

Charting the Course
in Stormy Seas:
Planning and Forecasting in
Turbulent Times

Research Results

Research conducted by



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Introduction

In turbulent times, organizations face challenges to their very survival. What might have seemed extraordinary in the latter half of 2008 is likely to become ordinary in the near future—specifically, the need to drive performance in the face of increasing variability and an escalating pace of business. This turmoil is placing greater pressure on organizations' performance management systems. The premise of this white paper and the underlying planning and forecasting research is that now, more than ever, companies need new performance management tools and disciplines across their planning and forecasting activities to better manage risk, drive cash flow, contain costs, and maximize profits.

In the fall of 2008, Cognos, now a part of IBM, sponsored APQC, in conjunction with Steve Player of the Beyond Budgeting Round Table, to research what organizations are doing to transform and improve their planning and forecasting processes as they chart their courses in these stormy seas. For additional demographic details about research participants, please see the Research Background section on page 10.

Research Findings

Simplify Processes and Eliminate Redundancy

If a ship were sailing on an unsettled sea, the captain would need to constantly adjust his course and re-chart based on actual conditions to arrive at his destination swiftly and safely. The same is true of business planning in these turbulent times. How does a company adjust its course to ensure it gets to its destination? Today's business environment requires constant adaptation, but many current financial planning processes are not designed to enable this type of agile management. An organization must simplify and eliminate redundancy to create flexible financial systems and processes that move it proactively in its desired direction.

Shockingly, 77% of financial analysts' time is **not** spent performing value-added analytics work that could help the organization chart its course. Instead, analysts are spending the majority of their time collecting and validating data and administering the process (Figure 1). Because so much time is wasted in gathering data that is likely out-of-date by the time it is reviewed, analysts are able to devote less than one-fourth of their time to analysis, an activity of greater value to the enterprise.

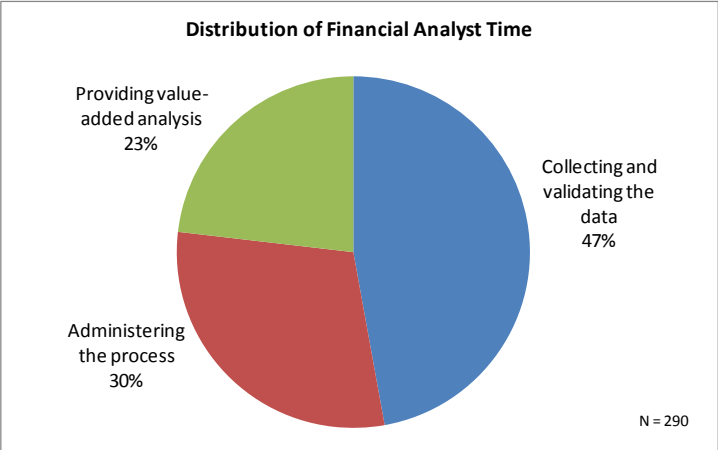


Figure 1

Achieving simplicity requires stopping unnecessary activities and ensuring access to real-time data, real-time updates, and a robust infrastructure to allow constant, instantaneous review of measures and other vital information. Commercial applications, such as solutions from IBM Cognos and others, can play a pivotal role in creating a more controlled planning environment to address performance management.

Technology can also help trim the number of budget iterations and increase planning accuracy. Decreasing the number of iterations is key to eliminating redundancy. More than half the participants in this research are undertaking three or more budget iterations annually, and some run as many as six per year. The data shows no correlation between a greater number of iterations and accuracy of output.

Complete a Budget in 1 or 2 Iterations

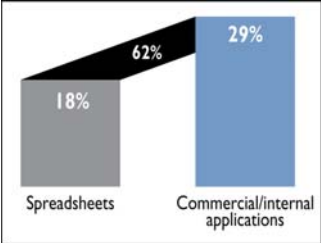


Figure 2

Organizations using commercial applications or internally developed systems are 62% more likely than spreadsheet users to complete their budgets within one or two iterations (Figure 2). In addition, organizations using commercial or internal applications are 59% more likely than spreadsheet users to land within 5% of planned targets (Figure 3).

Planning Accuracy Within 5%

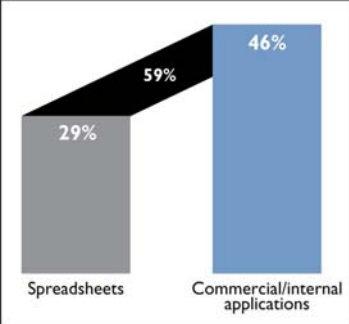


Figure 3

This research shows a positive correlation between enabling analysts to spend more time on value-added analytics and greater satisfaction with the planning process. Simplifying the process and removing rework by leveraging technology can yield more time for thoughtful analysis and can improve employee satisfaction with budgeting activities.

Increase Visibility Using Forecasts

Forecasts provide visibility, enabling organizations to see what challenges and possibilities lie ahead. Just as a ship's captain constantly scans the horizon for unexpected hazards, companies should forecast as far forward as is necessary to enable them to react when their environment changes. Instead of seeking visibility through their forecasts, however, 49% of the research participants are using their forecasts to evaluate whether they will hit the year-end targets previously agreed to—essentially changing the underlying fundamental approach from making decisions for forward action to evaluating a group's perceived past performance.

Companies that do well in turbulent times are those that can access actual data quickly and use it to understand what is coming. The good news is that new tools are available to make organizations more agile and better able to adjust. Commercial and internally developed software applications are 145% more likely than spreadsheets to have real-time data fully available (Figure 4). With the proper tools, forecasting can be more robust, and organizations can manage more proactively.

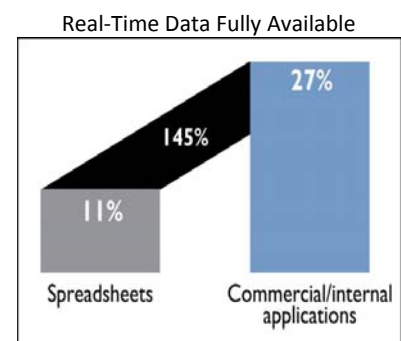


Figure 4

Technology can also speed up the process and improve forecasting accuracy, according to the data collected. Although the research shows that more details do not necessarily improve accuracy, organizations that use commercial/internally developed applications are 24% more likely than spreadsheet users to achieve forecast accuracy within 5% (i.e., 46% of commercial/internal application users forecast to within 5% accuracy, whereas only 37% of spreadsheet users do so).

Unfortunately, updating forecasts can consume a significant portion of organizational resources. According to this research,

49% of organizations require 11 days or longer to update their forecasts, and 70% update their forecasts at least quarterly—not a trivial investment of time and effort. Again, the goal for forecasting should be to try to simplify and create forward-looking visibility.

Findings Related to Driver-Based Planning

Another key trend in planning and forecasting is a growing shift toward a forward-looking, driver-based focus. Figure 5 shows that, currently, this type of approach is 63% more likely to be embraced by organizations using commercial/internal applications than by those using spreadsheets. With a driver-based approach, organizations can create more robust forecasts focused on leading indicators that drive the business, instead of relying on forecasts that emphasize outputs and financial results (e.g., sales dollars). Companies that look at leading indicators in their forecasts are more likely to see the early-warning signs when conditions change.

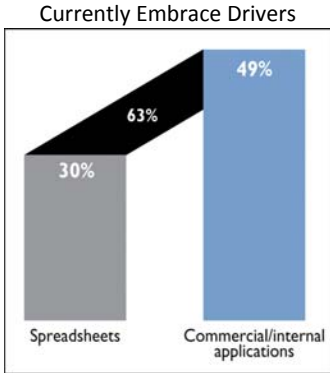


Figure 5

This research looked at three types of drivers: profit drivers impacting the income statement; balance sheet drivers (specifically, cash flow); and critical drivers of risk.

Focus on Profit Drivers

This research examined the factors that drive organizations from a profit-and-loss point of view and how those factors relate to planning and forecasting. Figure 6 lists the factors by descending degree of use as key drivers. Customer

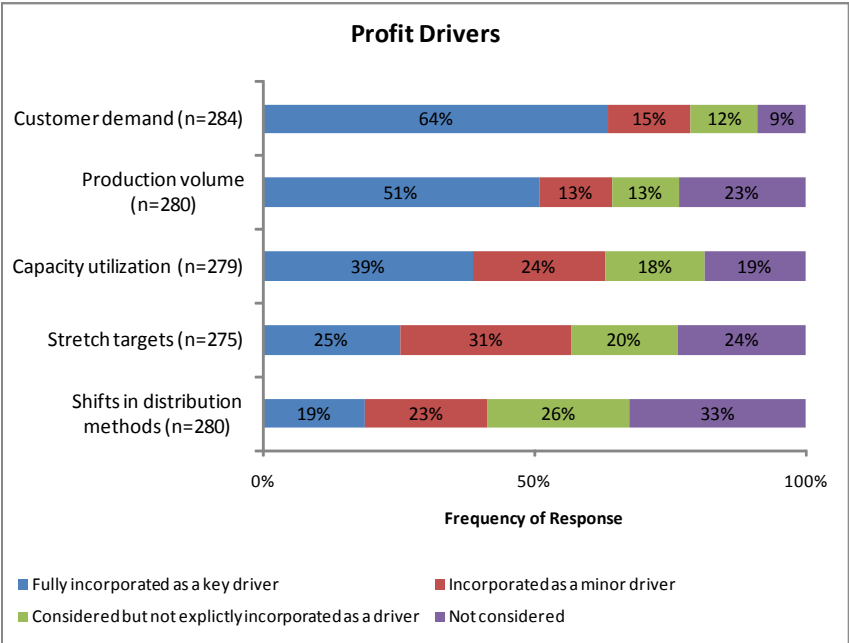


Figure 6

demand is the most common leading profit indicator, with 64% of participants incorporating it as a key driver. By understanding customer demand, often the front-end driver for sales volume, an organization is better able to gauge production volume, which drives capacity utilization and determines the organization's ability to hit stretch targets.

Organizations' budgets contain assumptions about the profit drivers listed in Figure 6 on page 5. However, the data collected shows that, for 55% of organizations, assumptions break down and the numbers are out of date by mid-year. In these turbulent times, when organizations are trying to wring out as much profit as possible, it is critical to free up resources to monitor these key drivers.

Use Working Capital Drivers to Manage Cash

As liquidity becomes an increasing concern, many organizations are focusing on understanding the drivers of working capital and how they impact the demand for cash. Organizations are struggling to accelerate the cash-to-cash cycle to reduce the working capital requirement. In turbulent times, cash is oxygen. Without sufficient oxygen, survival is impossible.

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The research shows that, when undertaking planning and forecasting, organizations' most common working capital drivers are labor costs and availability; material purchase-price changes; capital costs and availability; and service levels, such as amounts of inventory in stock and response times (Figure 7).

Overall, organizations need to link the drivers

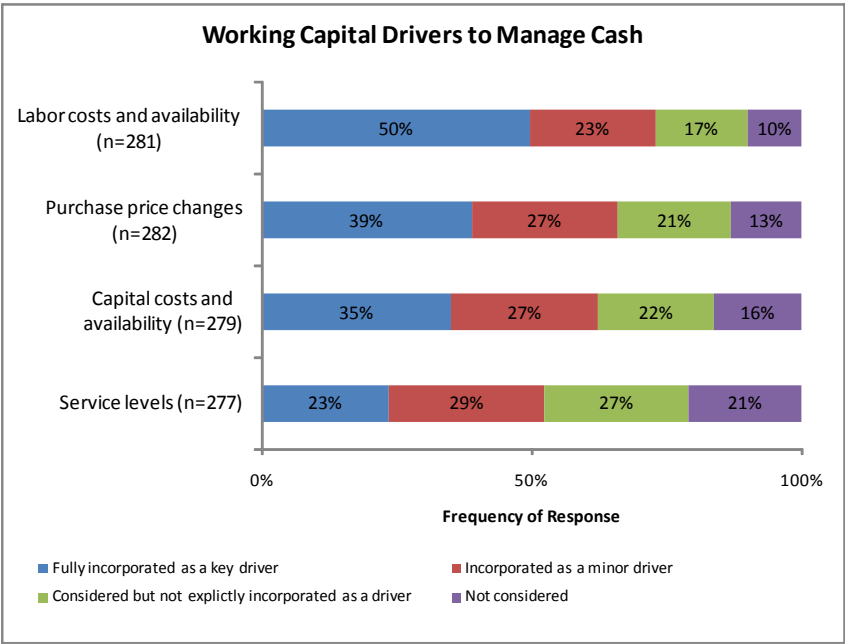


Figure 7

of working capital to their planning systems. Finance functions can then analyze factors such as the speed with which different types of customers return cash to the organization, or the impacts that shifts in distribution and sales channels have on the cash-to-cash cycle. This analysis can, if necessary, include looking for alternatives to bring cash in faster—such as factoring accounts receivable or negotiating with key customers to give better terms for faster payment—even if those options are more costly.

Unless companies move quickly, they can find themselves suddenly cash-starved—and that can be lethal. Organizations that take a long time to forecast tend to do it less frequently; however, in chaotic times, organizations need to look at cash regularly and rapidly to keep the cash forecast connected and integrated.

Provide Insights on Risk

Historically, risk drivers received the least amount of attention relative to other business drivers, but that changed in the second half of 2008. Companies now place great emphasis on risk management, and this topic is gaining more visibility than ever before in the planning sector.

This research explicitly highlighted key considerations from a risk management point of view (Figure 8), some of which are evergreen. In

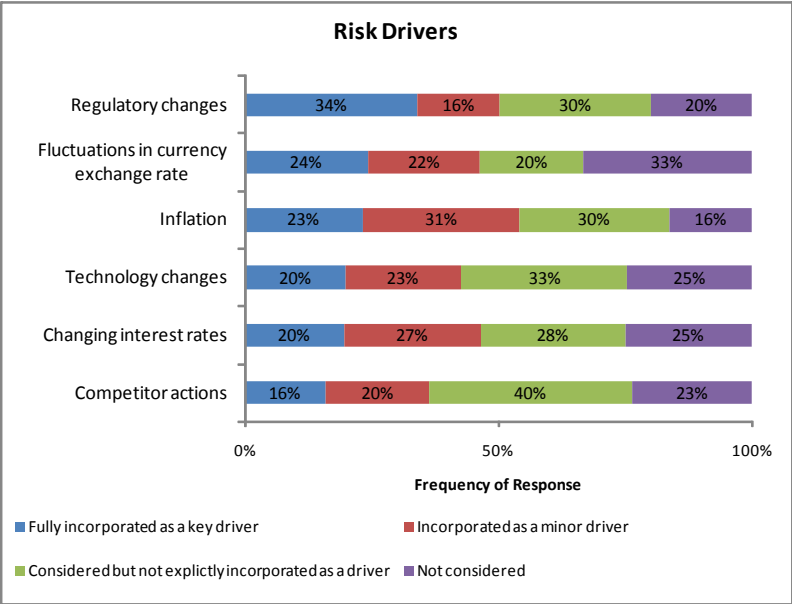


Figure 8

descending order, the following risks are fully incorporated as key drivers in planning and forecasting: regulatory changes, fluctuations in currency exchange rates, inflation, technology changes, changing interest rates, and competitor actions.

Risk factors may be difficult to control or quantify, but that does not negate the fact that organizations must identify them. In

challenging economic times, organizations should explicitly focus on and discuss risks and how to monitor and mitigate them.

Looking Forward — Advanced Topics

As an organization builds a robust platform for planning and forecasting, it sets up the ability to examine advanced topics.

Driver-based planning and forecasting is at the top of the list of advanced practices in use (Figure 9). The challenge for management teams is to determine and agree on a handful of key drivers.

In moving to a rolling forecast, another advanced practice, organizations adopt a view that looks forward for a set number of quarters, instead of only

looking to the end of the year. By seeing their problems pop up five quarters out, for example, these organizations have sufficient time to re-plot their routes.

As Figure 9 shows, other advanced practices adopted include balanced scorecards, activity-based budgeting, and zero-based budgeting. Some organizations have also implemented an office of strategy management, engaged in investment optimization/corporate portfolio management, and even eliminated the need for an annual budget process—often as the result of moving to a continuous planning environment with driver-based rolling forecasts.

Many of these leading organizations are using advanced technologies and integrated systems to achieve their goals. Technology is paving the way for the rapid implementation of advanced techniques as organizations strive to evolve and outrun their competition.



Figure 9

Summary: Overarching Themes

- ❖ Create a flexible organization to survive turbulent times. Learn to ride the waves, instead of getting crushed under them.
- ❖ Eliminate planning and forecasting activities that do not benefit the organization. Replace them with more value-added analytical activities.
- ❖ Focus on an integrated planning approach that leverages current technology. Avoid limiting the timeliness and reliability of information through overreliance on spreadsheet-based processes.
- ❖ Concentrate on increasing the visibility of forecasts and providing broader organizational access.
- ❖ Consider a continuous, forward-looking planning approach, rather than relying on assumptions tied to a fixed point in time.
- ❖ Strive for an approach that looks at what drives profit, cash flow, and risk. Emphasize leading indicators to give the organization time to readjust.

Research Background

This planning and forecasting research project collected data through an online survey that was administered by APQC on behalf of Cognos, now a part of IBM, in October and November 2008, with data collection closing on December 1. Participants received a summary report in December. The data in this report represents the aggregated responses to the survey. A total of 430 responses were received, and from that total, a set of 383 responses were used in the analysis.

Participants in this research represent a diverse population. More than 32 industries are represented in the data, with the largest percentages coming from manufacturing (15%), consulting (9%), and banking/financial (6%).

Participants represent 54 countries, with 46% of responses from the United States. The participants are also diverse in terms of organization size and the centralization of planning and forecasting. In terms of revenue, 42% of participants report more than \$1 billion (USD) in annual revenue, whereas 44% report less than \$500 million (USD). With respect to centralization of planning and forecasting, 52% of participants have a hybrid model, 29% are centralized, and 19% are decentralized.

The participants represent key players in planning and forecasting. Sixteen percent of respondents are senior executives, and 57% are mid-level executives. Forty-two percent of respondents are in charge of planning and forecasting for either the entire enterprise or a division/group. With respect to the departments represented, 42% of participants are from finance, 10% are from IT, and 9% are from corporate management. The others are spread across 14 different departments.

About the Authors

About APQC

A global resource for process and performance improvement, APQC helps organizations build better ways to work, adapt to change, and succeed in the marketplace. APQC discovers improvement methods, identifies benchmarks and best practices, disseminates findings, and connects individuals. Founded in 1977, the member-based nonprofit serves more than 500 organizations in all sectors of business, education, and government. For information about APQC, call 1-713-681-4020 or 800-776-9676. To learn about APQC's financial management research, visit www.apqc.org/fm.

About Beyond Budgeting Round Table

The Beyond Budgeting Round Table of North America (BBRTNA) is a network of member organizations with a common interest in improving planning, forecasting, and control, thereby improving overall performance. The company's goal is to help organizations learn from world-wide best practice studies by encouraging the sharing of information, past successes, and implementation experiences to develop dramatically improved solutions to traditional budgeting constraints. The Beyond Budgeting Round Table also has international memberships based in Europe, Australasia, and the Middle East. To learn more about the internationally based companies, visit www.bbrt.org.

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