Jack Alexander & Associates, LLC
Solutions for FP&A and Performance Management

Fast Track for Implementing Rolling Forecasts and On-Demand Business Outlooks

By: Jack Alexander

Introduction

Rolling Forecasts(RF) and On-Demand Business Outlooks(DBO) are extremely useful tools in the CFO's tool box, especially in these times of great uncertainty and rapid change. Inexplicably, these projection models are still underutilized. The benefits include the ability to easily recast expectations of future performance and a significant reduction in the efforts to develop an annual operating plan.

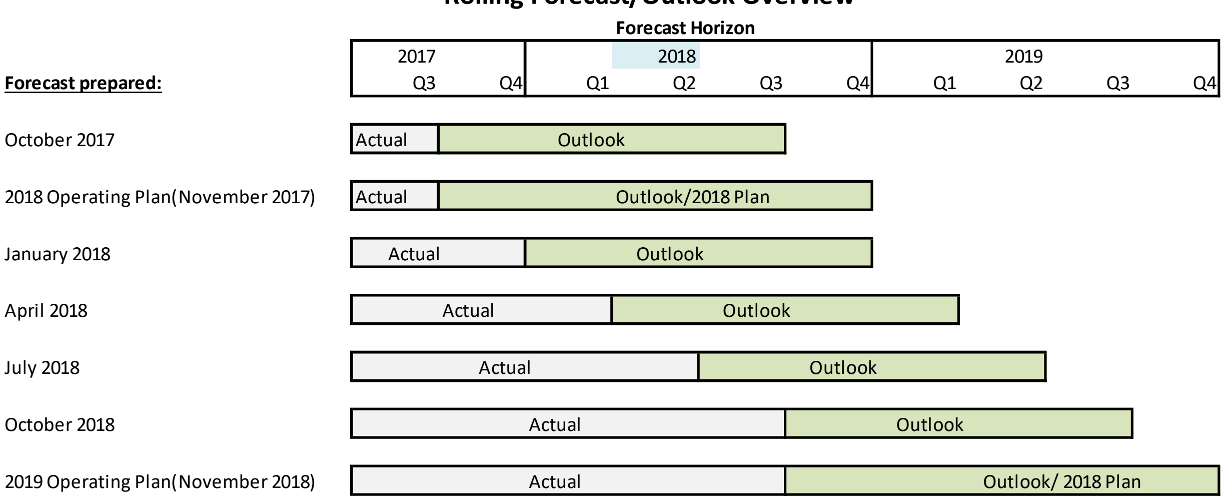
Evolution of Plans and Forecasts

The annual budget and plan processes originated in simpler times, with relatively stable environments and highly predictable business performance. The pace of change and uncertainty facing organizations today make these tools obsolete. Due to the rapidly changing business conditions, it has become increasingly important to be able to recast expected performance periodically during the year and, even, on demand. Uncertainty calls for the ability to efficiently project multiple scenarios. In many organizations, the rolling forecast or Business Outlook has become the cornerstone of the planning, projecting and management control activities.

Description

My first use of a rolling forecast was in 1985. As CFO of a division of large, publicly traded organization, we were required to provide quarterly forecast updates to the annual operating plan. Due to rapidly changing business conditions and the need for an early preview into next year's outlook, the Corporate Finance Team began requiring us to extend the forecast horizon at the end of each quarter. Figure I illustrates the timing and horizon for a typical rolling forecast process. At first, the RF was a largely mechanical exercise, almost exclusively done by the Finance team. The RF quickly demonstrated its worth when we encountered a significant competitive threat that required us to develop impact and response scenarios. Over the years, as I took on more responsibility as Corporate Controller and CFO, I always utilized a robust projections model and consider it an essential part of Financial Management.

Rolling Forecast/Outlook Overview



The forecast or Outlook model must be robust to easily reflect changes in key assumptions, performance trends, events or management decisions. Key assumptions and performance must be explicitly identified and incorporated in the DBO. In order to provide a comprehensive view of expected financial performance, financial projections in the rolling forecast should include the P&L, Balance Sheet and Statement of Cash Flow.

The frequency and timing of iterations will depend on a number of factors. A very dynamic environment will require more frequent updates than a stable environment. Companies that report earnings and provide earnings or other guidance to public capital markets typically use a quarterly cycle. Private companies typically update the outlook around management or board of directors meetings. Significant events may dictate a special revision to the Outlook.

Advantages

The rolling forecast has gained wide acceptance and serves as the cornerstone of planning and projections for many organizations. It provides a terrific starting point for a more rigorous annual planning process, long-term projections and also scenario and "what if?" analysis. Many organizations think of the forecast as a "***Business Outlook***" or "Continuous Business Outlook," or on-Demand Business Outlook (DBO). Describing the forecast as a Business Outlook ***changes the view from a financial exercise to a business or operating activity***.

Implementation

Many organizations have yet to take advantage of Rolling Forecasts or Business Outlooks on Demand. Typically, they cite limited human resources and capabilities, or an absence of effective software tools. More importantly, many are overwhelmed by the process. Try these five steps to fast track implementation:

1. Start with a quarterly P&L trend Schedule. Extend the forecast horizon by one quarter as illustrated in Fig 1.
2. Estimate the values for each line item (revenue, margins, expenses, etc.) based on trend analysis, year over year performance and by identifying major drivers impacting future performance.
3. Identify the most ***significant and variable drivers***. What essential assumptions and factors need to be considered? Don't try and replicate the annual budget/plan process. 80% of the estimates used in the annual budget can be readily trended and changed on an exception basis. Focus on those factors that are most significant and most likely to vary over the forecast horizon.
4. Document major assumptions, identify upsides and downside events/forces and develop KPI's and Dashboards to track and evaluate.
5. Build a projection model that incorporates steps 1-4. Evaluate, revise and improve based on results and experience. Then evaluate software requirements and other long-term process needs.

Summary

By effectively implementing a DBO, organizations will realize several benefits. It will facilitate early identification of trends and issues, enable scenario analysis and greatly reduce the inefficiencies and effort in annual planning cycles.

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