Financial Planning, Budgeting and Forecasting

HOW TO IMPROVE YOUR PLANNING PROCESS?

OneGlobe
Data to Clarity

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OneGlobe's View

Top Priorities

More-effective budgeting-and-forecasting abilities are top-of-mind for CFOs this year.

Source: The Hackett Group 2011 Key Issues Study

Financial Planning, Budgeting and Forecasting (PBF) are critical activities for any and every organization. The problems, pitfalls and issues associated with this trio of financial activities has been cataloged in a number of different articles, text books, "best practices" white papers and other thought pieces on the subject. The CEO, CFO and management of most companies can recite the pitfalls and issues most likely by heart. The reality is there are no alternatives. The company needs a thought out strategy and plan as it moves into the new fiscal year. The financial implication of the plan needs to be calculated in enough detail to be credible to management and the company. The plan has to be updated periodically during the year as business conditions change. The core problem is it takes too long and too much effort to arrive at budgets and forecast, and because it takes so long they are out of date on arrival.

Some believe the answer lies in moving from 'Once a Year' detailed budgeting process to a more agile ongoing quarterly or even monthly rolling forecast. Some companies have moved to this approach. It begs the question of where the detail contained in the old budget process moves to in this new rolling forecast approach. Companies still need to set, manage and monitor expenditures at some level of detail. This requires that the annual budget exercise stays in place or is moved into forecasting process as a rolling plan. In the case of a few companies who have moved away from annual budget process all together, such as Southwest Airlines and American Express, detail budgeting has been pushed lower into the organization. Either way, the work doesn't change, it just moves around bringing us back to the effort and time problem. The Hackett Group's Key Issue Study supports this view of the problem.

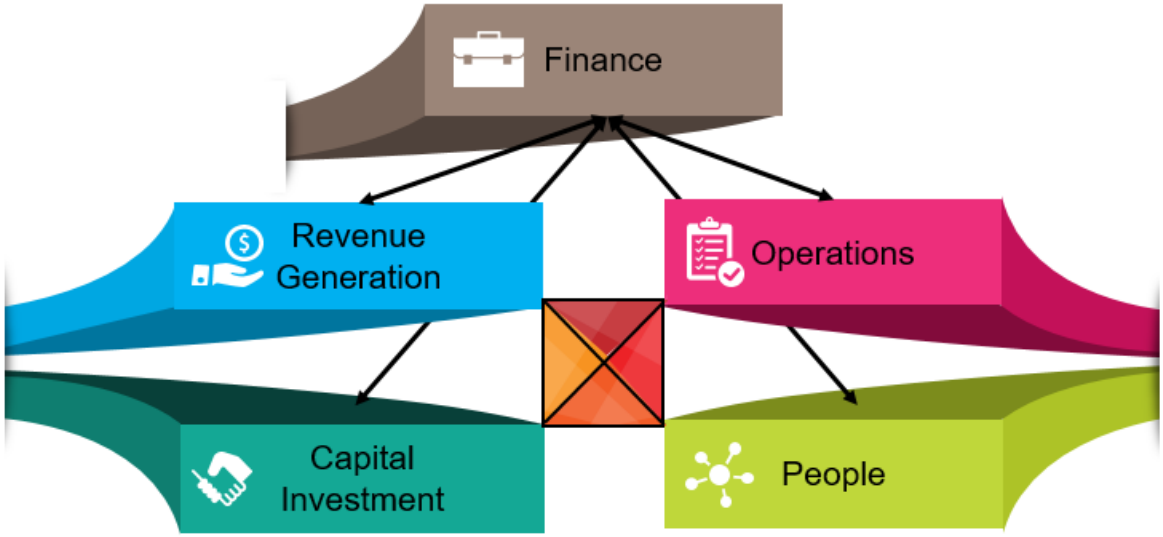
This brings the conversation logically to technology as the tool to help reduce time and effort in the process. Microsoft Excel has been one of the key tools that has allowed financial departments to increase the complexity and detail of the PBF process to better approximate the real world. It stands to reason that more sophisticated excel like tools would help financial organizations decrease the time and effort required for PBF process. These sophisticated tools, like Oracle Hyperion, IBM Cognos and others can play a very critical role in reducing cycle times. These types of tools are critical but they are not the total solution.

Our view is that these sophisticated financial planning tools must be linked with their corresponding planning counterparts in other key parts of the organization. It is through this approach; we believe that companies can achieve the maximum benefit. The rest of this paper expands on this concept.

Complexity Drives Time and Effort

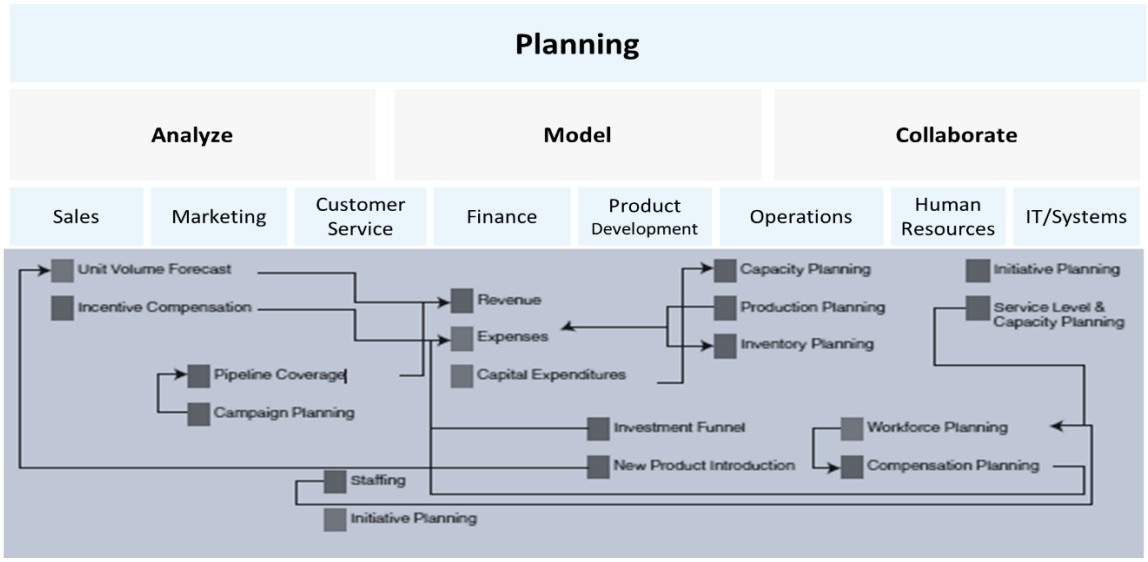
Any business can be thought of very simplistically as four major pieces which is integrated by a fifth as shown in the figure below. A **Revenue Generation** piece responsible for finding and capturing revenue opportunities. For some business this maybe a salesforce for others a network of stores but there is always some function in the organization responsible for revenue generation. Likewise, there is an **Operations** piece which is responsible for creating, building and/or delivering what was sold or to be sold. **Capital Investment** is a critical part of all business whether that is to build capacity, open stores, build new products, etc. The particulars are different for different business but they all consume investment dollars in the hope of future returns. The fourth major piece is the management of the **People** contained in the business which for most companies is a major piece of their cost structure. Finally, **Finance** helps manage the business and keeps score.

Simple Business structure



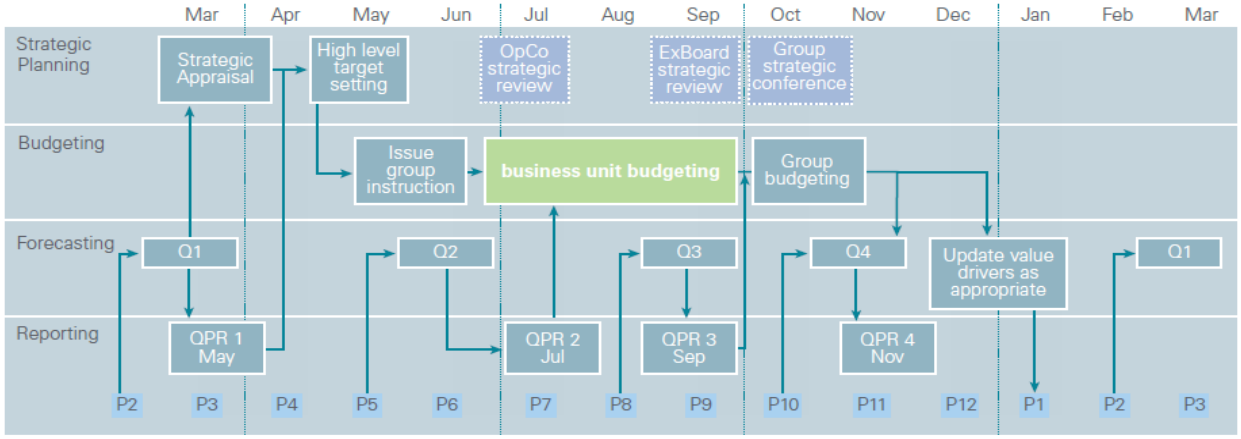
These four major areas are integrally linked in a way that major change or disruption in one impacts the other three areas but the most critical linkage is between the **Revenue Generation** and the **Operations** sides of the business. A drastic change in revenue, up or down, impacts operations from standpoint of delivery, inventory or other key metrics of the operations groups. A drastic change in operations through raw materials shortage, supply chain disruptions or other operational impacts will hamper the revenue generation group's ability to meet revenue goals. These types of impacts then have knock-on effects on the **Capital Investment** and the **People** parts of the business.

To manage the business, each of the five areas discussed, have their own management systems to help manage the day-to-day and longer term objectives. For most areas these are underpinned by major information technology systems. These systems may be different for different types of business but if we take a manufacturing company as an example – **Operations** will have some sort of Enterprise Resource Planning (ERP) system. The People side of the business will have Human Resource (HR) system for tracking people, pay, etc. **Revenue Generation** using a salesforce will have some sort of Customer Resource Management (CRM) system like Salesforce. **Capital Investment** will have their own unique system depending on the types of investments, for example – building out stores is different from building manufacturing plants. Finance will have its own systems or is integrated into the ERP system but will most likely have a planning system of excel spreadsheets on top of that.



Source: IBM Best-Practice Budgeting, 2009

From the budgeting standpoint, each of the four major pieces of the business, given planning parameters developed by top management, will use their internal systems to generate their piece of budget puzzle as shown in the figure above. Revenue is the starting point but since each area impacts the other, any changes will have a knock on effect across the other groups. Once finance has assembled the puzzle, most commonly using excel spreadsheets, then management will be able to provide feedback and input which starts the process and effort again. If we look at this process and a typical time line, as shown in the figure below of an "Integrated Performance Management Framework", then it is not hard to see the pain of the process.



Source: KPMG Planning, Budgeting and Forecasting

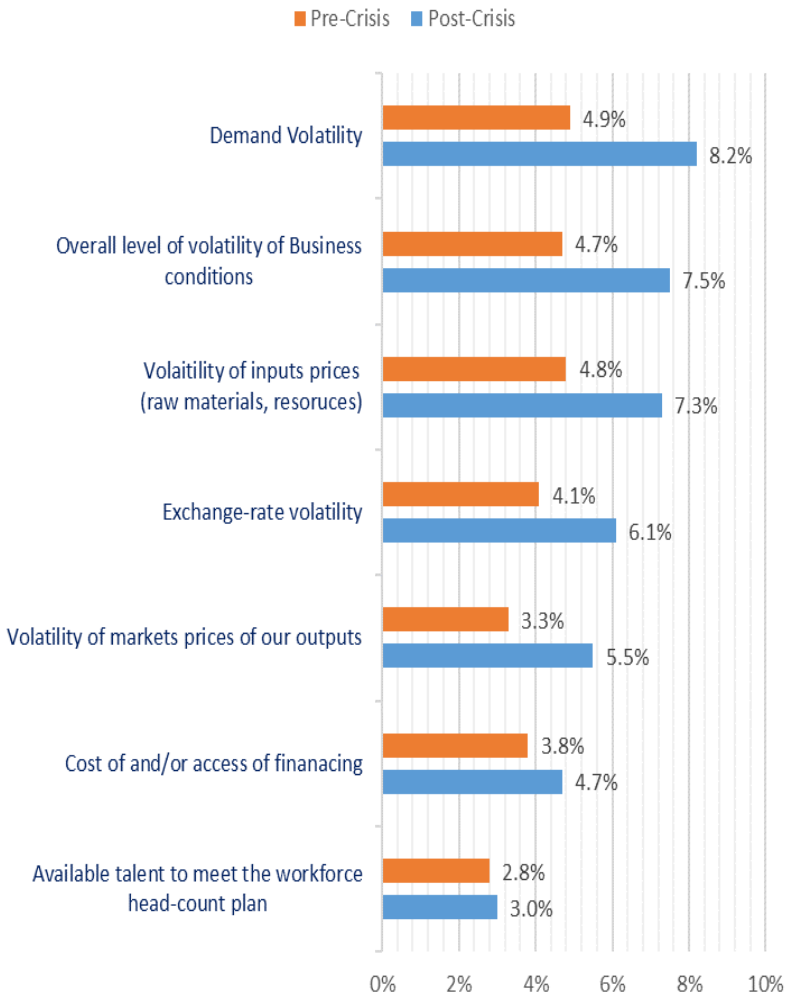
Looking at forecasting in this context, it is clear to see that the quarterly forecast requires the company to focus on less detail to not overwhelm the organization and keep the forecast timely. So organization will focus on key revenue and operational components for forecasting keeping all other things constant. Any major disruption on either the revenue or operations side of the business will require a budget recast which will be very painful for the organization to accomplish in a timely manner.

Advanced Financial Planning Tools Can Help

Advanced financial planning tools like Hyperion can help because they will replace the finance's dependence on excel spreadsheets to put their pieces of the puzzle together. This saves finance resources, time and effort to accomplish the PBF task but it still leaves the work in the other parts of the organization required to get the process completed, in place. Finance has become more efficient but the rest of the organization is still mired in the effort and time required. Some gain has been achieved but not enough.

Coping with Uncertainty

The increase in various forms of economic volatility is driving companies to rethink their approaches to budgeting and planning.



Looking at what causes the most volatility in the business environment from a planning perspective, as shown in The Hackett Group Study, we see some interesting points. Volatility in the Revenue and Operations side of the business are the major causes of change. Revenue side changes account for over 13.7% of volatility while the Operation side changes account for 7.3%. Given the connection between the Revenue and Operations side of the business this accounts for 21% of the overall volatility. Issues under finance's purview account for about 10.8% which focuses on exchange rates and financing cost. General business volatility accounts for 7.5% with People only accounting for only 3% of the volatility. Given the level of volatility associated with demand and supply, addressing only the financial side of the PBF process effort does not address the total problem.

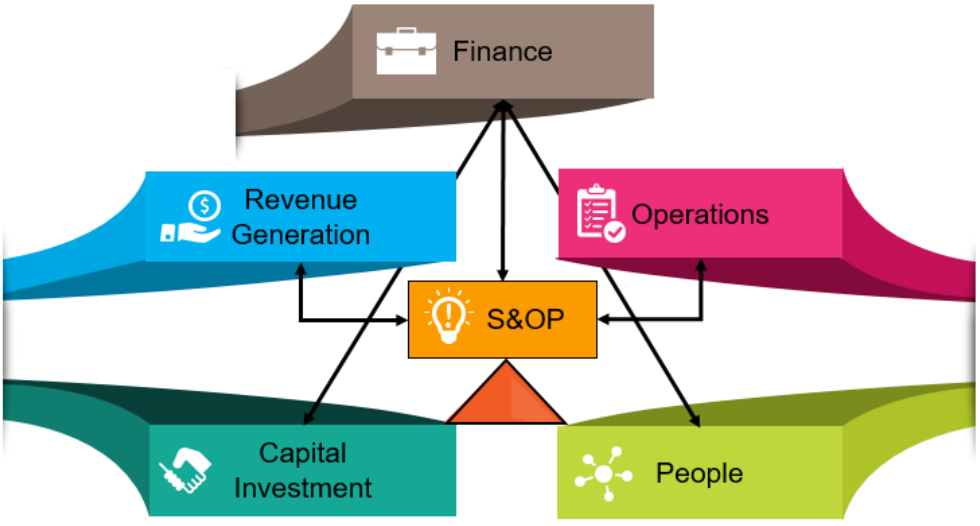
To get the rest of the way requires using the advanced financial planning tool as a linchpin providing a linkage to the other parts of the organization. In a way, allowing the other parts of the organization to rely on their planning systems without manual translations that are usually required during the PBF process. This requires more than simple integration of systems. It requires transforming the information coming from these other systems while using a common framework. So for example, most organizations relying on a salesforce for revenue generation have moved to or are planning on moving to a CRM system to manage and predict sales. These revenue forecast can be aggregated and loaded into an advanced financial planning tool. The key considerations are what should be loaded – order value, factored order value or maybe order units. These types of decision have to be understood and agreed to by both the **Finance** and **Revenue Generation** groups. The same discussion can be had around the other three organization areas we have discussed. The trick is understanding how to do the transformation between systems.

A Key Linkage

We have talked about using the advanced financial planning tool as a linchpin to other systems but we believe there is one critical linkage in the organization that should be addressed before all others. That is the linkage between demand and supply or between the **Revenue Generation** and **Operations** groups. As we have seen the volatility associated with these two groups is larger than any other so the benefits to the organization of addressing this linkage are great. Best performing companies address this linkage through the process of Sales and Operational Planning (S&OP).

In some organization S&OP is more of a process in which both **Revenue Generation** and **Operations** groups match their views of demand over time. Best-in-Class organizations leverage their information technology systems to make the process more timely, efficient and effective. The truth is that even in the companies with no S&OP process, demand and supply will be harmonized because in the current month the company is operating in will have to match. Unfortunately, the match between supply and demand at that point will be a painful one and probably not the one the company would have preferred. The reality is that any **Operations** group will have to develop its view of demand to be able to perform its function. S&OP just makes this view of demand external and actively matches this against the **Revenue Generation** group's view

Simple Business Integrated with S&OP



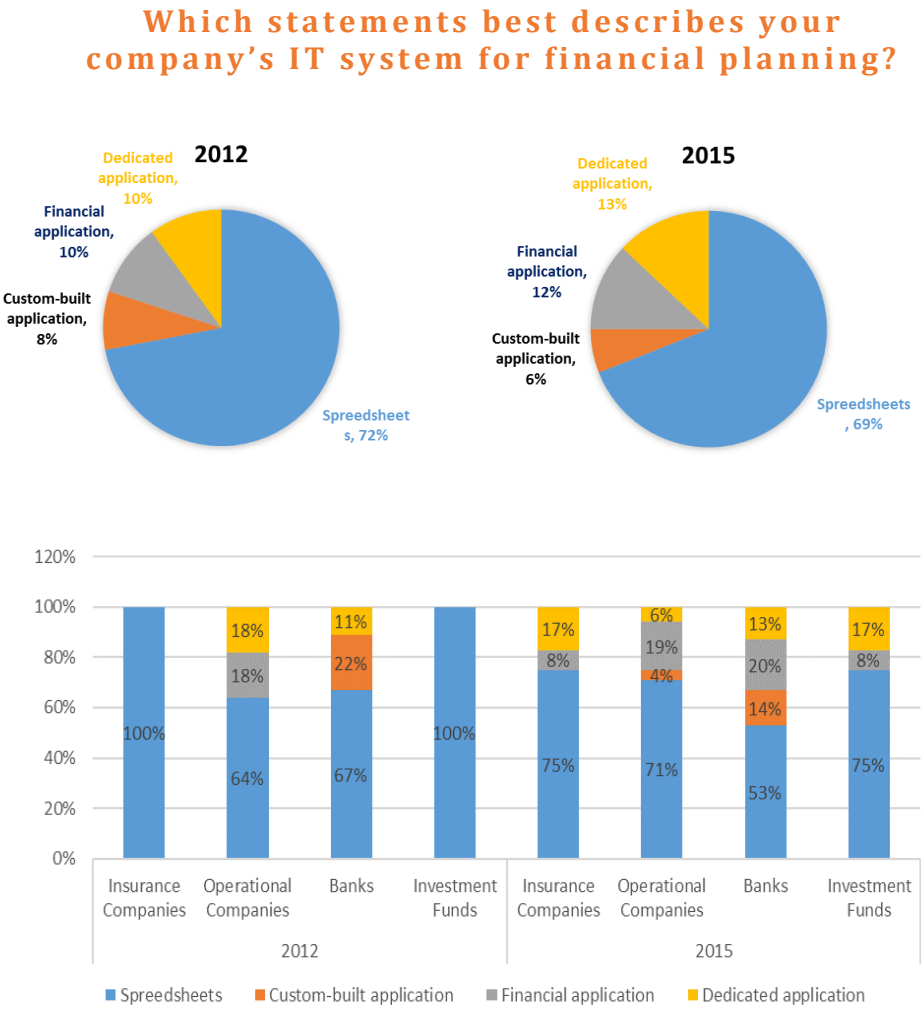
S&OP theoretically creates a sixth component in our simplified view of an organization shown above. It creates a group within the organizations with best consensus view of demand. Operations then works to this consensus view until it is changed or supply issues interfere. Either way all is visible to other parts of the organization including finance. This view of the organization reduces finance linkages to three versus the original four, with two of the most difficult linkages reduced to one.

How to Get There

What we have covered so far, we believe, at some level most organizations would view as intuitively obvious. The real challenge is how to move the organization forward. How to move forward to some degree depends on where you currently are. If you are using spreadsheets as the main tool for the PBF process, then the good news is you are not alone.

From the recent survey of CFO's from PWC shown to the right, 69% of companies in 2015 were still using spreadsheets in the PBF process. That is down from 72% in 2012. That is about a 1% reduction rate in spreadsheet usage per year. So if you are using spreadsheets today there is a high likelihood you will be using it next year and the year after. Why such a low adoption rate given the known deficiencies of the spreadsheet approach? Simple, the PBF process gets done every year.

Most companies move to new methods either because of downsizing pressure or new management. Either way these become a crash course in implementing a new PBF tool and process under time pressure and resource constraints. Not the best way to implement but it can and has been done. Best-in-Class companies try to build a business case for change ahead of these types of events thus providing time for a more well thought out implementation of new PBF tools and process.



Source: PWC CFO Budgeting Survey

Given you have the luxury of such an approach, how to proceed? As we have stated the goal should be to provide a central PBF tool like Hyperion or others with linkages to the other planning systems throughout the organization. At a macro level, the key steps should be:

- **Document The Current State:** This includes understanding the following at a high level - key data sources, calculations/spreadsheets, work flows and any special planning tools used currently.

- **Document The Effort Contained in the Current State:** Conduct a high level activity based analysis of the effort required in the current PBF process using existing tools. This should include the effort of all organization resources used in the process not just finance.

- **Build The Business Case:** Calculate the benefits of a new PBF process using new tools. This should be broken out by benefits of a PBF tool and linkages to the other planning tools in the organization. This may also include introducing planning tools into other parts of the organization as needed.

- **Build The Road Map:** Given the benefits, the organization can develop the best sequence of technology introduction as it moves from the current state through its various future states. The road map should also include change management phases which allow for the absorption of these new technologies. These technologies will require time to adopt and will cause the process to change even after adoption, as the organization becomes more sophisticated in its use of the tools.

- **Build A High Level Plan:** The purpose of the high level plan is to provide enough detail to build both cost and time estimates for the organization.

Once the organization has built a consensus around the business case and road map, then a detailed project plan can be put in place to start the implementation process. A high level activity based analysis can be conducted after each phase to confirm expected results and benefits. The output of the analysis can also be used as the basis for corrective action during the change management phases built into the road map.

In closing, we have tried to layout the case for moving from the current excel based approach to PBF versus a more well thought out use of advanced financial planning tools, including linkages to the other organization planning tools in place. If organizations tracked the amount of time and effort consumed in their FBP process, this would be an easy decision to justify. Most do not because they are too busy doing the FBP process. This is effort wasted on rolling up the financial numbers versus a focus on helping the business to understand the key threats and opportunities conveyed by the financial numbers. In the current challenging economic environment this is not an approach which is sustainable long term. It is not a question of if you will have to change but when? And unfortunately in many cases change comes at the worst time possible.

About OneGlobe – We are a global consulting company focused on helping companies improve their key financial processes using Oracle technologies as a driver of change. Our goal is to help companies achieve best-in-class performance across their financial processes.

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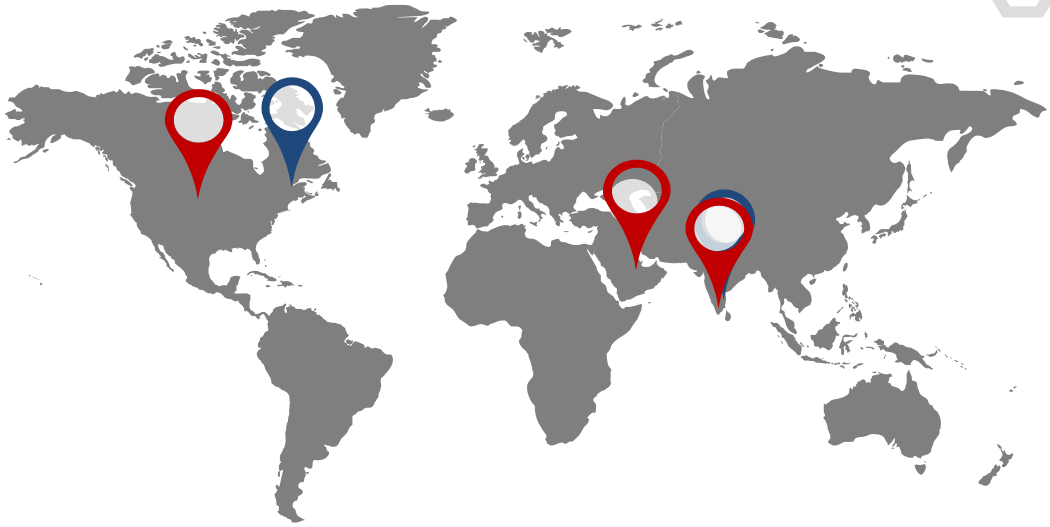

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