than not generate a feel good factor. Clearly there has to be good governance in choosing the steering mechanism for the business, but don't waste time making comparisons to outdated plans, move on and focus on the path ahead. So, treat the budget like a 0 + 12 Forecast, don't over-engineer it, and it will serve you much better.

Why is the Budget Disproportionately Important?

One factor which has maintained the importance of budget is executive pay. Many board members are paid on a bonus' calculated on exceeding the budget in terms of profit keeping it central in the process. This results in lowballing behaviour at every point of measurement, leading to a tendency to underinvest and in short-term gaming; such as increasing prices for short-term profitability at the expense of longer term growth, easy to understand, but difficult to eradicate.

The advice is to pick different measurements such as market and competitor comparisons, but the reality is these will probably generate a new set of issues. So, the reality is that whilst the budget may not be useful in taking the business forward and when it has outrun its usefulness, there are still interested parties to assuage, when arguing the case for a better solution. Nevertheless, budget structure and processes do not have to dominate how you reporting through the year.

The solution has to be right for the company, not just key individuals or finance. Forget the rear view mirror, the focus should be on generating plans and forecasts that are useful across the business and which can assist progression in growth. Remember that those plans are estimates, have a shelf life and move smartly on to the next forecast or plan. Don't cling on to out-dated plans!

So what should we do?

Driver Based Forecasting

What we see most frequently in the market is businesses not forecasting often enough. There are still businesses out there who do a budget and don't re-forecast. For most this is really not appropriate. Many finance directors we talk to would like to forecast more frequently, but find the whole process disruptive. Agility can be enhanced considerably by embracing driver based forecasting, and the process of working out the relevant drivers usually clarifies a lot of peripheral issues along the way.

Every plan and forecast incorporates assumptions, but driver based forecasting goes much further than this, identifying cause and effect relationships, using financial and non-financial measures such as sales volumes, employees, production, marketing expenditure etc. The deeper these relationships are pushed down the planning model, the fewer items have to be individually planned, leaving the drivers to be more easily tuned to change the outcome. Frequent re-forecasting, say monthly, usually depends on a driver based approach unless you engage in undue degrees of complexity.

Forecast more frequently, but don't just forecast frequently because you can, do it because it helps.

Rolling-Forecasts

Appropriate for some but not for all. You need agile systems, a driver based methodology and you need to have prepared the organisation for the cultural shock of a moving target. The period of roll (usually anything from 6 months to 3 years) and frequency of forecast (monthly or quarterly) needs to be well thought through for your business. You also need an active strategic plan to steer by (not the filing cabinet type), you can't roll off into the future aimlessly. It's probably best to start with a quarterly roll (say 6 - 8 quarters, if appropriate to your business cadence), get used to that and then move to monthly if such a frequency is relevant. The year-end will retain its relevance for financial accounting, tax and external markets, but not for planning, but that is not a problem.

Better Planning Applications

Get yourself appropriate tools for the job. A modern cloud application will not cost much more than all those hidden costs in your current processes but will do a much better job. They are manageable by the Finance team, easy to deploy and come without the spreadsheet risks of data integrity and data management. They can be securely distributed around the organisation, enable collaboration and will help you focus on what is important to drive your business forwards.

In Conclusion

- Time is a scarce resource. A budget is just one of a continuing thread of business plans, match the time you spend on it to the value you derive from it.

- A budget is an estimate. Don't assume that large volumes of data down to SKU or similar are necessary to improve the quality of the output

- Budgets and forecasts have a useful life. Don't waste time on them beyond that point.

- Find easier ways of budgeting and then forecast. Using a driver based approach so you can increase the frequency to whatever is appropriate for your business.

- Treat budgets and forecasts a bit more equivalently as you pick a path closer to rolling forecasts.

- Spreadsheets are great reporting tools, but they are not collaborative planning tools. Get yourself a modern cloud based planning application.