Financial planning: Realizing the value of budgeting and forecasting

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PwC's executive summary

Managing business performance in today's complex and rapidly changing business climate is crucial for any organization's short-term and long-term success. In order to maintain investor confidence and provide insight to top management, there is an increased demand for finance organizations to provide prospective insights on business trends and drivers of performance. Financial planning, a key component of managing and driving business performance, continues to be of limited value and mired with conservatism for many organizations. Extended financial planning and forecasting cycle times that delay decision making, financial drivers and metrics that don't align with strategies and the ownership of planning projections that often gets attached to finance adds to the frustration with many planning and forecasting functions. Dissatisfaction with financial planning often echoes across the organization from executives who can't trust the accuracy and outputs from the process to the front line managers who question the amount of time spent on activities supporting the analysis, making it imperative for finance to reassess and transform the value of the overall financial planning process.

Companies that have addressed these challenges recognize that reshaping the financial planning process to deliver value throughout the organization is an art, not a science. Transformation and improvement extends well beyond reengineered processes and new financial planning systems into organizations' overall management style and culture.

The need for increased value and accuracy from financial planning led us to commission a thorough research study that not only focuses on the current challenges but also on the practices organizations are deploying to improve financial budgeting and forecasting activities. The study included a survey of 220 large companies with annual revenues greater than $2 billion, as well as in-depth interviews with selected finance executives who are successfully driving improvement efforts in the financial planning process.

PwC's key findings from the research include the following:

- Historical weaknesses in the budgeting and forecasting process persist, limiting the perceived value of the financial planning process within the organization. The process continues to be time consuming, iterative, and inaccurate. The call for action to fundamentally improve the financial planning process is now coming directly from CEOs, CFOs, and business-unit leadership and taking priority over other competing finance and business initiatives.
- Business changes and uncertainty are leading factors cited as causes for planning variability from actual performance. A key trend that surfaced was that organizations where the financial planning process leverages external indicators and business drivers are demonstrating a higher level of success in harnessing uncertainty and delivering prospective insights with higher confidence and accuracy. Business driver planning provides better insight to understand, analyze, and proactively impact business performance.

- The optimal level of detail to be utilized for financial budgeting and forecasting has surfaced as a passionate topic for debate for many organizations. Our experience has shown that extensive detail in account planning often extends planning cycle times, making the information dated by the time the outputs are finalized. In addition, the research did not show any correlation between the number of accounts utilized for planning and overall forecast accuracy.
- The concept of continuous forecasting based on changing business conditions (versus predetermined monthly or quarterly projections) is hitting the right chords both with finance and operations. Developing a flexible financial planning and modeling capability enables more timely decisions and actions to be taken regarding overall performance.
- Rolling forecasts are no longer an emerging trend but becoming an established leading practice, extending the forecasting horizon to rolling quarters beyond year-end to provide additional visibility. We did not see a trend to completely eliminate the annual budget once rolling forecasts are adopted due to overall management control and incentive compensation linkage.
- Increasing forecasting accuracy is on top of the improvement agenda; however it remains an elusive target for many. Companies continue to struggle with the shared ownership between business and finance of the financial plan and the overall financial conservatism built into the planning process. Our experience shows that companies that formally measure and report on forecast accuracy have achieved a higher level of precision.
- There is an increased need to link sales and operational planning activities and outputs with the financial planning process. Care must be taken to avoid overburdening the financial planning process and system with detailed customer- and product-level data that may reduce flexibility and increase financial planning cycle time.
- Best-of-breed financial planning applications such as Oracle/Hyperion and SAP BPC can significantly improve the overall financial planning process and reduce manual planning activities and disparate spreadsheets. Most companies have yet to fully deploy these planning tools throughout their organizations. However, technology by itself does not lead to sustainable and desired improvements in the financial planning processes. Our experience has shown that when technology alone is the primary driver for financial planning improvement, the desired results are not usually achieved and the new tool functions and features are not fully realized.
- Successful financial-planning transformation and improvement requires a close partnership and teaming between the corporate office, functional areas, and business units. Simplifying the planning process, iterations and level of detail requires a strong leader and change agent to drive the desired outcomes.

We sincerely hope that you gain insight from this study and that it will provide you with real-life experiences of companies that have embarked on the journey to gain value from their financial planning processes.

About this report

In Q4 2010 and Q1 2011 CFO Research Services (a unit of CFO Publishing LLC.), in collaboration with PwC, conducted a research program to explore the current issues, practices, and improvements associated with financial planning at large companies.

For this research program, CFO Research Services conducted a survey of senior finance executives and an in-depth interview program among senior finance executives.

Respondent demographics

CFO Research Services gathered 220 complete survey responses from senior executives for this research.

Survey respondents:	
CFO	12%
EVP or SVP of finance	6%
Controller	14%
VP of finance	14%
Director of finance	31%
CEO, president, or managing director	7%
Other	16%

Survey respondents' revenues:	
$2B-$5B	35%
$5B-$10B	20%
$10B-$20B	17%
$20B+	29%

Survey respondents' industries:	
Auto/industrial/manufacturing	15%
Business/professional services	5%
Chemicals	3%
Energy/utilities	6%
Financial services/insurance/real estate	22%
Food/beverages/consumer packaged goods	6%
Hardware/software/networking	7%
Health care	4%
Media/entertainment/travel/leisure	3%
Pharmaceuticals/biotechnology	5%
Telecommunications	4%
Transportation/warehousing	4%
Wholesale/retail trade	9%
Other	7%

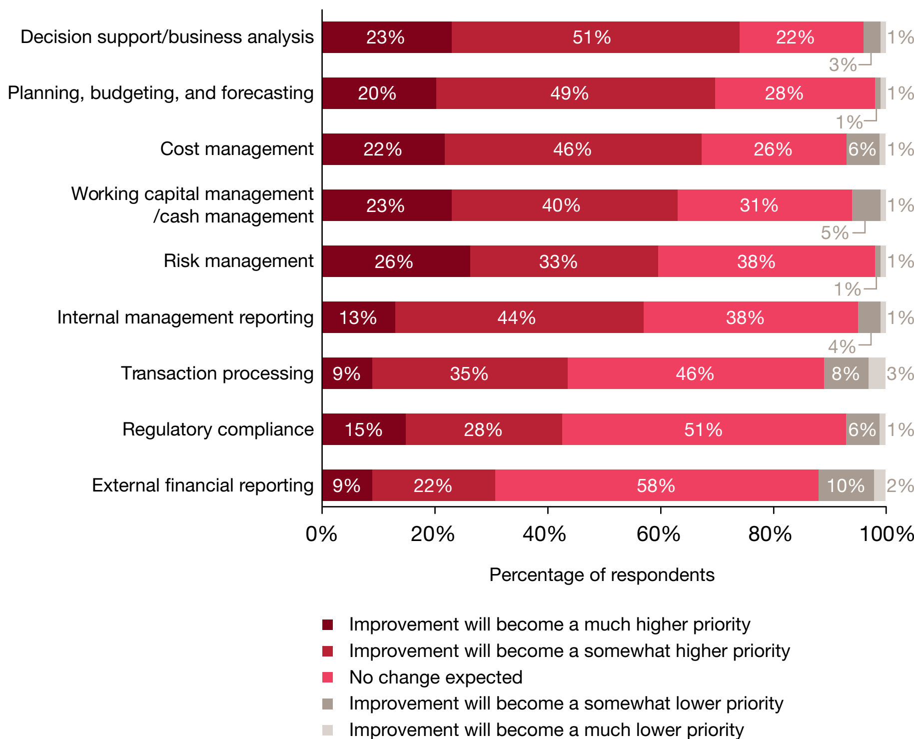
Note: Percentages may not total 100%, due to rounding.

Financial management priorities

Fierce competition. Uncertainty. Volatility. These are the challenges of today's business environment. In times like these, the stakes for being able to understand and respond to change are high indeed.

Figure 1. Finance executives frequently predict that improving performance management activities including decision support and planning, budgeting, and forecasting will become a higher priority over the next two years.

In your opinion, to what extent is your company's interest in improving the following finance activities likely to change over the next two years, compared to today?



Meeting demand in an environment of fierce competition and price pressure means delivering greater value—the combination of price, quality, and service that customers expect and even require. The "do more with less" mandate, combined with competitive pressure, means that companies need to accomplish more than ever with fewer resources and less room for error.

The ability to forecast and plan for the future is a critical dimension of companies' efforts to meet demand and serve customers while maintaining hard-won operating efficiencies. Survey results confirm that finance executives are turning their attention to these and other performance-management activities. When we asked finance executives to gauge their improvement priorities in finance for the next two years, survey respondents most often predicted that decision support and business analysis (74%) and planning, budgeting, and forecasting (69%) would become higher priorities for improvement. These performance-management activities managed to edge out cost management (68%) and working capital management (63%)—even as survey results amply reinforced the importance of cost and working capital management. (See Figure 1.)

The PwC perspective:

In our interaction with CFOs, we recognize the multiple challenges that they face in dealing with competing and often conflicting priorities. Today, CFOs and finance organizations are not only tasked with enhancing performance insights but also maintaining control and delivering services more efficiently.

At Eastman Chemical, controller and CAO Scott King explained that the finance function is leading the company's current efforts to improve its processes and technology for planning. The impetus for change, however, emerged from listening closely to managers in the business. "Our CFO charged us to lead this initiative, but part of what contributed to that is the business leaders talking with the CFO about how much time their business people were spending on forecasting," he said.

Better processes and technology systems for financial planning can not only help decision makers respond to changing business conditions more effectively. These improvements can also allow line managers to focus on some of the highest-value activities in the enterprise: producing goods and delivering services efficiently, developing new business, and meeting customer requirements.

Financial-planning improvement as platform for growth at Gilead Sciences

As economic conditions ease, companies are working to map their path to growth amid specific industry- and company-level circumstances. Factors such as increasing buying power in emerging markets, burgeoning regulation, and more intense investor scrutiny are shaping industry dynamics, creating new opportunities for growth—and introducing new risks to performance. Improving processes and systems for financial planning, our sources told us, can help companies make the most of these opportunities, while minimizing their accompanying risks.

Robin Washington, CFO of biopharmaceutical Gilead Sciences, said her company is investing in financial-planning process and technology improvements to help provide a foundation for future growth. Gilead Sciences researches, develops, and manufactures drug therapies for HIV/AIDS, liver disease, and other serious medical conditions. Ranked first in BusinessWeek's index of 50 top-performing companies, the company has enjoyed strong growth in the two decades since its founding.

The company recently kicked off its transition to a new ERP platform (including an integrated, best-of-breed planning system). As a former CFO of Hyperion Solutions who spent nearly 10 years at PeopleSoft, Ms. Washington is perhaps uniquely positioned to appreciate the value of dedicated financial planning technology. She was careful, however, to emphasize the importance of process improvement as part of the overall effort. "We're trying to be sure that we have everything in place to move to best-in-class processes, while creating a flexible, sustainable technology platform that will allow us to continue to build on those processes, because we expect they'll continue to evolve as the company evolves," Ms. Washington said.

As the company moved to expand its business further in Europe, it needed a technology platform that would accommodate a highly outsourced manufacturing model and a complex distribution system. The new ERP platform will make it easier to comply with local reporting standards as the company expands its global reach, Ms. Washington said, while also allowing the company to pursue its expansion plans more efficiently—by, for example, adopting a shared-services model for finance in Europe. "An antiquated platform wasn't going to allow us to support those sites remotely [from a shared-services center]," Ms. Washington explained. "We wanted to be sure we had a system in place that will allow us to scale, without having to add many more resources in these various countries as we expand."

From a financial planning perspective, Ms. Washington is in the process of standardizing planning processes and implementing a best-of-breed technology solution which will help Gilead respond effectively to changing competitive dynamics in the pharmaceutical industry in the years ahead. The unprecedented shift in the proportion of generic-versus-branded drugs is clearly affecting the industry, Ms. Washington explained, setting conditions for rapid consolidation. "The complexity of modeling these kinds of industry dynamics requires us to have much more robust capabilities to build out various scenarios," she said. "Pharmaceuticals and biopharmaceuticals have a very high free cash flow-generating business models. We need to think about what these [industry] changes mean for our capital structure."

One of the process changes Gilead has made as part of its broader financial-planning improvement effort, Ms. Washington continued, will help the company establish a stronger nexus between its established long-term R&D planning perspective and the planning requirements of other business constituents. "We used to do one-year and ten-year planning," she said. "We added an interim step—a three-year plan—because it's very hard for people on the commercial side of the business to think ten years in the future." That side of the business, Ms. Washington explained, is "driven more by the launch of new products and by expansion into new geographic territories. When we launch new products or expand into new areas, we have to think about our sales force and our promotional activities. So at certain points in time, we need to make shorter-term decisions on questions like, "Is this the right time to enter a market [with a branded product]?" A 10-year time horizon is, of course, necessary for R&D planning, Ms. Washington explained, "but for other aspects of the business [such as production, distribution, and sales], three to five years is a timeframe that I think people can grasp better, which provides a better understanding of some of the dynamics and changes in the market." Making the right changes in financial-planning processes yield more than improved efficiency. Financial-planning process improvements can help managers gain a better understanding of the business—and make better decisions as a result.

Key challenges and trends in financial planning

The finance executives who participated in this study recognize that overhauling processes and technology for financial planning is a major undertaking. These improvements demand not just a substantial commitment of time and resources, but a careful consideration of company organization and culture. Our research shows, however, that many finance executives—convinced of the benefits that will flow from change—are championing financial-planning improvement efforts at their companies. In this section, we'll examine the current state of financial planning at large companies and capture what they're doing now to improve their capabilities to manage future performance.

Time-consuming, inflexible processes

Although the time it takes to finalize a budget or prepare a forecast naturally varies from industry to industry and company to company, most of our respondents agreed that their companies are spending a great deal of time and effort on consolidating, summarizing, communicating, explaining, and reviewing information for financial planning. One unfortunate consequence of these lengthy planning cycles is that final budgets often fall out of step with quickly evolving business conditions. As one senior finance executive put it to us, "Given that the heavy work is done by the field in September and October, and that's batted about at corporate in November and December, I would say that by the time the budget is approved, it's already stale."

The PwC perspective:

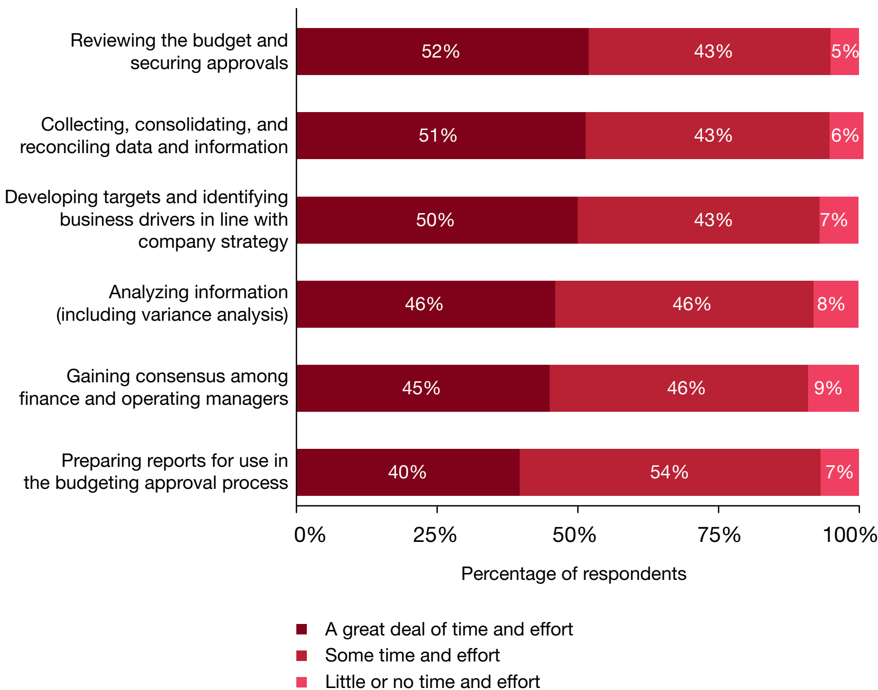
Finance organizations that have successfully revamped their planning processes can today complete a forecast in two days or less and develop an annual budget in less than three months with three iterations or fewer. These organizations have reduced the time spent on lower value planning activities and benefited from having prospective information and plans available earlier in the cycle to impact business performance.

Why are so many companies willing to conclude lengthy, effort-intensive budgeting cycles with a document that's already out of date? In part, because many companies find the process of negotiating the budget valuable in itself. Companies also rely on forecasting processes to help them adjust their financial plans as the year proceeds (with varying results). Still, most finance executives heartily agree that the time and effort expended on the most mechanical tasks associated with budgeting and forecasting—tasks like data-gathering, reconciliation, and consolidation—would be better spent on more valuable activities.

We asked survey respondents to identify key financial-planning activities that are absorbing their resources. Which specific budgeting activities, for example, are taking up "a great deal" of their companies' time and effort? A substantial number of respondents (over 40%) reported that their companies spend an overwhelming amount of time and effort on all of the activities we queried on—from collecting, consolidating, and reconciling data, to analysis, to developing targets, to budget review and approval. (See Figure 2.)

Figure 2. Most budgeting activities require a great deal of time and effort from finance teams.

In general, how much time and effort does your company currently spend on the following activities when preparing its budget?



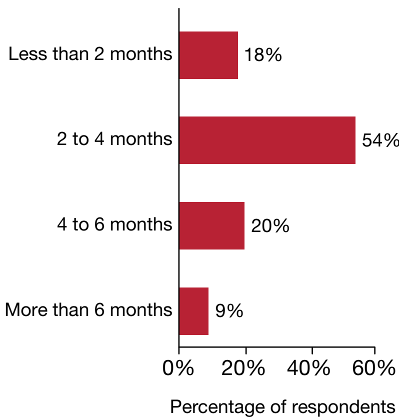
The PwC perspective:

Leading companies have focused attention on simplifying the overall financial planning process and automating offline and low value-added budgeting and forecasting activities. We've see companies implement focused programs aimed at reducing planning iterations and cycle time, automating data sources and report preparation, and reducing levels of review and approval. These programs have allowed business and corporate financial planning analysts to move away from the budget generation churn, freeing up time to analyze trends and develop meaningful business insights.

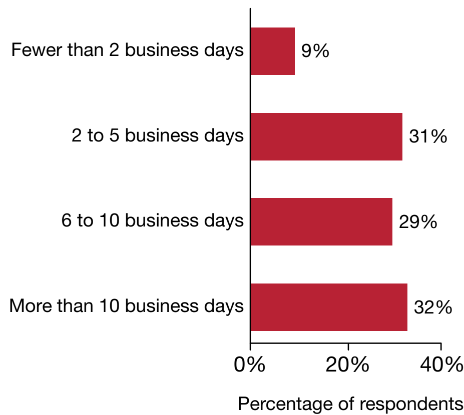
Survey results further confirmed that financial planning activities are complex, iterative, and time-consuming at many companies. More than three-quarters of all respondents (83%) reported that budgeting takes two months or longer to complete at their companies. Meanwhile, more than half of all respondents (61%) reported that it takes six business days or longer to produce a forecast, and nearly one-third (32%) said that it takes more than 10 business days for their companies to generate a forecast. (See Figure 3.)

Figure 3. Budgeting and forecasting are time consuming at a majority of companies.

Approximately how much time does it currently take your company to prepare its budget?



Approximately how long does it take your company to generate a forecast?



Seeking the right level of detail

Many of the finance executives who participated in this study said their companies are working hard to strike the right balance between too much and not enough detail in the reporting and deliverables associated with financial planning. "It's really about getting down to what some people call the 'drivers' of the business, which in turn define the level of detail," said one senior finance executive at a large manufacturer. "What we want—the deliverable that comes out of this whole planning effort—is actionable data. … We're asking ourselves 'How far do we want to go in grouping the details of the drivers that are coming in?' We don't have a good answer to that question yet. We're working on it."

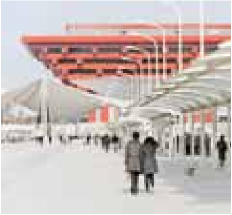
One of the toughest jobs in getting to the right level of detail, the executive continued, is reconciling the information needs of various company constituents. "There are two primary stakeholders with different needs: the finance department and corporate management, and the supply chain operations team," he said. "I don't know if we're ever going to reconcile those two [sets of needs] fully.… One of our key objectives over the next couple of years is to try to develop one set of master data that will satisfy both groups of stakeholders in this [financial planning] process. But as of today, we in finance don't think we have *enough* data, and operations doesn't think we have the *relevant* data. There's a lot of work to be done."

The PwC perspective:

PwC's experience suggests that the level of detail in the planning process should be minimized adequately to enable managers and planners to focus on the key drivers of the business. Although planners and managers may need to drill down on actual results in order to explain variances, finance teams benefit from focusing on controllable drivers, rather than detailed accounts to drive overall forecast and plan accuracy. While hundreds and hundreds of planning accounts and detail can provide a level of review and insight into a planner's thinking, it does not necessarily correlate into improved forecast or plan accuracy. In fact, the key findings that we have found in our experience with planning and forecasting with a lot of accounts and detail is longer timelines, more complex processes, and reduced transparency to the real business drivers across the organization.

We also observe that leading finance organizations develop plans and forecasts at a maximum of 50 account lines, major product groups or families, and at an entity level that is consistent with their accountability structure.

Obtaining the right level of detail for an organization means that a company has to understand and focus on the real drivers of the business that significantly impact their financial statements and spend less time managing detailed accounts and products that have little impact on decision making.



The PwC perspective continued:

Developing the balanced level of detail in a company's planning environment translates into the following benefits:

Avoids giving the perception of false accuracy. A company may have a very complex and detailed planning model but that does not mean that it is more precise and develops a better projection than a simpler model. Detailed plans and models with elaborate calculations can lure planners and managers into the trap of thinking that plan or forecast is more accurate just because a model performs more calculations and calculates more accounts and products.

Allows financial planners and managers to focus on the most important accounts and their drivers. Many times we see elaborate models and calculations supporting small balance accounts that are not significant to the overall financial plan.

Enables finance teams to perform scenario analysis and turn around "what-if" challenges in a timelier manner. By moving the organization to a higher level of detail in the forecast and plan, the finance community will now potentially have time to run additional versions of the forecast or plan to understand the earnings impact under different assumptions. This now moves finance from a role of plan developer to one that can help make solid recommendations to its business partners.

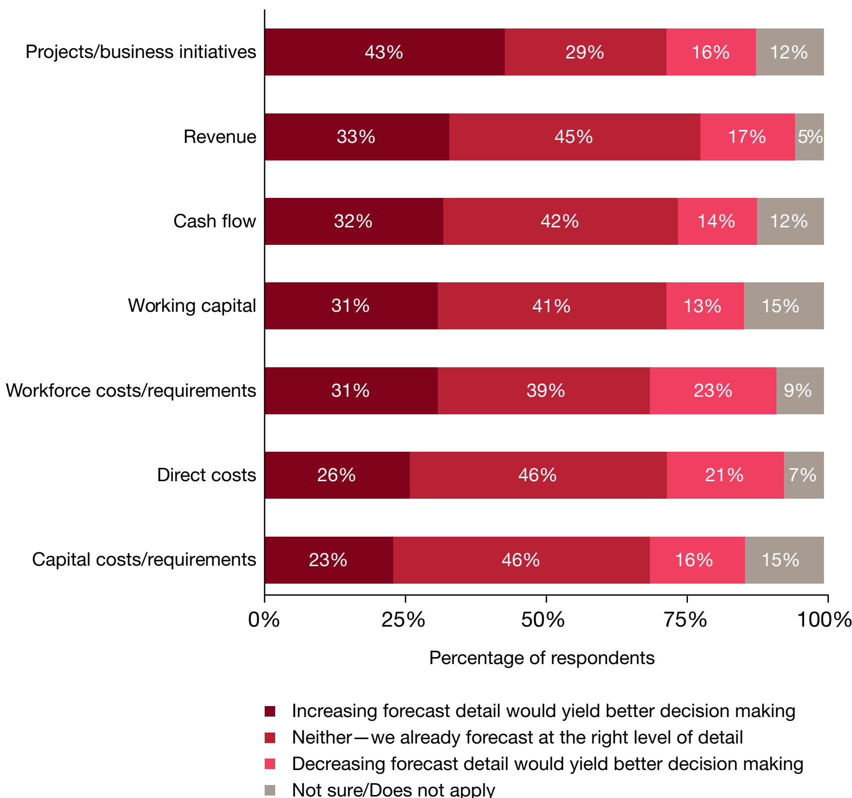
Survey results suggest that, broadly speaking, finance executives aspire to increase the level of detail in their forecasts to gain a more granular view into the future but recognize that additional detail may increase forecast timelines and provide additional challenges. (See Figure 4.)

In the end, finding the right level of detail involves tailoring deliverables to fit the requirements and objectives of the task at hand—and of the needs of individual users. "Depending on who you ask, you'll get different answers," Peter Lynch, VP of finance at Gates Corporation, observed. "I'm an accountant and by nature, I like to dig into the details," he said. "So if you ask me that question, if I get all the details, I'm happy. But then again, I don't always have time to go through and analyze everything. I just need to get enough information to understand what's going on in the business."

The fundamental service orientation of the finance function, respondents told us, should lead finance to weigh carefully the burden that its requests for detailed information can place on the business lines. As Mr. Lynch put it, "Certainly controls are our most important priority in finance. But from my perspective, as a financial leader, if I'm not operationally focused—if I don't know what's going on in our plants—then I'm failing. The point is that I'm working for them—they're not working for me. I've got to be able to make decisions to support those plants, to make the right decisions to help them grow. If I don't know [about our operations], then that's my fault. I shouldn't punish them [by forcing them to] give me every little bit of detail in order to make a decision."

Figure 4. Finance executives seek greater detail in forecasts—especially for projections of top-line performance.

In your opinion, would your company benefit most from: increasing the detail of its forecasts in each of the following areas (to gain a more granular view into the future), or decreasing forecast detail (to focus on the most critical factors)?



A tendency toward conservatism

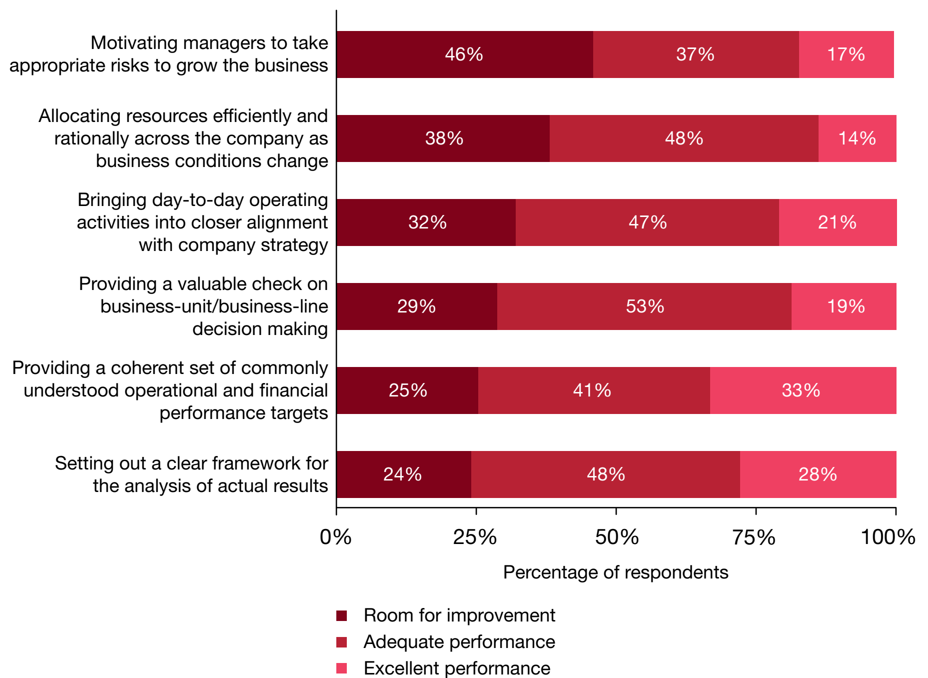
A persistent issue in financial planning is the challenge of establishing a realistic view of future performance while encouraging appropriate risk-taking. Business-line managers are close to emerging trends and provide much of the internal data that informs the financial planning processes. At the same time, managers—understandably wary of inflating expectations—are sometimes more conservative in their outlook than business conditions warrant. This is troubling because, over time, overly conservative financial plans can lead companies to miss opportunities and, ultimately, to underperform.

When we asked survey participants what their companies' budgets did well—and where they could be improved—finance executives were most likely to say that their budgets effectively provide coherent, commonly understood operational and financial performance targets (33% of respondents reported "excellent performance"). But finance executives often reported that their budgets were less effective at motivating managers to take appropriate risks to grow the business (46% report "room for improvement"). (See Figure 5.)

Many companies that rely on forecasts to refresh financial plans and correct course throughout the year are finding that their forecasts tend to be conservative, too. Forecasts are expected to vary compared to actual results—"the question is by how much," one finance executive told us. Over time, however, a company's forecasts ideally should fall within a reasonably circumscribed range.

Figure 5. Respondents say their budgets often discourage managers from taking appropriate risks and from allocating resources dynamically.

The following items are commonly cited benefits of budgeting. In your opinion, what do your company's budgets do well? Where could they improve?



The PwC perspective:

It comes as no surprise that CEOs and CFOs are demanding "reality" from the financial planning process. Budgeting and forecasting are key pillars of an enterprise performance management system and getting realistic and accurate planning information is critical for executives to quickly adapt to changing business conditions and maintain confidence of external stakeholders.

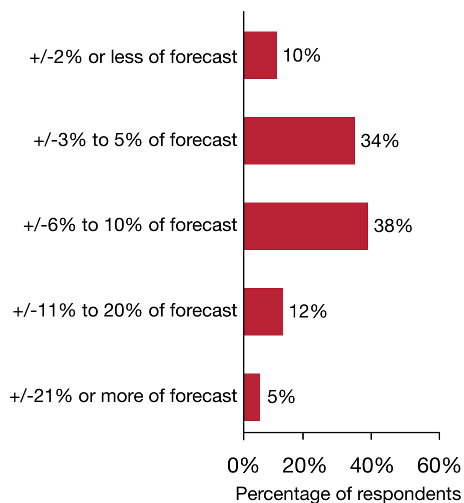
From our experience, we observe that the more organizational review layers, the greater the conservatism, which tends to get added at each organizational layer.

Survey results suggest that forecasts are falling short of that mark at many companies. More than half of all respondents (55%) reported that their companies' actual performance has generally varied more than 5% compared to forecasts over the past three years. (Seventeen percent of respondents reported that actuals have generally varied more than 10% compared to forecasts.) Only one-third of respondents said their companies' forecasts have tended to be evenly distributed between conservatism and optimism. Forty-four percent of respondents reported that their forecasts have tended to be conservative—while only 23% confirmed that their forecasts have tended to be optimistic. (See Figure 6.)

Figure 6. Amid great uncertainty, companies often err on the side of conservatism.

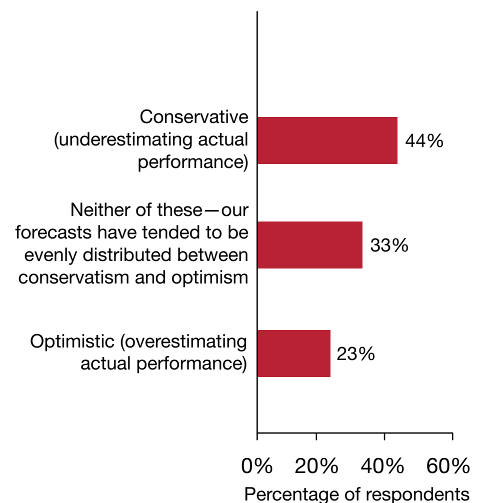
In general, approximately how close to actual performance have your forecasts proven to be over the past three years?

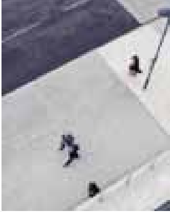
Over the past three years, actual performance has generally fallen within…



In your opinion, have your forecasts tended to be conservative or optimistic?

My company's forecasts have tended to be…





The PwC perspective:

We often observe that management views the budgeting process as a control mechanism to achieve a target and culturally start to think within its boundaries. This mindset keeps an organization focused inwards and limits the value it can provide to manage a business which naturally is externally focused.

The common practice of linking budget targets to incentive compensation also enhances tendencies toward conservatism. This naturally drives the behavior where personal gain influences the level of commitment and results versus plan. In our experience, leading companies have worked to better link the financial planning process to the strategic plan, but they also recognize that strategic planning is not a financial budgeting exercise.

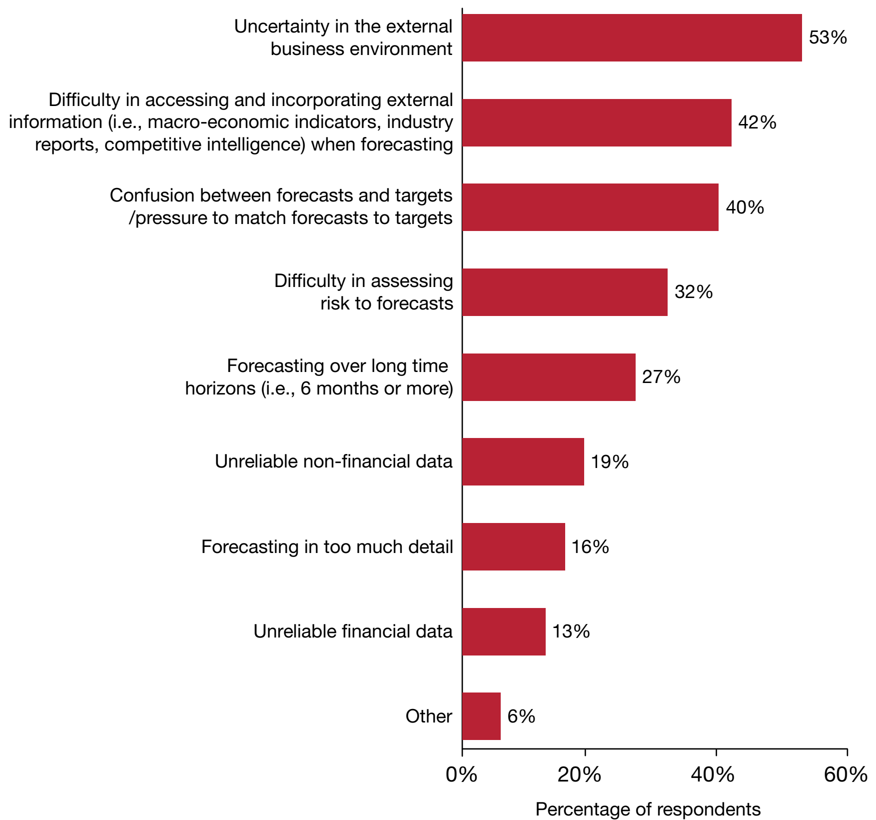
Boosting forecast accuracy

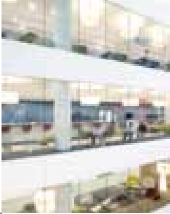
We asked finance executives to tell us which factors are most likely to lead to variances between forecasts and actual performance at their companies. More than half of all respondents (53%) confirmed that uncertainty in the business environment leads to variances.

The point of forecasting, however, is to gain insight into the future despite uncertainty. So it is perhaps more troubling that survey respondents also frequently report that forecast variances stem from difficulty in accessing and incorporating external information (such a macro-economic indicators) (42%), and from internal pressure to match forecasts to targets (40%). (See Figure 7.)

Figure 7. External market information, not internal data, is most likely to improve the quality of forecasts.

In your opinion, which of the following factors are most likely to lead to variances between forecasts and actual performance at your company?





The PwC perspective:

Leading finance organizations are addressing the challenge of conservatism in forecasting by culturally shifting the focus of the forecasting exercise away from control to how effectively the business capitalizes on the new opportunities and how successful they are in gaining market share from the competition. The focus here is not if the organization beat the budget; instead, the focus is on winning in the marketplace.

Finance can help drive this change by focusing less on looking for holes in the forecast and comparing it with budget and more on upfront collaboration with the business units to proactively identify new opportunities and appropriate risks and to incorporate those opportunities and risk in the forecast process on a continuous basis.

The finance executives we spoke with observed that external sources of data—including macro-economic indicators, industry reports, and competitive benchmarks—can provide a useful perspective on internal performance projections. "We don't use the historical data any less, but we are looking for more external information to help validate what we think," one senior finance executive noted. "To be honest, at times that external data has contradicted internal thinking, so it's actually created questions." Exploring those questions and contradictions, however, has often proved to be a valuable exercise. "The conversation has definitely evolved to the point where we're discussing both the internal point of view and the external information. There's definitely more conversation going on," said the executive, noting that his corporate finance function is now encouraging business managers to seek new sources of relevant macro-economic data.

The pressure to match forecasts to budget targets leads to a dilemma familiar to many finance executives: when forecasts are confused with budget targets, the temptation to water down those forecasts is understandably great. "I've seen it unfold at many companies in my career," Mr. Lynch said. "It's a lot easier to under-forecast and over-deliver—you don't get beat up as much. And you're a hero when you beat your forecast." To combat that pressure, Mr. Lynch continued, "We're trying to instill the mentality that we're measuring forecast integrity. It's accuracy that counts. The question isn't 'Are you beating your forecast?' but rather 'Are you missing it on the downside—or the upside—by more than five percent? If so, why? And let's figure out a way to better align [forecasts with actual performance].'" To help promote that alignment, Gates Corporation is in the process of implementing technology tools to aid in information gathering and demand planning, as part of a broader business intelligence initiative.

The PwC perspective:

It is not surprising to hear that uncertain and changing business conditions are contributing to forecasting variances versus actual results. However, the leaders in this environment have consistently shown a disciplined forecasting process that tackles uncertainty by increasing attention to external influences and key business drivers.

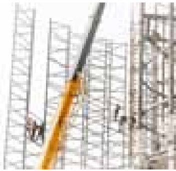
Other finance executives we spoke with pointed out that aged technology platforms often can't accommodate the annotations and analytics that contribute to more accurate, risk-sensitive forecasting. At one large manufacturer, a new CRM system holds the promise of more robust revenue forecasting capabilities that will, among other things, take the range of possible sales outcomes into account more fully. "One of the main things we're looking at [in the new system] is much more robust functionality for the [sales] forecasting process," said a senior finance executive at that company. "Our current system is very binary. You can forecast that something either *will* happen or it *won't* happen. You can specify a fixed dollar amount and a fixed time period, and there's really nothing you can do to express the uncertainty around that."

The executive continued, "One of the things we're looking for in a new CRM tool is to be able to put a whole bunch of other data points around that opportunity—to indicate, for example, 'This is something I'm sure is going to happen, because I already have the contract.' Or to indicate, 'This is something I'm speculatively putting out there that I'm not ready to commit to, but I want to make sure that it's on your radar.' Ultimately, this will give the sales force an opportunity to describe more holistically, using some sort of probability analysis, the range of things that might happen—or *will* happen, or *definitely* will happen." This more nuanced view, in turn, will help the company to match production resources much more closely to shifts in demand for its products.

A blend of top-down and bottom-up approaches

Which approach to financial planning yields greater value: a top-down approach? Or one that proceeds from the bottom up? Participants in this study pointed out that each approach has its advantages. On the one hand, a top-down approach can help mitigate conservatism and encourage managers to stretch their divisions to better performance, respondents said. On the other hand, the most reliable information on critical business trends tends to bubble up from the bottom.

In practice, many companies seek to gain the best of each approach by employing a combination of the two. Gil Borok, CFO of commercial real estate services firm CBRE, observed that a blended approach to forecasting has proven especially useful while economic conditions have been in flux. "Budgets almost never correctly anticipate the first year of an upturn or the first year of a downturn, because change on that scale—positive or negative—is fairly precipitous when it happens. That's why the forecasting process is essential," he said, noting that forecasts tend to receive even more attention in down cycles than in growth cycles. "On the down side, companies are trying to figure out as best they can if they're going to be off budget, and by how much. …on the up side, it's still important to be accurate, but knowing fairly early in the year that you're going to beat your plan? That's a good problem to have."



The PwC perspective:

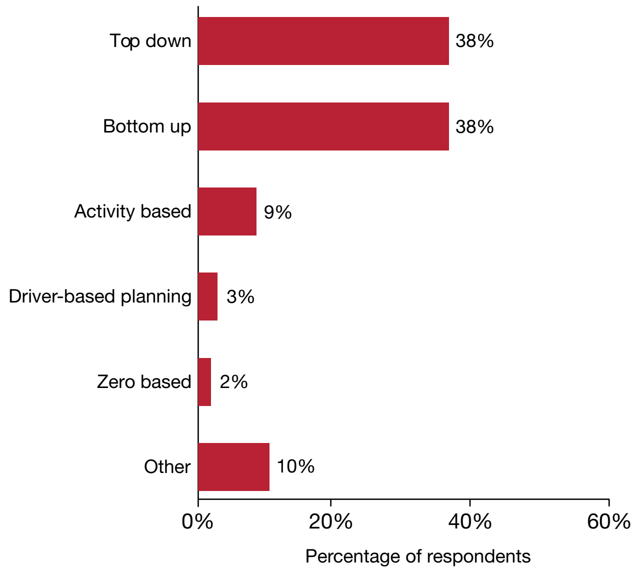
Our hands-on experience in collaborating with clients to analyze various budgeting approaches suggests that a balanced approach incorporating both top-down and bottom-up is the optimal path. It encourages upfront target discussions and negotiations which streamline the number of planning iterations and churn on the back end. Leading companies that utilize an 18-month rolling forecast process frequently provide top management the initial view of next year's plans to help set initial targets.

The corporate finance department at CBRE brings a broad perspective to forecasting that, together with valuable contributions from business managers, leads to more accurate forecasts, Mr. Borok said. “It’s certainly not to say that we at corporate know better than field managers; we’re simply doing analytics that are different from the field,” he said. While field managers report on what they observe in their markets, he continued, the corporate finance function has access to information and analytics that can help interpret these trends across the enterprise. “We’re able to validate, for example, what our field managers observe is changing fairly quickly, based on historical trends. We’re able to look at prior time periods and prior cycles. We look at this information and analysis, and try to make top level adjustments to get to a realistic projection.”

Survey results confirm that finance executives value both the top-down and the bottom-up approach to budgeting. We asked survey respondents to choose the one statement that best describes their companies’ current budgeting process. A solid majority of respondents (76%) split evenly between top-down and bottom-up budgeting. Far fewer respondents said their companies primarily used activity-based budgeting (9%), driver-based planning (3%), or zero-based planning (2%). (See Figure 8.)

Figure 8. Three-quarters of all respondents split between top-down and bottom-up budgeting.

In your opinion, which of the following statements best describes the current budgeting process at your company?



The PwC perspective:

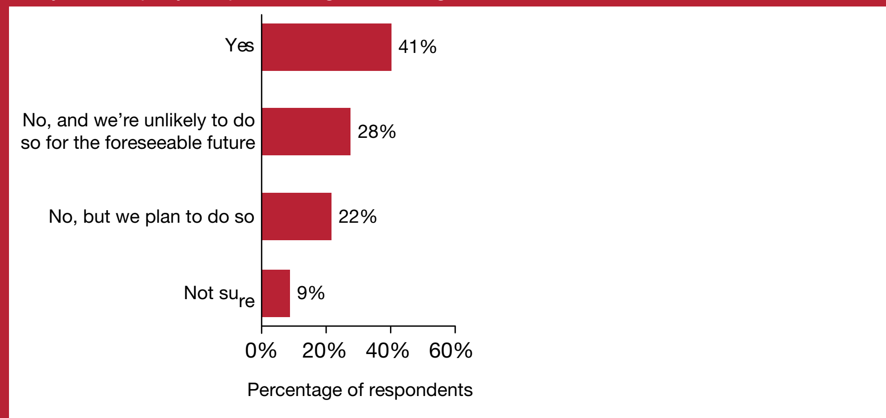
We have consistently observed that leading finance organizations have a mindset of continuous forecasting—business units refresh or edit the forecast as events occur or as new external data becomes available that changes underlying forecast assumptions. However, the business-unit update to corporate remains a monthly/quarterly process, based on corporate requirements. One of the key lessons that finance organizations have learned is that while increasing forecasting frequency is desirable, equally important is to improve the underlying process and technology to avoid the strain on finance and its business partners.

Rolling forecasts gain traction

While it's notable that a substantial number—41%—of respondents to our survey say they've already adopted rolling forecasting, it may be even more notable that another 22% of respondents say they plan to transition to rolling forecasts. Only 28% of respondents say they haven't adopted rolling forecasts and are unlikely to do so in the foreseeable future. (See Figure 9.)

Figure 9. Rolling forecasts have become fairly commonplace.

Has your company adopted rolling forecasting?



"From a forecast perspective, I believe it is critical to implement a rolling forecast process in order to stay on top of what's happening," said James Arnold, SVP and CFO of the USA and Caribbean at global container shipping firm CMA CGM. "This allows you to quickly assess changes on the horizon and to provide key information as a business partner to both executive management and to operations."

Stephen French, division financial leader in the electronics division at W.L. Gore, told us that shifting to a rolling five-quarter forecast had helped his company link sales forecasts and production planning more closely. "We tend to have a fairly flexible workforce, and a lot of our parts require some very specific engineering and some very unique raw materials. The better we can get a view into what's going to happen on the sales side, the better we can do on lead times and so forth."

Since the shift to rolling forecasting, "The sales force is now consistently providing the most current information they have on the coming quarter, albeit with a lower level of granularity, and then refreshing the three or four 'out' quarters. That helps with macro-level planning," Mr. French continued. "By placing the emphasis on getting the best available information for the coming quarter, and then perhaps emphasizing the details less—taking sort of a macro-level view—for the 'out' quarters, we can help our production staff figure out where they need to put people and buy materials. It's sparking a change in behavior that promotes better alignment between the sales and production functions." This, in turn, "helps with the whole global planning process—figuring out who you need and where you need them," he concluded.

Mr. Lynch of Gates Corporation offered a succinct summary of some of the advantages—and the challenges—of adopting rolling forecasting. "A rolling forecast allows you to continually look forward at new opportunities, market developments, and new expectations from customers," he said. Rolling forecasts are also less disruptive, Mr. Lynch continued. "It's less 'Drop everything, let's do a forecast,' or 'Drop everything, we've got to do the plan,' and more, 'OK, let's do the refresh and make sure our assumptions are still accurate.'"

Part of the challenge in implementing rolling forecasts, he suggested, is gaining buy-in and alignment across the organization. "Part of it is getting the right systems in place for demand planning so we can align supply chain and production with the sales forecasts. But it's also having ownership of [the transition to a rolling forecasting process] at a high enough level in the organization. If top-level management doesn't buy into the process, it often doesn't become embedded in the organization. If, for example, a company calls on supply-chain managers or sales directors to drive the process, it may not take hold as it should, because sales heads in one direction, supply-chain management heads in a different one, and production goes in another one altogether. It can be a difficult process to implement, and it can be expensive, but once it's in place, it should be a sustainable process that has significant benefit to the organization."

Survey responses also suggest that driver-based planning concepts are gaining traction. When we asked in a separate question which changes would yield the greatest improvement in the usefulness of their companies' forecasts, respondents most often cited "adopting driver-based forecasting" (35%). And in response to open-ended questions, respondents described a variety of hybrid approaches to budgeting that clearly aim to reap the benefits of both top-down and bottom-up approaches to financial planning.

More frequent forecasting

Many of the finance executives we spoke with acknowledged that more frequent forecasting can yield a better view into swiftly emerging trends. But moving to more frequent forecasting, they said, poses challenges—not least of which is identifying the right level of detail for those forecasts. Implementing more frequent forecasting can create unnecessary burdens in finance and in the business unless companies take compensatory measures: automating processes, reducing the amount of forecast detail, or some combination of both.

"Our forecasting, because it's updated monthly, was taking a great deal of effort, and that extra incremental effort wasn't necessarily yielding a better result," said Mr. King of Eastman Chemical. "We've undertaken a major effort to improve our forecasting and take some of that effort out—which means, in general, implementing a process that will yield the same insight, but from a higher-level point of view." That improvement project is currently in progress, Mr. King continued. "Automating forecasting processes allows you to get at that [granular] level of detail more easily. We're definitely looking at ways to do that. But since we're also looking for an efficiency gain, we may look at the forecast from a higher-level perspective as well."

The PwC perspective:

Based on PwC's experience, all three areas—people, process, and technology—must be considered when looking to improve an organization's financial planning and forecasting activities.

Simply stated, organizations should be structured to support rationalized financial processes, and technology should be viewed as an enabler. If all three aren't aligned, improvement in only one area often will not yield sustainable results.

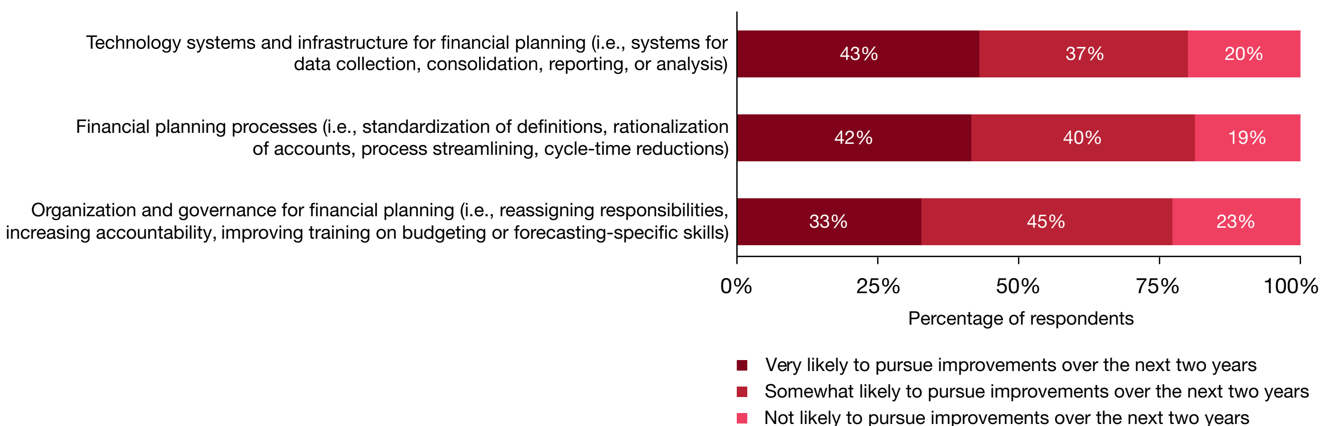
While taking some of the detail out of forecasts can help make frequent updates a less intensive effort, adjusting to high-level reporting can itself be an adjustment, our sources said. “There can be some understandable resistance to change, because people know that their submissions will be followed up with questions,” Mr. King said, observing that people can be understandably reluctant to relinquish supporting detail. “It’s a normal, human tendency to resist change—and then you’ve got the pressure of thinking, ‘I’m going to be asked questions; I’m just going to keep doing it this way. It’s a lot of work, but if I don’t do it, what happens then?’ That’s why we chose to launch a large-scale, centralized project to try to bring new tools and approaches to the table and come up with a better way of forecasting,” Mr. King said. “Absent that well-thought-out process and approach, I don’t think people are generally willing to accept a lot of changes.”

Technology, process, and organizational improvements

The results of our survey confirm that finance executives have wholly embraced the “people, processes, and systems” paradigm: the idea that technology, processes, and organization are each important and complementary dimensions of improvement. A substantial number of respondents—one-third or more—said their companies are “very likely” to pursue improvements in their financial-planning technology, processes, and organization and governance. A solid majority of respondents (77% or more) said their companies are at least “somewhat likely” to pursue improvements in each of these areas. (See Figure 10.)

Figure 10. Companies plan a combination of technology, process, and organizational improvements.

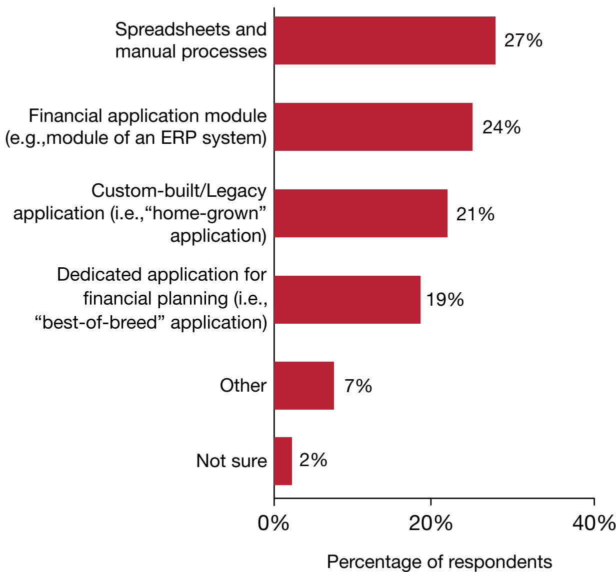
In your opinion, how likely is your company to pursue improvement in the following areas over the next two years, as it works to improve its financial planning (including both budgeting and forecasting)?



While few technology-improvement efforts are successful without attention to both process and organizational factors, it's also true that financial-planning change efforts, in particular, often require technology improvements. However, more than a quarter of respondents to our survey (27%) said their companies are using spreadsheets and manual processes—not ERP, custom-built applications, or best-of-breed systems—for financial planning. (See Figure 11.)

Figure 11. Spreadsheets and manual processes are commonplace in financial planning.

Which of the following statements best describes your company's IT systems for financial planning (including budgeting and forecasting)?



There are good reasons for the ubiquity of spreadsheets, finance executives observed. "The reality is that spreadsheets aren't going to go away," said ATK's director of finance Michael Varecka. "Financial analysts like them; they're fast, flexible, and they're personal, too." Understandably, analysts "have confidence and take pride in the models they've developed," Mr. Varecka noted. One way to ease the transition, he suggested, is by introducing best-of-breed systems that can accommodate some degree of personalization, while providing powerful reporting and analysis tools—and drawing from a single version of the financial truth. "What we're trying to do is make sure that, for our core financial planning and forecasting process, we have a best-in-breed backbone that captures critical data that's common across the company." At the same time, he says, "We're really trying to find ways to work in concert with the personal-spreadsheet dimension that individual financial analysts want as well. We're doing some things that are a bit customized with our IT folks, to try to bridge the functionality between our enterprise BPM tools and the individual analysts' spreadsheets, while providing for standardized data input and data extraction."

The PwC perspective:

A common misconception is that all spreadsheets will be eliminated through the implementation of "best-in-breed" technology. The fact is that many best-in-breed planning solutions integrate fully with Microsoft Excel® and the goal through implementation is to reduce spreadsheet reliance, not fully eliminate it.

Cross-functional collaboration

The path to financial-planning improvement, our respondents said, starts with strong leadership from the top—and continues with the close, cross-functional partnerships that arise when business constituents come together to work for change. Often a combination of IT and finance leadership provides the initial impetus for change, respondents told us. "The leadership [behind this effort] started with our controller, Mr. Scott King, and our Chief Information Officer, Mr. Keith Sturgill," said Eric Miller, finance Six Sigma black belt at Eastman Chemical. "They identified the need for this, and together agreed that this is something the company should do."

The improvement initiative at Eastman, Mr. Miller continued, was conceptualized as a company-wide effort from the beginning. "In my first conversations with Scott, he looked at me and said, 'This is not a finance initiative. This is a corporate initiative, and it's going to take all of us working together to get it done.' Keith and Scott are working with the appropriate senior leadership teams, and they're also working across the organization—not just within the organizations that they serve, but with those who are touched by these processes," Mr. Miller continued. The steering team for the initiative, Mr. Miller said, includes the director of IT for finance—"that was key." Furthermore, "our project team is a very cross-functional team," Mr. Miller said. "It touches the business, manufacturing, supply chain, finance, accounting, and other areas as well, such as pricing." Meanwhile, he said, "Our IT organization has pulled out all the stops in their approach to this financial forecasting redesign effort."

The finance-transformation effort at Gilead Sciences involves close collaboration between finance professionals and the functional leaders who rely on information to make decisions, said Ms. Washington. Their partnership is premised on the company's overarching functional orientation. "We've always had in the finance function a kind of 'business partner' model. We have a group called 'operations finance'—and that's a good name for it, because that group is aligned with each of our operating functions. We have a finance lead who supports R&D, another who supports manufacturing, another who supports G&A functions, another who supports the commercial [sales and distribution] function, and of course we have the corporate finance group, which supports executive management. These [functional finance leaders] are part of my group and they report through the finance function, but they also fit in and are a part of the staff of all of these functional operational groups," she explained.

Ms. Washington continued, "Part of [these finance leads'] job in this finance transformation—really on an ongoing basis—is to understand the reporting [that's most effective] in each of their functional groups. Our head of commercial, for example, likes to see daily sales reports." One advantage of this organization in the context of the ongoing finance-transformation effort, Ms. Washington observed, are the already-existing, close ties between the finance function and the functional constituents that finance serves in the business. "The head of commercial, for example, is able to rely on that finance functional leader to ensure that when the system goes live, the integrity of those daily sales reports won't change," Ms. Washington said.

The PwC perspective:

The budgeting, planning, and forecasting process at most organizations is a very expensive and time-consuming activity that has often failed to deliver its intended value. Having more reliable and timely views of future financial performance continues to be at the top of the improvement agenda for many CFOs. Transforming the financial planning process requires strong leadership and the ability to have finance, sales, and operations work together to offer realistic views of the future. Through collaboration, a higher level of planning detail utilizing business drivers, reduced planning cycle times and system automation, companies are beginning to reap the true benefits of integrated financial planning.

The ERP implementation process at Gilead, Ms. Washington continued, was designed to ease the transition to new systems and processes by gaining acceptance prior to go-live. "We're going to go through a user-accepting testing program that will bring together a group of people who I call 'global process owners,'" Ms. Washington said. "Our head of manufacturing, for example, is one of those global process owners. It won't be just the functional finance leader for manufacturing alone accepting these reports—the finance leader will be side-by-side with our head of manufacturing, turning to her and asking, 'Is this the output that you want? Do you believe in the integrity of this system?' Because otherwise, if I were one of [these functional business leaders], I wouldn't trust a new system either, unless I'd been involved in it, seen it transformed, and can see that what I'm now getting meets my needs—hopefully even better than before."

Many of the sources we spoke with acknowledged that financial planning at their companies could be improved—made less risky, less time-consuming, and more effective. But with finite resources and many competing priorities, companies are considering their options carefully before making a move.

Those undertaking major financial-planning improvement efforts don't disagree that change requires a substantial investment in time, effort, and resources. Nor do they necessarily see their original financial planning processes—their starting point—as broken. What makes all that time, effort, and expense worthwhile? The benefits of improved financial planning, finance executives explained, are not limited to smoother, more efficient, less risky financial-planning processes. Efforts to improve financial planning also contribute to more rational, coherent, and more effective ways of understanding the business, its world, and its future. And this, in turn, helps create a platform for future growth—yielding greater certainty, more sustainable profits, and, ultimately, more value for shareholders.

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