Replacing the Annual Budget with Rolling Forecasts

Executive Summary

Gone are the days when annual budgeting and planning steered the business, with only predictable, minimal budgeting changes. With increasing competition and a changing economic environment, companies need a better way to predict the future. As a result, new forecasting techniques have emerged to help anticipate changes and better inform strategic direction.

Traditional forecasts take a structured approach to scoping uncertainties within a specified timeframe. Those predictions have a reasonable chance of being accurate. In today's highly volatile business environment, however, organizations are forced to be dynamic in adapting to changes to ensure their very survival. Companies that don't expect to encounter economic or political turbulence and operate via annual budgeting and forecasting exercises are finding it difficult to create plans and deliver results that meet expectations, be they internal management objectives or external performance goals set by financial and industry analysts.

In such an environment, chief financial officers need reliable and relevant insights into risks and opportunities. By embracing continuous planning or rolling forecasts, companies can remain agile, focused and flexible in meeting internal and external performance expectations. This white paper discusses the essentials for making rolling forecasts a reality.

Turning Rolling Forecasts into Reality

A rolling forecast is a process in which key business drivers are forecast on a continual basis. Its objective is to foresee the risks and opportunities presented by a dynamic business environment, revisit strategy in the light of new business scenarios and align resources/activities for competitive advantage at periodic frequencies. Rolling forecasts are not simply periodic updates against the annual budget and are not associated with a specific financial year.

A rolling forecast, also called continuous planning, is a leading planning technique that will help organizations find opportunities amid persistent volatility and intense competition. However, there are many practical difficulties in converting the theory of rolling forecasts into reality. Organizations that want to embrace rolling forecasts should focus on the following key steps:

> A rolling forecast is a process in which key business drivers are forecast on a continual basis.

1. **Move toward driver-based forecasting:** A common decision-making challenge is having too many details to work with. Forecasting should focus on drivers that are relevant for analysis and decision-making. This will provide organization-wide alignment and control over forecasting, as well as consistency in decision-making.

2. **Link forecast to strategic and operation decisions:** A key objective of the rolling forecast is to revisit strategy and align resources quickly and efficiently. Risks and opportunities identified during a rolling forecast should trigger "what-if" analyses and scenario planning. From the strategy postulated by scenario planning, resources for capital projects and operational expenses should be allocated and new performance targets set as key performance indicators.

3. **Ensure direct ownership and involvement of budget owners in forecasting:** A rolling forecast is primarily a reality check; it is not a process for adjusting numbers to fill the gap and meet a target. For this process to be successful, budget owners should be directly involved and provide unbiased data. Wider involvement will ensure that decision makers gain a more accurate picture of the current position and future outlook.

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4. **Deploy appropriate tools and technologies:** Rolling forecasts work on multiple budget assumptions and iterations. Also, they are largely dependent on timely integration, analysis and interpretation of information to ensure meaningful decision-making. It is essential to implement robust technology that supports driver-based forecast modeling and reacts to changes in key performance drivers.

5. **Design appropriate change management policy:** As a continuous planning practice, rolling forecasts are radically different from fixed forecasts, where projections are adjusted to fill gaps. Moving to this new process will be a major cultural change for all levels of employees, from top management, through budget managers. Many participants in the process will need to jettison their monthly budgeting and target negotiating mindset. Organizations should create a solid change management policy to embrace and drive process change.

The change policy should primarily explain the objective of the change, which is that the rolling forecast initiative is a reality check to explore profitability opportunities, not the measurement of numbers. The policy should also clearly explain the communication routines and practices related to rolling forecast policies, such as review meetings. It should cover in detail the knowledge sharing and training programs required to adapt to new processes and technology.

Finally, the policy should list the key metrics to measure the success of change management policy (e.g., communication effectiveness).

Data and Analytics Essentials for Rolling Forecasts

While changes in strategic thinking and the planning process are essential, equally important is the focus on data to support the rolling forecast initiative. Rolling forecasts should quickly analyze current data (both internal and external) and predict where the business is heading. The whole process of moving toward effective rolling forecasts, in a true sense, is more dependent on data, data-related processes and traditional forecasting techniques. Organizations that want to make the transition should consider the following:

- **Focus on relevant data and data-related processes:** Rolling forecasts should focus on a small set of metrics and drivers that are essential for keeping track of changes in the environment. This should include external market and demand information, along with internal business details. Since rolling forecasts happen at smaller intervals and are expected to produce current and future state views of business within a shorter period of time, it becomes mandatory to more quickly integrate and aggregate relevant data.

  > For the forecasting to generate quality results, processes around data generation, consistency, maintenance and integration should be well-supported by the organization's data policies and technologies.

- **Apply proven statistical techniques and predictive models:** The goal of forecasting is to be as accurate as possible. In the case of business-demand forecasting, it is naive to think that an accurate forecast is unnecessary. On the contrary, the more accurate the forecast, the more profitability options there are to deploy allocated resources against.

  > Rather than relying only on historical data to understand what just happened, rolling forecasts apply real-time data to see what is happening or is going to happen. Companies can anticipate the future by visualizing patterns found in historical and transactional data. Predictive models can be created

for "scoring" data and simulating scenarios using statistical techniques to identify risks and opportunities. This information will become more useful in making meaningful decisions during the forecasting process.

Cognizant's Forecasting Offerings

With 400-plus consultants and 700-plus technology specialists, our dedicated Corporate Performance Management (CPM) Practice has successfully executed more than 120 engagements for leading companies around the world. The practice is recognized for a robust and tested CPM methodology, with a complete set of blueprints for CPM implementation. Forecasting solutions are among the key offerings of the CPM Practice.

Our CPM Practice can provide rapid scorecarding with lead/lag indicators from pre-defined industry-specific KPI repositories and scorecard templates. The practice partners with many of our technology Centers of Excellence to extend best practices, reusability assurance processes and knowledge management.

FAST is our framework for a structured approach to building a rolling forecast. It is an organized tool to help businesses achieve proper coordination between the operation and strategy, facilitate the planning process and ensure a smooth handshake with the interdependent functional modules, such as sales, revenue, etc.

Operational cycles are aligned by periodic rolling forecasts and adaptive actions for changing scenarios through an organized hierarchy flow.

The FAST steps for creating a rolling forecast are as follows:

1. **Monitor performance areas**
   All financial and non-financial metrics related to the organization are identified and tracked. These metrics include both internal and market metrics to help the business remain on top of market changes and challenges.

2. **Forecast**
   New assumptions and a new basis provided by performance monitoring will trigger the forecasting process. A detailed risk opportunity analysis will be made using the appropriate technique applicable for the industry.

3. **Revisit strategy**
   A "what-if" analysis and scenario planning are carried out to identify alternative strategies to adapt to wider opportunities and risks.

4. **Align operations**
   For the newly identified strategy, priorities are redefined for the operative processes, and adaptation measures and activities are proposed by operational managers.

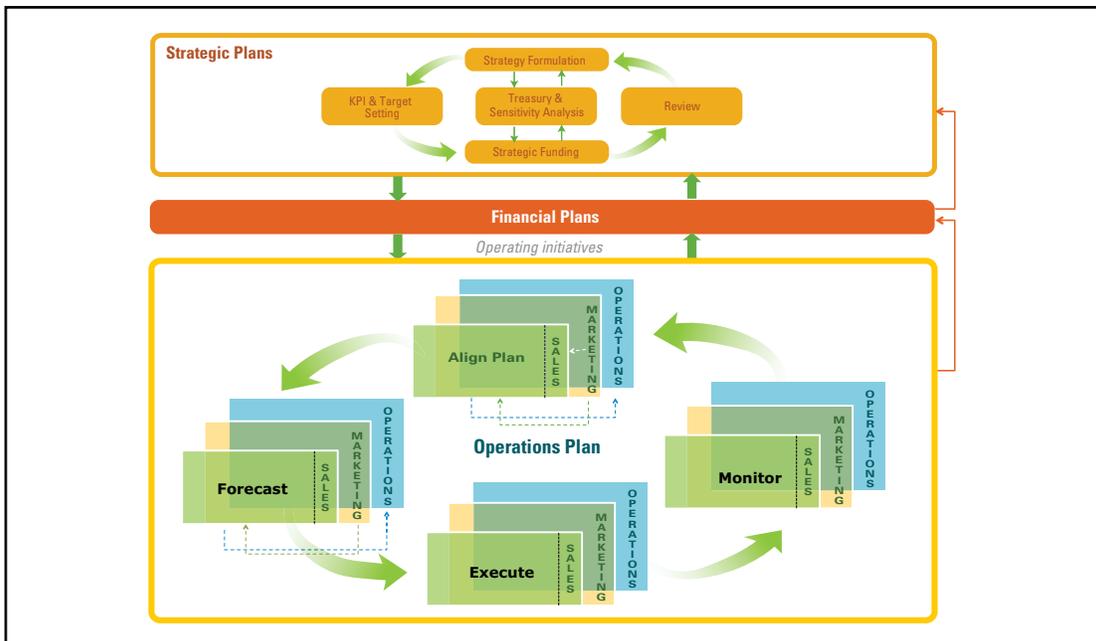## Rolling Forecasts Made FAST

Figure 1

Among FAST's benefits are the following:

- Vertical integration of strategy with the continuous planning/rolling forecast.
- Horizontal integration across different functions in forecasting.
- Greater visibility and monitoring capabilities.
- Driver-based functional process outcomes consolidated and integrated at corporate levels.
- Enhanced "what-if" analysis/simulation capabilities, as projections are linked to drivers.

Application Evaluation for Rolling Forecast

Technology plays a vital role in the success of any rolling forecast initiative. Rolling forecast CPM applications should be able to create and manage different scenarios to facilitate scenario planning, as well as integrate with actual information for analyzing trends and extrapolating the future. These systems should have different user interface options, as well.

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A CPM application for generating rolling forecasts should be evaluated for specific business fit and strategic features, such as:

- Forecasting ability across months and years.
- Driver-based planning and scenario management.
- Integration of sales, revenue and cost rolling forecasts.
- Ability to integrate projected information and compare it with the user-created forecast.

Technical features should include:

- Ability to customize.
- Scalability to meet current and future business needs.

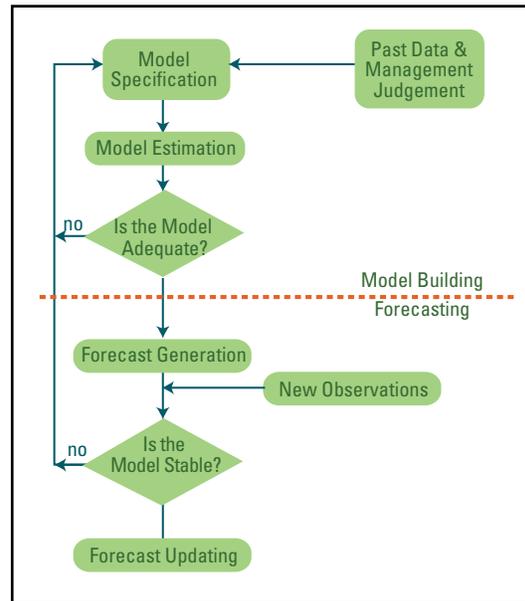## Forecasting System: Model-Building and Forecasting Phases

Figure 2

- Automated data input and different user interface options.

In our engagements, all rolling forecast applications are evaluated using EVAL, our CPM Tool Evaluation Framework. EVAL is a systematic analytical hierarchy processing-based scoring framework to evaluate tools based on a well-defined mathematical and analytical model. The approach consists of two steps:

- **Step 1: Feature Comparison:** Compares a detailed listing of the tools.
- **Step 2: Proof of Concept (Optional):** Focuses on finding the working behavior of the enlisted features.

The deliverables include a tool comparison report, a proof of concept (PoC) and a final tool recommendation. Figure 3 describes the steps involved with the EVAL tool.

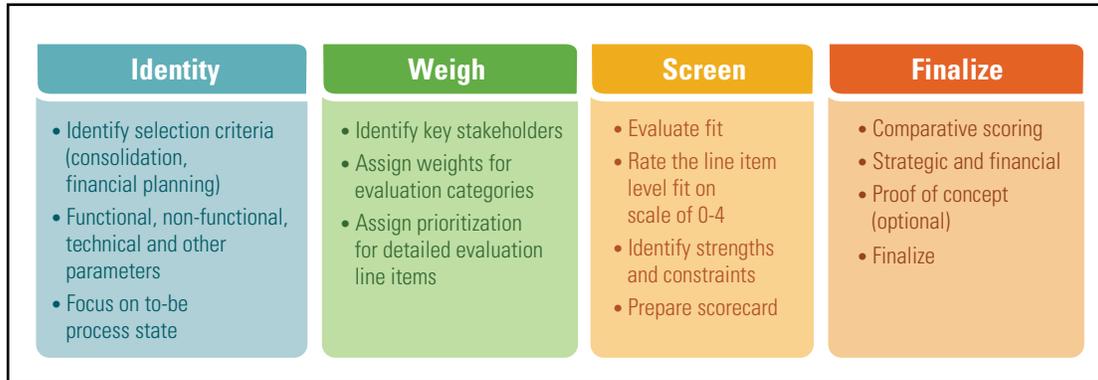## Working Through the Rolling Forecast Process

Identity	Weigh	Screen	Finalize
• Identify selection criteria (consolidation, financial planning) • Functional, non-functional, technical and other parameters • Focus on to-be process state	• Identify key stakeholders • Assign weights for evaluation categories • Assign prioritization for detailed evaluation line items	• Evaluate fit • Rate the line item level fit on scale of 0-4 • Identify strengths and constraints • Prepare scorecard	• Comparative scoring • Strategic and financial • Proof of concept (optional) • Finalize

Figure 3

About the Authors

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