

## **Requirements for Budgeting, Planning and Forecasting**

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A series of key business processes in successful business performance management (BPM) systems is planning, budgeting and forecasting. This area is well understood by people working in the Finance department, misunderstood and generally disliked by budget managers throughout the company and of little interest to everyone else. However, the team charged with identifying the ideal technology solution to support the company in this area needs a solid understanding of what's involved.

First, there is some confusion around the terms planning, budgeting and forecasting. Although related, these terms mean distinctly different things and have different technology requirements as well. Let's start at the top: planning. Most companies put together an annual plan that is part of the larger strategic plan of the company, usually covering three to five years. This is where the senior executives lay out their vision for the company at a high level. For example, they may show total revenues growing at ten percent per year while expenses are shrinking at five percent per year and the margins are improving accordingly. These plans usually do not show the details of where the increases or decreases are coming from. In some instances, a more detailed version of the strategic planning process can include scenario modeling and what-if analyses. The plan is a way to share

the intended future path of the company with investors, board members and management.

Budgeting is when the plan is brought down to Earth. In the budget, managers are charged with showing the details of how they intend to meet the goals of the plan in the coming year. In most companies, budgeting gets very specific, essentially having line items for every meaningful revenue and expense item, even tracking salary and benefit costs related to individual employees. In the first pass, the budget may be done on a quarterly basis, but it's usually taken down to the monthly level before too long. As you would imagine, several passes are needed before the budget is finalized. There is an approval process as individual budgets are reviewed and consolidated upstream, but even with that, the consolidated company budget rarely ties out to the plan goals in the first several iterations. Sometimes, it is necessary to supplement this bottom-up budgeting approach with a top-down assignment of budget numbers to make it all work. In many cases, this involves allocating the total approved corporate expense for a particular item across several business units according to some formula. Once the budget is in place, it is intended to be the roadmap for the company's spending for the next year. However, things change very quickly - for example, if revenue targets are missed and expenses need to be reduced accordingly, if revenues are exceeded and hiring needs to be ramped up or if things simply cost more than anticipated in the budget. That's where the forecast comes into play.

The forecast leverages actual performance data as it is received to more accurately project where the company will be in the next period. Without changing the underlying budget, it is a way for the company to manage to current data and set realistic expectations. Forecasts are usually done at a level of detail somewhere between the high-level annual plan and the very detailed budget. There are several different approaches to forecasting. Some companies use models to generate the numbers, and others have senior managers enter their best guess. The frequency and duration of forecasts

also vary. In some cases, companies may forecast the remainder of the year as each new month of actual data comes in. Other organizations may have a rolling forecast where they enter data for the next 12 months even as it crosses over year-end boundaries.

There are many technology implications for these important business processes. For starters, because most companies will spend time in each area of planning, budgeting and forecasting, the technology needs to support all three, ideally with a consistent interface and set of processes. For instance, if someone is familiar with how to budget in the system, they should be able to easily move on to forecasting when ready.

Now, let's look at each areas specific requirements. Planning is most closely related to strategic planning where a company sets its goals and objectives. The plan essentially quantifies the strategy. Some vendors deliver a separate strategic planning module to accomplish this. Others provide some of the basic capabilities as part of their performance dashboards. This plan is most often put together in a spreadsheet by senior management. Which brings us to one of the first major decisions regarding technology selection for budgeting and planning - what role should spreadsheets play?

There are three main schools of thought on spreadsheets. The first group (composed of end users and some vendors) says there is no place for spreadsheets in a performance management system. After all, aren't spreadsheets the cause of most of the problems driving people to new systems in the first place? This group usually selects systems that have custom-built interfaces that may or may not resemble the spreadsheets people are used to. The second group says spreadsheets are great; we just misuse them, and besides, you'll never pry them out of the hands of the Finance team. This group looks for systems that fully exploit all that is good about spreadsheets (including familiarity, built-in functions and formulas, formatting, existing models, etc.) but ties the spreadsheets to a central and

secure database to take the chaos out of the equation. The third group is somewhere in between. They want a system that isn't dependent on spreadsheets as the primary interface but is still able to directly import and export data to and from spreadsheets as needed. You'll need to decide which group your company fits because this is one key area where vendors differ in their approach.

Budgeting requires a system that can handle a sizeable amount of data with adequate performance, provide workflow to manage the review process and allow for both bottom-up and top-down approaches. Regarding performance, keep in mind that budgeting is one of those processes where everyone tends to submit at the last minute. In other words, when the due date and time approaches, you could have hundreds if not thousands of users trying to post their data at the same time.

The system also needs to be able to maintain multiple budget scenarios. These can be the versions that were gone through to get to the final version, they can be a best case/most likely/worst case set of versions or they can be a budget with and without an anticipated merger. Because there are a lot of departmental interdependencies when creating the budget, the ideal product should provide a means for easy collaboration across groups. For example, manufacturing and customer service can't properly prepare their budgets unless they know how many units the sales department expects to sell and when.

For top-down budgeting, the solution needs to be able to easily handle allocations, including the ability to derive allocations based on other line items. For example, allocate the cost of the creation of a product sales demo to the regions based on their projected revenues from that product. Most budgeting products also support various spread functions that enable you to take an annual number and spread it across the months evenly or based on

some calculation. As with any system dealing with financial data, there needs to be a good audit trail capability to show who changed what data and when.

Forecasting is the area that can be the most complex and challenging when it comes to the underlying technology. Most companies use some amount of modeling in generating their forecasts. This requires a product with a robust modeling capability, which is not too difficult to find. However, it is hard to find a product that is easy for business end users. Even if the product utilizes a familiar spreadsheet interface, keep in mind that not everyone in the company is a power user of spreadsheets.

The other technology related to forecasting that is growing in importance today is predictive analytics, or the ability to more accurately determine the probability of a particular forecast coming to pass. This is another area where the vendors vary widely in their ability to provide the tools for this sophisticated analysis.

I have only scratched the surface here, but it should be enough to give you a sense of some of the things to consider as you move forward with this phase of your BPM project. This can be one of the most challenging areas of BPM to get right. If you are lucky enough to have someone in house who understands the intricacies of planning, budgeting and forecasting as well as the current state of the available technologies, make sure to involve them in this process. If not, consider adding an expert to your team either for the duration of your project rollout or as a permanent addition. A well-designed planning, budgeting and forecasting system can have a significant impact on the transparency and accountability of your organization - an important consideration for most companies today.

