

# Achieve Agility Via A New Way to Forecast

By Mary Brandel

If there is anything to be learned from today's turbulent economy, it is that the business world will not be predictable for a long time—if ever. Indeed, the words “stable” and “predictable” seem as old-fashioned today as penny candy. It is similarly outmoded to believe that companies can continue using traditional budgeting and planning processes and not miss unseen opportunities or fall victim to unnoticed threats.

Companies today can no longer roll their eyes and complain about static budgets and the resource-consuming process of generating them. Those firms that survive and even thrive in the global recession will be able to link their spending plans with their strategic plans and quickly make midcourse corrections based on accurate, real-time input.

“There’s been too much emphasis on preparing a planning document rather than seeing planning as a critical management activity,” says Jack Alexander, president of Jack Alexander & Associates LLC in Shallotte, N.C., a corporate financial consulting firm. Alexander is the former CFO for EG&G Inc. (now PerkinElmer), and is also the author of the book *Performance Dashboards and Analysis for Value Creation* (Wiley, 2006). The value of planning is not in the plan itself, he says, but in the process of identifying, testing, and tracking the key performance drivers and assumptions, in addition to developing multiple scenarios and increasing the flexibility and agility of the enterprise.

## Why the Budget Process Must Change

An important tool in changing the approach to budgeting and planning is rolling forecasts. Such forecasts are increasingly relevant among companies seeking agility. Rolling forecasts ensure that planning is a continuous, dynamic exercise—not something that is outdated as soon as it is complete. Knowledge enables managers to react more quickly to changing economic and business conditions. Still, only about a third of all companies used rolling forecasts in 2007, about the same percentage as in 2004, according to Miami-based strategic advisory firm The Hackett Group.

As far back as 2001, consulting firm Accenture declared the budget process obsolete. It researched companies that adopted new budget processes (including rolling budgets) that were more closely tied to their strategic plans. Not only did these companies reduce their budget cycle time 30 percent to 40 percent, but they also saw five-year share price

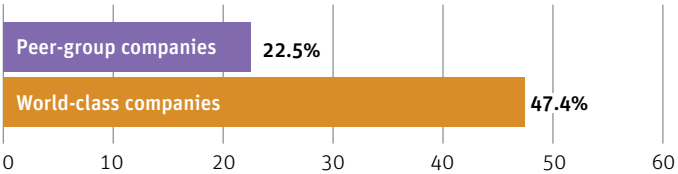
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Chart 1

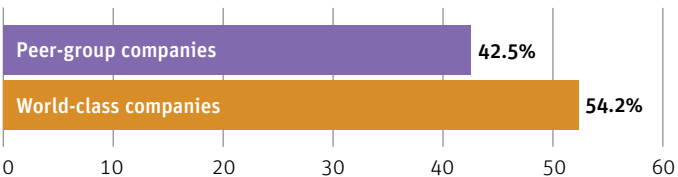
### Looking Forward

The best finance departments spend more time on forward-looking planning and analysis versus others that focus on historical numbers.

(Percent of companies with fully integrated strategic planning, tactical business planning, and budgeting processes.)



(Percent of time the focus is on proactive planning vs. historical reporting.)



“World-class companies” are those that perform in the top 25 percent on a variety of efficiency and effectiveness metrics. The other 75 percent are classified as “peer-group companies.”

Source: The Hackett Group's 2008 Book of Numbers research series

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growth of 221 percent on average, compared to 167 percent among their peers. The study concluded that traditional budgets are “time-consuming to produce, of little predictive value, subject to gamesmanship, and out of date by the time they’re implemented.”

Similarly, in 2008, The Hackett Group found that companies it categorized as “world class” were more apt to integrate their budgeting and strategic planning processes and that they were more likely to focus on proactive planning than on the historical reporting traditional budgeting emphasizes (see Chart 1, “Looking Forward”).

Because static budgets focus on the past, they tend to become “plans of record” for financial purposes, rather than a mechanism to drive agility across the company. Microsoft’s Bruno Aziza, worldwide business architect for business intelligence, and Joey Fitts, senior business development manager, take a critical look at traditional forecasting in their book *Drive Business Performance* (Wiley, 2008). In it, they say traditional forecasting encourages behavior like sandbagging results, “use it or lose it” attitudes, or—even worse—“hit my quota and stop.”

Traditional budget processes are also renowned for requiring enormous amounts of time and effort (see Chart 2, “A Process in Need of Change”). The results are stale by the time the plan is complete. With market conditions in wild flux, it makes no sense to compare actual results generated under one set of market conditions to targets created under another, says Steve Lyman, an advisory services partner at business advisory firm Grant Thornton LLP, in a recent Webcast.

Rolling forecasts, on the other hand, are adaptive systems that are continually amended to reflect variances that arise due to changing circumstances. They require forecasting several quarters out and then re-forecasting for those quarters every month. The goal is not pinpoint accuracy but agility.

“Fast reaction is more important than prediction,” says Jeremy Hope in his book *Reinventing the CFO* (Harvard Business School Press, 2006). Hope is co-founder of the Beyond Budgeting Round Table, a not-for-profit collaborative, and author of the book *Beyond Budgeting* (Harvard Business School Press, 2003). By regularly reviewing plans and making corrections to them, Hope says companies can narrow the gap between forecast and reality.

### Visualizing the Process

Besides leading to better forecasts, the rolling forecast process offers additional benefits. Not the least of these is opening a channel for business units to communicate up the hierarchy what they think they can accomplish in consideration of corporate requirements and perceived market conditions (see Chart 3, “Annual Budgets vs. Rolling Forecasts”).

Microsoft’s Aziza and Fitts provide a rough sketch of what the rolling forecast process looks like from the inside. First, the company needs to clearly set its strategic direction, which is translated into realistic, attainable targets. An example

Rolling forecasts ensure that planning is a continuous, dynamic exercise—not something that is outdated as soon as it is complete.

Chart 2

### A Process in Need of Change

Key statistics illustrate how wasteful the budget and planning process really is.

- **Average time it takes to complete:**  
4 months
- **Percent of executives’ and financial managers’ time it consumes:**  
20% to 30%
- **Time consumed per US\$1 billion of revenue:** 25,000 man hours

Source: Steve Player, North American director of the Beyond Budgeting Round Table

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of a target might be, “Europe needs to grow 10 percent, the United States 25 percent, and Asia 40 percent.”

Targets are then submitted to the individuals and groups in charge of achieving those goals. It is at this point, Aziza and Fitts say, that forecasting comes into play. The resulting plan is reviewed periodically—three to four times a year is about right for many companies—by comparing actual results against the most recent forecast. Based on these reviews, targets are renegotiated and corrective changes are made. “It’s all about building an operating plan and deciding how you’re going to deal with ever-changing circumstances,” consultant Jack Alexander says.

### Laying the Groundwork

To achieve the benefits of rolling forecasts, you need to overcome several challenges. The most significant, says Lyman of Grant Thornton, are behavioral, cultural, and procedural. People need to see budgeting less as an event and more as an ongoing part of the financial planning process. Similarly, stakeholders such as the board of directors need to move away from the widely accepted practice of using budgets as the key way of measuring performance against expectations.

Organizations also need to upgrade their budgeting and planning tools to fully enable trend analysis, scenario planning, financial modeling, data consolidation, global/local capabilities, and dissemination of results. These tools need to be flexible and intuitive so that processes such as re-forecasting do not intrude on productivity.

Until recently, many software solutions have limited companies’ ability to apply change easily. In the end, Microsoft’s Aziza and Fitts say those firms that succeed will have technology that adapts to the way the organization plans and that leverages the office software already in use.

A case in point is Millipore Corp., a life sciences company based in Billerica, Mass., that has integrated its strategic planning and financial forecasting through the use of balanced scorecards and rolling forecasts. As a result, the initiatives that get funded are the ones geared toward executing the corporate strategy. Additionally, constant re-forecasting enables Millipore to achieve optimal results, says Christophe Couturier, vice president, corporate planning and strategy management, in the book by Aziza and Fitts.

Millipore recently moved from a numbers-intensive budgeting process to developing an operating plan that is a logical output of its strategy discussion and its rolling

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– JACK ALEXANDER  
 PRESIDENT OF JACK ALEXANDER &  
 ASSOCIATES LLC

Chart 3

### Annual Budgets vs. Rolling Forecasts

Budgets are static documents with a focus on cost control, while rolling forecasts are a process intended to improve decisions.

	Annual Budgets	Rolling Forecasts
Timing	Annual	Monthly or quarterly
Focus	Cost control	Value creation
Link to strategy	Tenuous	Direct
Mentality	Beat the budget	Information for decisions
Understanding reports	Easy	Difficult
Report variances	Not too useful	Very useful
Owners of the numbers	Finance manager	Line managers
Basis of preparation	Last year’s numbers	Forecast business drivers
Locus of control	Centralized	Decentralized

Source: *Managing with Rolling Forecasts*, (John Stretch, 2008)

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financial forecast. Thanks to this new approach, company CFO Kathleen Allen told Beyond Budgeting Round Table's Player in a BusinessFinance interview that Millipore now can see:

- How it is executing on strategy by defining what has gone well.
- Where it needs to course-correct.
- What it funded and how that translates into profit and loss.
- Its balance sheet and cash flow for the next year.

With the economic downturn, the trend will be for companies to turn inward, scouring business processes to drum out inefficiency and inflexibility. That makes the budgeting and planning process a prime target. More than ever, businesses need a solid grip on where to spend, incisive visibility into how those investments are working out, and the ability to quickly make midcourse corrections based on real-time data.

As Millipore illustrates, the budgeting and planning process is no longer a headache to be endured but an enabler to companies in their quest to become more agile—a key attribute to surviving in uncertain times. ■

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