



cutting through complexity

Forecasting: The Future of Budgeting

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A new model for modern times

My name is John O'Mahony. As a KPMG Director specialising in the efficiency and effectiveness of the Finance function, I was compelled to write about forecasting, which I see as being the future of the budgeting process.

Current planning and budgeting processes do not reflect the modern times we live in: a world where demand and expectations continue to grow but all the while balancing the drive for the efficient use of resources to serve it. In order to support this expectation, I believe that organisations will need to deploy robust rolling forecasting models, somewhat at the expense of traditional budgeting processes. I believe that such a shift will help businesses to make more rational strategic decisions that are reflective of the external environment they are operating in. I would also suggest that such a new model must be built on the close partnership between Operations and Finance. The Finance function will now need to take a lead role in facilitating the integration of the rolling forecasting process on an enterprise level.

A new partnership between Operations & Finance

In my view, putting primary focus on rolling forecasting will enhance business decision capability, in any sector, at a macro-level. Those who blithely claim that it won't work for their organisation or sector are blinding themselves to the organisational innovation which I think it can bring.

To achieve it though, CEOs must support the use of clear and objective forecasting as an enterprise-wide priority which will lead to more informed decision-making though deployment of one single rolling forecasting process adopted universally across the business.

For his or her part, the COO will need to work in tandem with Finance to ensure that Operations provide the right level of insight and integrity into the forecasting process which will be facilitated by Finance. As a traditionally finance-led activity, this will require strong process integration between the two disciplines, resulting in full alignment across budgeting and forecasting and planning; which in turn can be used as a mechanism for developing and cascading company strategy and performance. Where once Finance typically acted alone, other players must now be involved.

Killing off arcane processes

This is not a case of relegating Finance's role, it is about changing it and giving the function the opportunity to demonstrate that they can think more commercially and play a truly partnering role to the operations executives.

This will be the fundamental skill for Finance professionals of the future. As IT tools become even more powerful, data management and provisioning will be a completely computerised process, finally killing off the typical accountant and bookkeeper. The real value will come from Finance's interpretation of the data, through integration with external information sources, [and facilitating the ability to link enterprise risks and opportunities to hard tangible numbers in the latest forecast and inform the underlying assumptions.

We are already seeing companies in a number of sectors using such data to forecast in this way. In Consumer Markets, the major online retailers have gained market share over their competitors through their power to assimilate demand and opportunity with sales and marketing functions to understand the consequences on their supply model. So, as you can see, while it might appear as Finance is being relegated somewhat, they are still going to be incredibly important, albeit no longer the master of the process.

The status quo

The purpose of the budget has always been to allocate resources required to achieve (and align organisations around) a particular goal, but today the goal is often a moving target and the resources are volatile and unpredictable. We live in uncertain times, coupled with dynamic business models; yet companies still manage expectations through a document that is outdated the minute it is finally signed off.

This does not exactly bode well with today's faster moving business environment, which demands agility, flexibility and confident decision making. Whilst the onset of technology has provided industries with significant cost benefits and freed up resources, the actual budgeting process has scarcely been made more meaningful to businesses over the past 30 years.



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A lack of external awareness

How many times have we seen seemingly sound, market-leading businesses suddenly fall from the height of popularity and sidelined by a new industry entrant or product? I wonder if a number of these profit warnings, from Retail through to Oil and Gas, stem from businesses' inability to budget and forecast.

Oil and Gas firms tend to be comfortable in estimating risks and probabilities across ranges but translating uncertainty into a budget is another matter. In Retail, businesses have to grapple with the speed with which social media is empowering consumers, but again the sector has been slow to factor in these risks and opportunities into their budgeting framework.

The reason for this failure to act and contingency plan is because most businesses' budgeting models do not interact often enough with the external environment the organisation operates in. To suggest that rolling forecasts should take over from the budget as the focus of the planning process does not seem groundbreaking in an age where the business environment can change at break-neck speed, yet it is surprising how few organisations make the connection between the two.

The budget is a view at a point in time that sets the organisation on a particular path. However, what will separate the successful organisations from the others is their ability to see beyond "the budget book" and react swiftly to any external (and indeed internal) changes in scenery.

The power of rolling forecasting

Rolling forecasts will still not be able to guarantee total quality management but they will provide a better steer on current and emerging risks, opportunities, strategy and performance.

The budget will still be important for performance target setting and a strategic planning benchmark, but the rolling forecast must compliment that; keeping it relevant. It must bring insight in terms of where the organisation is heading, indicate what it is achieving and highlight the aspirational gap between projected performance and defined budget targets. It should also become the starting point for the budgeting process, which has tended in the past to be inspired by historic data.

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A culture of game playing and sandbagging

To become a reality, there needs to be an acceptance of the budget's limitations as simply an expectation and goal setting tool rather than the bible of business management. But, this will require a massive mindset change. For a start, it is no secret that in many organisations people responsible for contributing to the budget plan will be conscious to manipulate the figures in a way that suits their individual prospects, potentially at the expense of the organisation's goals.

That is because companies typically reward staff based on achieving the budget number and punish them for failing. As a result, the budget process is a drawn out affair, involving a fair amount of negotiation. Forecasts, on the other hand, have no direct impact on one's performance but have a huge role to play in setting the scene when it comes to performance reviews.

Enterprise-wide approach

Secondly, the sheer size and complexity of organisations today does not help, creating a silo effect which can slow down the business's reaction times. This is why it is so important that their budgeting and forecasting model is clear in its understanding of where the risks and opportunities lie. Alarming, in a recent discussion with a KPMG Pharmaceuticals expert, they mentioned that they had never known of a Global Head of Risk or Assurance being involved with the budgeting and forecasting process, let alone having an enterprise-wide map of risks. Surely without this insight, companies cannot effectively model scenarios and sensitivities.

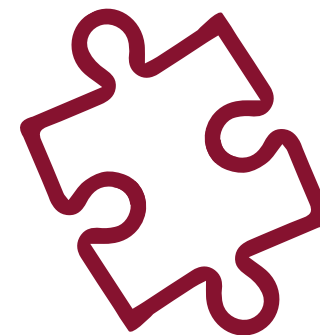


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Data fit for purpose

The quality of data will dictate the value of information organisations gain from budgeting and forecasting. This not only relies on regular data cleansing but also on considered and targeted investment into the actual data systems themselves, incorporating flexible data models that can grow and flex with business challenges.

Finance need to be able to quickly develop and analyse different scenarios and help the business to understand 'what will happen if...'. A lot of companies are incapable of producing this analysis quickly and most systems in place are not actually fit for purpose. This will present particular problems for Media and Telecoms companies with the rise of on-demand TV and media services, for example, as they will have to forecast and manage potentially millions of data variables.

Similarly, in Oil and Gas companies today, there is a huge funnel of geophysical data that needs to be converted to multiple forecasting information requirements, such as prospect inventories. The challenge of taking all of this information and siphoning it down into relevant, budget data, let alone an absolute forecasted number, is problematic, particularly for a sector which focuses on data ranges.

Despite these difficulties, there have been rapid improvements in budgeting and forecasting technology over the past five years. Most enterprise performance management tools have functionality that allows for modeling, scenarios and sensitivity analysis and my advice would be to make the most of this functionality.



Organisations that do not embrace forecasting will be left behind, without question.



Little appetite to change...

Budgeting and forecasting processes are complex and well-ingrained in business. They are not something that can be changed overnight, but still must evolve into something much more relevant to today's operating environment.

Some may say that the model I am promoting is not revolutionary, but from speaking to numerous sector colleagues it is clear that there is little appetite to adapt. But why is this? Is this because of cultural issues and bad budgeting practice or simply laziness? I don't know. I am not suggesting ripping up the budget and starting again with a brand new process. It's more a straightforward case of prioritising the rolling forecast once the budget is in place, all the while maintaining the link between the two. After all, the forecast could not work effectively without the budget to refer to.

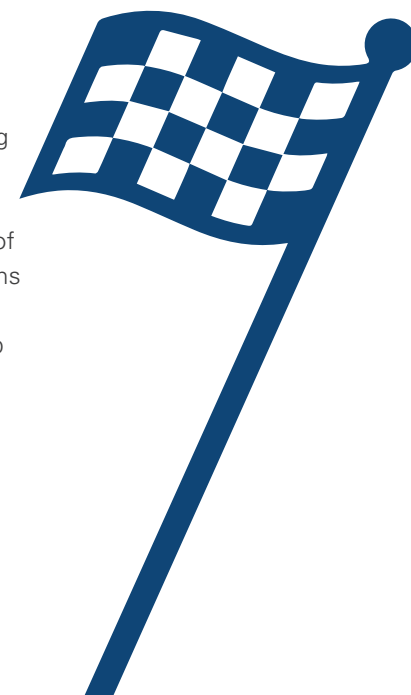
...but no choice

Organisations that do not embrace forecasting will be left behind, without question. Take the potential impact of Google's contact lens on Pharmaceuticals, for example. This disruptive technology was created outside the sector, but could manage to displace some of the leading pharmaceutical products, by offering diagnostic monitoring through a contact lens. This is a huge warning to companies to pay attention to market change and emergent threats, not just in their industry.

Across a range of sectors that I have spoken to, there is an omnipresent theme of unstoppable external market change bearing down on them. Given this and the fact that new technologies are replacing traditional processes with increasing regularity, late adopters will struggle as their competition is able to respond quicker from the commercial insight they are gaining.

Where do I begin?

A key thing to get right is building efficiency into the forecasting process. This will involve integrating sales and operational planning with legacy Finance forecasting processes to create a reliable driver-based rolling forecasting model at an enterprise level. After that, the focus should be on driving integrity and openness into the process. That must provide the framework for linking strategic intent with targets by overlaying initiatives linked to agreed budget goals (defined by the strategic plan) as a means of 'operationalising' the budget. If organisations can make baby steps towards delivering these actions, they will quickly start to reap the benefits of rolling forecasting.



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