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Supply chain: Forecasting

Rolling forecasts
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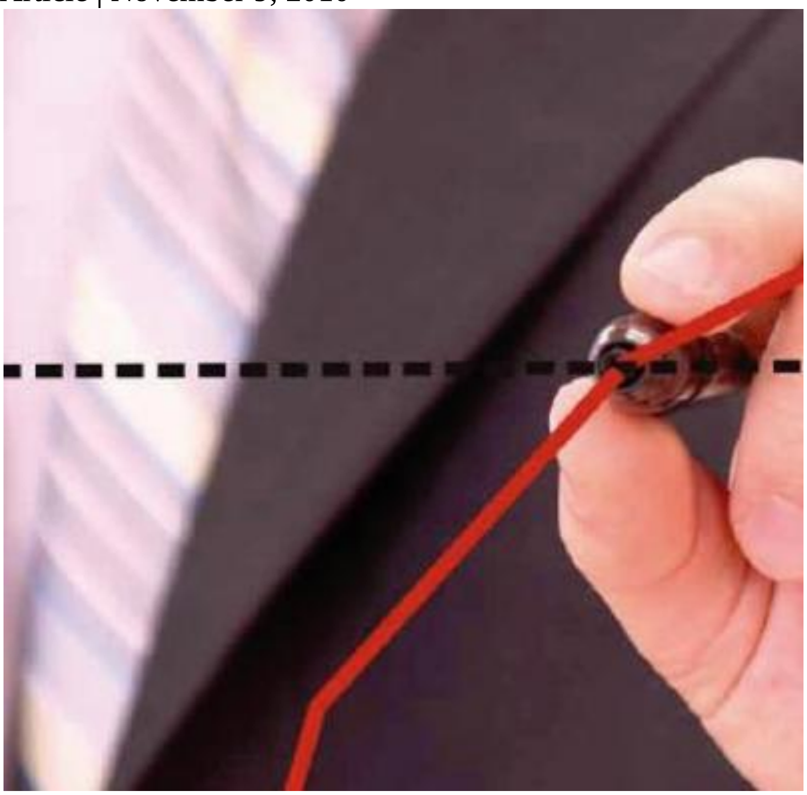

The traditional once-a-year budget is quickly falling by the wayside as a key management tool. Rolling financial forecasting can take the ambiguity out of the budget planning process, says Jason Webster.

No doubt about it; financial forecasting is a perilous task, yet budgetary accuracy remains a consistent top priority concern of most CFOs….and with good reason since the role of financial forecasting has never been more critical.

In today’s business environment, technological developments have created new opportunities for expansion, but with new opportunities come new challenges. As competition intensifies, businesses are under increasing pressure from shifting customer expectations. Combine that certainty with the unpredictability of data and an economic “perfect storm” could be brewing.

But rolling financial forecasting can provide a significant instrument to reduce that uncertainty; therefore businesses should arm themselves with as much knowledge about this fundamental component as possible and come to terms with the probability that “old school” forecasting methods may be exercises in futility.

As Jack Welch said in his powerhouse book *Winning*…. ‘not to beat around the bush, but the budgetary process at most companies has to be the most ineffective practice in management.’

Corporate performance management is no longer a mere buzzword—it is a reality at leading and upwardly mobile organizations and is fast evolving into a core discipline. The result is better insight, tighter management discipline, and greater forecast accuracy, but to achieve these ideal long-term goals, fiscal planning must include changes to the traditional budget, financial reporting and target-setting.

No longer can companies count on internal historic performance as the core metric for future results inasmuch as the best predictors of performance—financial, sales and supply chain—are often external to the organization. And that is why the traditional once-a-year budget, which typically requires two or three months of time and effort to accomplish and provides precious little actionable value, is quickly falling by the wayside as a key management tool.

Planning, divorced from the real world, can have little value, but many organizations fail to grasp this insight. The rolling forecasting process can serve as a vehicle to increase confidence in decisions made by management since it takes a rational view of potential financial outcomes based on available information. In other words, “planning” is designed to meet some predefined and agreed upon objective, while “forecasting” seeks to understand the impact of events on the likelihood of achieving the objective.

The rolling forecast methodology is a more realistic planning model since it helps to determine the best methods to integrate a company’s internally-driven data for subsequent budget calculations.

Let’s look at it in terms of a GPS. If your GPS indicates it will take an hour to drive from point A to point B and you decide to “beat it” by driving faster, you’ll be in for a surprise—the GPS will adjust to your new speed and you will still arrive at the time of first indication.

The GPS “forecast” is the planning road businesses should travel more often. Constant communication translates into predictability and ultimately into fewer surprises, which is the very definition of the rolling forecast.

Whereas the traditional or static annual plan locks a budget in for a year, the rolling forecast approach decreases management’s burden to “crystal ball” the future; this methodology projects performance out over one to two years on a monthly basis, allowing all levels of an organization to illustrate variances in their projections.

That said; it must be noted that financial forecasting is not about predicting and controlling future outcomes; its purpose is to provide the tools for appropriate decision-making that will help shape future outcomes.

A rolling forecast typically looks ahead four to eight quarters into the future and can establish a practical and functional information system for CFOs and other senior management. It provides a continuous or "rolling" picture of all aspects comprising a company's current, short-term and longer-term financial outlook and is not encumbered by the narrow focus of a calendar or fiscal year viewpoint.

In a nutshell, a rolling forecast is a combination of customary expenditures, action plans in progress and those in the pipeline. It is a principle that allows companies the capability to close the gap between their operational budget and their strategic plan.

One of the fundamental elements of the rolling forecast is an understanding of key business drivers within an organization. As these drivers are updated, changes in financial projections are subsequently reflected, thereby allowing company executives to perform the appropriate analyses to modify crucial driver assumptions.

Consistently up to date, the rolling forecast process has an eye on continuous business management as opposed to annual results. Moreover it allows management to make decisions based on the most current data and eliminates the many and varied details that ultimately have little or no bearing on business drivers.

And since the rolling forecast provides 12 to 24 month cash projection, the necessary data for borrowing and debt reduction plans and/or potential funding sources for capital or personnel requirements is always at hand.

It should be noted that in order to be effective, a rolling forecast must have a clear long-range "attitude" and inspire executive level personnel to look beyond short term goals and instead focus on longer range company objectives. To accomplish that target, rolling forecasts should be performed with an advanced level of summarized detail in contrast to giving credence to monthly budgetary anomalies.

A rolling forecast must also be modeled with appropriate operating metrics and parameters and not with template updates that utilize previous years' operational statistics. These metrics should transition an organization's strategy into observable outcomes and allow performance to be measured against purposeful goals.

In addition to grasping a more realistic handle on financial projections, the implementation of a rolling forecast can result in other company-wide achievements, including elimination of the cost and disruption of annual static planning sessions and the ready availability of a future forecast should a lender, shareholder or potential merger partner require that information.

The rolling forecast approach is a model for reliable results that in turn will provide actionable information…to the right people…and in a timely manner. It is an opportunity to replace the traditional “set in stone” budget with a constant changing discipline.

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