Innovation in Action Series
May 2009

Innovation roundtable Orlando

Replace traditional budgets with rolling forecasts
Enable driver-based planning

Information Management

Cognos® software

The IBM Cognos Innovation Center for Performance Management

The Cognos Innovation Center, now a part of IBM, helps participants put new ideas about planning and performance in action. It draws on the expertise of an advisory council with members from systems integrators, Global 1000 companies, and industry leaders; as well as its many participants. It offers the opportunity to:

- Find out about new planning processes and practices, as well as understanding the technologies that can enable them.
- Network with industry leaders like themselves.
- Broaden knowledge and vision for performance management.

For its inaugural meeting in Orlando, participants at the Innovation Roundtable included executives from the following organizations:

American Express

Baxter Healthcare

BC Ferries

Bedford, Freeman and Worth Publishing

Best Buy

Ceridian

The Cheesecake Factory

Chipotle Grill

Crescent Real Estate

DIRECTV

Genentech

Halliburton

Manpower

Marathon Ashland Pipeline LLC

Merck

Pfizer

Nike

Omnicom Group

Staples

Target

> *“Creativity is thinking up new things. Innovation is doing new things,”*
>
> *Theodore Levitt*
> *Professor of business and former editor of the Harvard Business Review*

Let’s get rolling

At the inaugural meeting of the Cognos Innovation Center for Performance Management, 30 executives from retail, pharmaceutical, public sector, financial services, and other major industries came together. The combined market capitalization of the companies they represented exceeded one trillion dollars. These participants came to hear innovative thinking, and how to do new things. They learned from each other how to improve their organizations’ planning and performance.

The Innovation Roundtable, sponsored by the Innovation Center, brought these executives together promising to challenge the status quo. The first item under discussion was exploring alternatives to the traditional approach for budgeting and planning and how to implement them.

Quo does not come much more status than that.

Participants discussed the shortcomings of traditional budgeting, the value and process of moving to rolling forecasts rather than rigid budgets, and how identifying the real drivers of your business rather than focusing on the multitude of line items in the general ledger can streamline the planning process and improve decision making.

Through this proceedings document, you too can benefit from the new ideas, new approaches, and how you can help your organization continue to innovate.

Why we have to replace budgeting

Inaugural Innovation Roundtable Survey:

How likely is it that you would recommend an IBM Cognos Innovation Roundtable event to a friend or colleague?

- 100% responded Very Likely or Likely

What was the most beneficial component of the Roundtable?

- "The small group setting comprised of decision makers allowed for a more technical discussion instead of going back to basics."
- "The awareness of the shared experience."
- "Meeting finance executives at other companies."
- "Learning how other companies leveraged technology and changed their management processes."

The traditional budgeting and planning process is long, costly, and arduous. On average it consumes between four and five months, and absorbs up to 20 to 30 percent of senior executives' and financial managers' time.[1] One of the big three North American auto manufacturers estimated the cost of its planning and budgeting process at $1.2 billion[2].

Despite the time, money, and effort expended, the return from a traditional approach to budgeting is diminishing. Traditional budgeting supported the command-and-control methods and absolute performance goals of past decades. Today, the focus is on agility, relative performance, and the ability to adapt. Traditional budgeting does not synch up with these requirements.

Despite its superficial appeal as a means to ensure accountability one of the most compelling arguments against traditional budgeting is the extent it encourages "gaming the numbers."

A typical budgeting process involves the field meeting with corporate after spending weeks preparing to negotiate down their targets. Why? Their incentives are tied to the results targets. For its part, corporate is prepared for the low-balling. Corporate's task is to get the field up to match what the CEO has already promised.

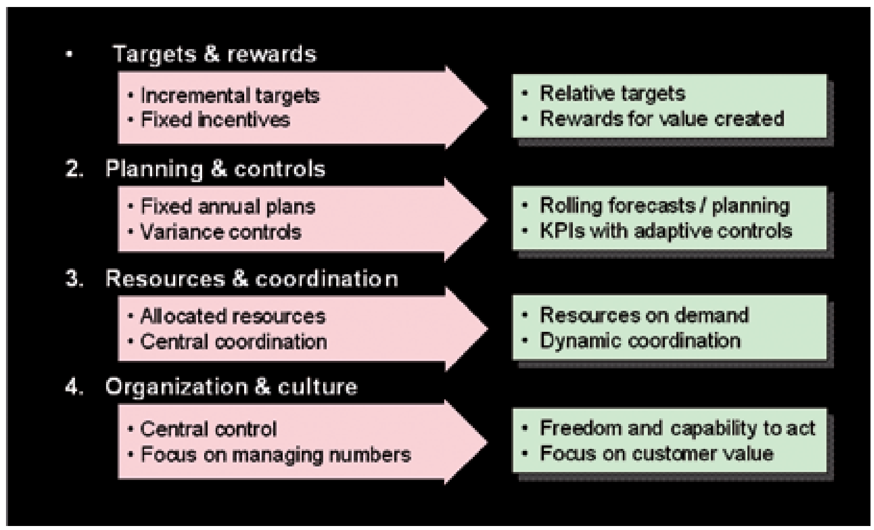
Steve Player, of the Beyond Budgeting Round Table, said corporations are dealing out hands of liars' poker.

"If your number-one tool for financial management is a game of liars' poker, when are your people ever going to learn to tell the truth?" Player said. But the biggest condemnation of this process is that stretch can become fraud. "Budgeting is a performance trap. It blocks you from where you have to go."

If targets may be suspect in traditional budgeting, adherents may argue that budgets do control costs. Player challenged this as well.

"Budgeting will put a ceiling on cost. But it creates a small room, because the ceiling is the same as the floor," Player said. "People use up the money because they fought for it and want to use it. And they want to use it for the sake of next year because their expenses are fixed based on this year."

The new framework:
Continuous planning & adaptive control



Organizations can reduce the amount of resources consumed, increase agility, and stop the numbers gaming with new approaches to budgeting and planning.

Why we have to replace our budgeting and planning technologies

The current model of budgeting and planning flourished with the use of spreadsheet software. This approach no longer fits the current business reality. The pace of change and the demands to adapt come too quickly for disconnected spreadsheets.

Spreadsheet software – innovative when introduced 30 years ago – creaks under the growing weight of traditional budgeting. And its inherent weaknesses make it even less effective for new budgeting and planning approaches.

The effectiveness of planning based solely on spreadsheet technology is hampered by:

- Unreliable data.
- Lack of flexibility in modeling business scenarios.
- Workflow nightmares.
- Version control problems.
- Inhibited collaboration and participation.
- Time-consuming, inaccurate aggregation of financial data.

These problem areas have real impact. Estimates on manual data entry rates range from about one-in-300 for professionals, to one-in-20 for non-professionals. Like a computer virus, an error in one department's spreadsheet can travel enterprise-wide and become impossible to find and fix when it affects totals in many areas.

Simple errors can result in significant miscalculations, casting doubt on the integrity of strategic plans overall. The inefficiency of spreadsheet applications, when stretched to the enterprise level, drives up the cost of the process in both dollars and staff time. Spreadsheets, when used alone, make corporate plans and budgets difficult to maintain. Worse, they inhibit – rather than facilitate – the collaborative enterprise-wide planning process. Collaborative planning is necessary to turn your fixed budgets into flexible, rolling forecasts that integrate the plans across the enterprise.

Of course, the benefits of spreadsheet software are its ubiquity and user acceptance. And user acceptance is key to any successful deployment.

One of the key presenters at the inaugural Innovation Roundtable was a major financial services company. They made a successful move from traditional, fixed budgeting, to flexible rolling forecasts.

In so doing, this financial services company used new planning software that goes beyond the abilities of spreadsheet applications. The success of introducing new software hinges on user acceptance. The VP of Planning Transformation, presenting the business case, confirmed that users actually prefer the new software to their former existing spreadsheet programs. They liked the built-in functions. Planners liked having a standard model that didn't allow others to edit it when inputting their data. Financial professionals were glad to have a way to fix chronic errors arising from the existing spreadsheet programs.

While moving to a flexible, rolling forecast may seem the antithesis of command-and-control systems, the new planning approach had a surprise benefit. The company said that better financial control was one of the chief values of the rolling forecast process and the technology supporting it.

Examining alternatives

Every good solution starts with good questions.

At the financial services company, their planning transformation started with a new CFO looking at operations and asking questions such as: How does a dollar billed on one of our cards relate to the bottom line?

When the CFO asks questions like this, better planning tools and capabilities became a priority.

To remain at the top of their industry, senior management agreed on the need to improve four factors:

- Employing corporate-wide consistency in planning and forecasting.
- Using a top-down approach to planning.
- Reducing the process cycle time.
- Mixing historical data with predicted economic drivers to forecast future outcomes.

The focus on economic drivers was key to better forecasting. With this focus, companies can replace traditional budgeting with rolling forecasts.

Focusing on the vital few business drivers, and transitioning to a rolling forecast can revolutionize any organization.

The 80/20 rule, also known as Pareto's principle,[3] makes the point that in any system, there are a vital few and a trivial many. Traditional budgeting and planning at most companies is the opposite. Traditional budgeting – organization-wide – can have hundreds and thousands of lines and cost centers. The quest for greater control usually means delving into greater and greater detail with more and more line items, typically with ever-diminishing returns.

However, the financial services company CFO did not want a traditional budgeting process. He wanted to focus on the business and the business drivers, not on cost center accounting. Gaining that focus is the key to better forecasts. There simply was no way to get an effective rolling forecast system in place while encumbered with thousands of budget lines.

Under the previous system, the financial services company based too much of its forecast on historical analysis. Relying on historical numbers works when economic and political drivers are stable. But that's simply not the case today.

To create the framework for the new system, business units had to identify key performance drivers based on company-specific algorithms.

Previously, the staff had given a lot of attention to the impact of salaries and benefits on net profits. Managers believed that all they needed to know was the cost of adding or eliminating an employee. However, they found that these numbers only had a five percent effect on the net figures. What they needed to identify were the volume drivers that influence 80 percent of the numbers.

This turned out to be only 15 lines on the profit and loss statement.

Billings drove much of their businesses. Two specific drivers behind this volume were the number of credit cards in circulation and the average spending per card. Knowing those two items allowed the company to calculate the billings numbers. These numbers, in turn, affected many other items on the profit and loss (P&L) statement. From the billings numbers, they could project things such as rewards, the level of delayed billings, amount of interest income, measures of risk for bad debt, and so forth. To meet the needs of future planning, they had to create algorithms that accurately forecast the billings.

Each business unit had their own drivers, many of which were flavors of one another, such as discount rates, provisioning time for charge cards, number of cards, and average spend. One Roundtable participant asked whether there had been much evolution in the driver models since inception. There had been, and that was one of the strengths of the new approach and the technology supporting it. It enables more flexibility, with top-down direction colored by bottom-up feedback.

"We wanted to get some models in place," the VP of Planning Transformation said. "Once people got their model, they began to say we could do this, or that. They saw the potential."

Driver-based planning is the key

"We wanted to get some models in place," Croake said. As the Nike participant might put it, the attitude must be Just do it. "We weren't aiming to make everything perfect; we just wanted to get something out there as a stake in the ground. Once people got their model, they began to say we could do this, or that. They saw the potential."

Making it work

Executive leadership for planning transformation was key, and this is a lesson all participants heard loud and clear.

One of the early challenges for the presenter was getting people to let go of the fine level of detail. People were afraid that they would be asked a question they couldn't answer.

"We had to make a deal with our users: we won't ask for budget against actual variance down to those low levels of detail," the presenter said. "If we take it to a more strategic level, we will find more value as a company." That message was credible because it came from the CFO.

Reinforcing this message, the company ensured wide exposure to the new planning technology and approach. The company sent more than 100 people early on for training to improve user acceptance and deployment.

They also created a recognition program for participants who embraced the new planning approach and became leaders in their departments. They highlighted best practices among planners and created competition among groups about their planning capabilities. As a result, the company now has a cadre of power users. These people are fully engaged with the approach and the enabling technology. They show initiative and leadership in adjusting their planning models to make them better, and help others do the same.

Executive sponsorship for the new planning process has helped align goals, strategy, and execution. Communications among levels and departments about the planning process also helps solve problems. Executives see one-page summaries on the planning process for business units, using green-yellow-red indicators to identify progress and areas of concern.

Below the executive level, clearly defining people's roles and keeping a consistent team in place has helped day-to-day execution. People know whom to approach with problems, and know they will get solutions.

Lessons learned, observations made

This experience presents a number of best practices:

- Ensure strong executive sponsorship.
- Understand the problem clearly before proceeding to solutions.
- Focus on the key drivers.
- Engage people from the outset with the solution.
- Give people freedom to take the plunge and amend as they continue.

During the Roundtable discussion, participants expressed other viewpoints and observations.

One participant noted that although costs may not be key driver for the presenter, his company's world was all about the cost of crude oil. While the presenter's CFO may prescribe against cost accounting, the energy company's CFO has to insist on it. The participant said that what was great about the IBM Cognos planning products were their flexibility to enable both approaches.

Through the Innovation Roundtable, a number of other lessons, observations, and how-to hints emerged from the animated discussions.

- **IT functions of the planning office:** For the presenter, the planning office developed its own data mart to contain the planning information. They went to IT with the problem of how to best gather data, report against it, and publish. IT's answer was establish a data mart. Another Roundtable participant concurred, saying a strength of IBM Cognos Planning was that his office could service itself with its own departmental IT resources, without relying on corporate IT.
- **Support:** The Office of Planning Transformation developed its own support triage system to make operations smoother for people using the new software. If the office can solve a user's problem, it does. If not, and it's an environment problem, the group can speak the right language with the Help Desk. If it's an IBM Cognos problem, the department is best able to engage the appropriate team at Cognos, now part of IBM.
- **Reassure people:** Culturally, people were nervous. Reducing cycle times could mean I'm losing my job. Senior management affirmed that if you are forward-thinking enough to transform yourself out of a job, you could also create a new one. Financial analysts merely re-keying data are simply number crunchers. The company needed these people to analyze data.

- **Consistency in planning applications:** Participants saw the value of one integrated system for planning, budgeting, and forecasting. For the financial services company, the budget is a rolling forecast. For long-range plans, the model is similar but amended. Forecasts typically have 20-30 lines; the long-range plans only 10.

- **Forecasting and flexibility:** One of the biggest arguments against traditional budgeting is the straightjacket it imposes—we can't make the needed improvement this month because we have to wait until the new year starts. The presenter gave this example of how rolling forecasts improved flexibility. For one project, the company released investment money prior to the quarterly business unit review. The greater visibility of rolling forecasts and the greater confidence in the numbers let the company promise the money early.

Next steps

Next steps in the planning process include improving scenario and what-if analysis. It's another part of the effort to reduce cycle times, increase consistency, and provide better forecasts— objectives first set out by senior management.

Improvement is not restricted to the Planning Transformation Office. The company is now taking a closer look at scorecards. One of the difficulties with any scorecarding initiative is determining the drivers that define your key metrics.

As a result of the planning transformation process, the financial services company has determined its true business drivers. As well, by fixing the planning process before proceeding to scorecards, they can avoid the situation where traditional budgeting—with its tactical gaming of numbers—chokes the strategic value of scorecards.

What success looks like

In concluding the presentation about planning transformation at the financial services company, the presenter described this situation that captures the day-to-day value of the initiative.

It occurred during a meeting among business-unit CFOs to discuss current and future investment opportunities. Something happened that had never occurred before, the presenter said

The CFOs were trying to figure out the targets and were coming up short in the available investment funds. Then, one of the business unit leaders said, 'I have this funding, and I don't need it. Take it back. Use it to close the gap we have as a company.' Instead of going forward with an advertising campaign under consideration, the business unit leader was offering to delay it to fund another business unit's project. Then the company as a whole could hit its targets.

Gone were the days of protecting budget turf for fear of losing it.

"It was a major shift to have one business unit just say go ahead, take my money, give it so somebody else. We were starting to think more as one company."

About The IBM Cognos Innovation Center for Performance Management

With its advisory board drawn from industry experts and leaders, Cognos, now part of IBM, created the Innovation Center to bring participants together:

- To demonstrate how innovative, technology-enabled approaches in planning and performance management are being successfully used.
- To help organizations transition to these innovative approaches.
- To make these ongoing initiatives as successful as possible.

About IBM Cognos® BI and Performance Management

IBM Cognos business intelligence (BI) and performance management solutions deliver world-leading enterprise planning, consolidation and BI software, support and services to help companies plan, understand and manage financial and operational performance. IBM Cognos solutions bring together technology, analytical applications, best practices, and a broad network of partners to give customers an open, adaptive and complete performance solution. Over 23,000 customers in more than 135 countries around the world choose IBM Cognos solutions.

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Endnotes

[1,2] Hope, Jeremy and Fraser, Robin, "Beyond Budgeting", Harvard Business School Press.

[3] In 1906, Italian economist Vilfredo Pareto created a mathematical formula to describe the unequal distribution of wealth in his country, observing that twenty percent of the people owned eighty percent of the wealth. The 80/20 Rule means that in anything a few (20 percent) are vital and many (80 percent) are trivial. For example, you know 20 percent of your stock takes up 80 percent of your warehouse space, and that 80 percent of your stock comes from 20 percent of your suppliers. http://management.about.com/cs/generalmanagement/a/Pareto081202.htm

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