



Financial Forecasting:

Room for Improvement for People, Process and Technology

IDG Survey Shows Collaboration Among Stakeholders Key to Accuracy

Executive Summary

Preparing an accurate forecast in this volatile business climate is challenging.

Still, it is critical for businesses to be able to predict outcomes for the next month, quarter or year, and be able to respond quickly when the actuals vary significantly from the forecast. Forecasting may be equal parts art and science, but the most dialed-in enterprises report using a solid, collaborative process for generating accurate forecasts upon which they build their business.

IDG Research Services and CFOWorld.com recently conducted a survey of 306 global finance professionals. Most respondents report having a high level of confidence in their forecasts, and update those forecasts on a monthly or quarterly basis. Among the other interesting survey results are that more than half of the organizations responding have implemented rolling forecasts and measure forecast accuracy by evaluating how well the forecast maps to actual business results.

Other research findings, specifically certain geographical variations and differing conclusions in the survey results, bring up at least one issue with forecasting: analyzing forecast results compared with actual results may be a matter of perception versus reality. Forecasts are, by their very nature, educated and informed guesses. There may be much more of a psychological component to forecasting in terms of how forecasts are perceived, how rigidly they're followed, and how they may impact job performance of those whose responsibility it is to generate and maintain an accurate forecast.





Introduction

Forecasting is an essential activity for global enterprises doing business in this uncertain economic climate. While the process of forecasting may be equal parts art and science, the most highly evolved enterprises use a solid, collaborative process based on timely, aggregated data for generating accurate forecasts upon which they build their business.

Some companies use historical data; others try to use real-time or at least more recent data. Some forecast on a quarterly basis, while others go monthly. More rarely, some forecast on an even more granular weekly basis. Some produce solid forecasts that are accurate predictors of their actual business results; others struggle to generate dependable, accurate forecasts.

Different organizations in various industries may handle forecasting in dissimilar ways, but there are certain standard, accepted practices. There are three aspects that come into play when generating a forecast: people, processes and technology. The right people must provide the right input in the right manner, and those finance executives charged with preparing a forecast must aggregate that input using the right technology. Each of those aspects must be involved to ensure that an organization's forecast is as accurate as possible.

"There is not a great set of cultural or physical barriers in how to create forecasts," says Lance Holbert, global practice lead for SAP. "Over the last 10 years, we have seen budgeting processes evolve into forecasting, using automated software processes and better business processes."

According to research recently conducted by IDG Research Services on behalf of CFOWorld, finance executives across the globe and across different industries report varied levels of confidence in each of the three aspects of people, processes and technology. Most are comfortable with the technology used to gather data and generate forecasts, but recognize the opportunity to improve on the efficiency of their processes and the people involved.

One respondent feels the human component is definitely the wild card. "I have the most confidence in the technology, followed by the processes," says a director of finance for a business equipment leasing firm. "Different people can take the technology and the processes and

ignore them or use them improperly. People are using the information generated by technology. At times, they even choose to use their gut. That's especially prevalent in sales."

For those preparing forecasts, there is one fundamental distinction they should never fail to recognize: the difference between an organization's goals and its forecast. Both are forward-looking estimates, but it's essential to not confuse the two. "You shouldn't build a forecast around a goal," says Holbert. "A lot of people manufacture a forecast that's close to their goal. That's another sandbagging behavior. You have to separate the goal from the forecast."

Collaboration and Confidence

Effective collaboration among financial analysts, business unit leaders and IT is essential to the process of developing accurate forecasts. Timely access to accurate hard data for comparison purposes is another critical component. More than 40 percent of the survey respondents cite ineffective collaboration among business operations, finance and IT as a major contributor to inaccurate forecasts. Interestingly enough, roughly the same percentage report adequate collaboration processes in place at their organizations.

The research respondents certainly corroborate that divergent view of effective collaboration. "People always want to protect their own 'empires,' so that creates a barrier for departments to help each other," reports a senior finance manager for an insurance company. "For the most part, though, we're not that bad at collaborating."

The process of getting different departments working together isn't as smooth in other organizations. "The IT guys don't want to understand finance and the business needs. The business guys need to understand finance," says a finance executive from a manufacturing firm. "You've seen where you give two dogs a rope and they pull in different directions? Now imagine this scene with three dogs all pulling in different directions. Not a pretty picture."

Despite the human component, and ineffective or incomplete collaboration, most organizations report a generally high level of confidence in their forecasts. Nearly two-thirds of the respondents are confident that their





forecasts will map to actual business results. More than half also measure the effectiveness and accuracy of those forecasts by measuring them against business results.

The CFOWorld study noted some interesting geographic differences in attitudes and actions related to forecasting. While the attitudes of finance executives in the United States, Europe and Asia-Pacific regions are relatively consistent, Latin American respondents overall paint a much rosier picture with respect to forecast accuracy. This can be gleaned from certain discrepancies in how they report high confidence in forecast accuracy, yet also report frequently encountering unforeseen business results.

This signifies a pattern of discrepancies, according to Holbert. While they may feel good about their forecasts, the actual business results don't support that level of confidence. That is not to say their businesses aren't thriving, just that their forecasts don't often map to that reality.

Plan for a Better Forecast

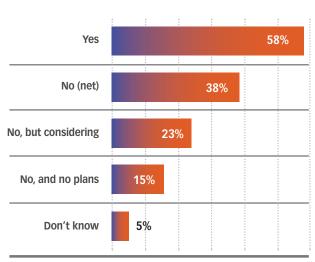
Forecasts are still a moving target. Operations and finance staff continue to refine the process, involve the right personnel and use the right technology, but good forecasts remain elusive. The frequency of forecasting and the accuracy of the data used in generating the forecast are two of the most dependable ways to refine the outcome.

Implementing rolling forecasts—changing and updating forecasts on an ongoing basis—is a valuable way to ensure a consistently accurate and up-to-date forecast. However, this can pose a significant challenge, and most enterprises question whether there is sufficient value in implementing a rolling forecast. Slightly more than half of the research respondents report implementing rolling forecasts, with the greatest concentrations of those doing so in Latin America and Europe.

"Rolling forecasts can be difficult to do. It's a concept some companies struggle to implement," says Holbert.
"It's a matter of execution, not strategy. Technology limitations and people's reflexive habits get in the way." Respondents report the top three barriers to implementation are resistance from executive management, lack of sufficient resources required to actually implement rolling forecasts, and the time and effort required to build and maintain the new processes to support those efforts.

Implementation of Rolling Forecasts

Has your company implemented rolling forecasts?



Source: IDG Research Services

Nearly half of the respondents (42 percent) report fore-casting on a monthly basis, with one-third reporting quarterly forecast frequency. Holbert maintains that a quarterly forecast frequency is the absolute minimum, and monthly forecasting is more preferable and likelier to result in more accurate forecasts. That increase in accuracy comes not only from access to more data, but more up-to-date data. "Depending on the volatility of the business, monthly is probably about as granular as most companies get," he says. "It depends on industry and market conditions, but quarterly should be the minimum."

As companies act on real and accurate data to predict future business outcomes, their forecasts should reflect that use of better data. "Over time, the forecasts should get more accurate," says Holbert. "It's a development process. Every month, you're going to learn a lot more. [Forecasts] will better reflect market conditions."

It's All About the Data

Better, more accurate and actionable data is key to preparing a more accurate forecast. Nearly 80 percent of the research respondents indicate relying on historical data to compile forecasts. Manual data and real-time operational reporting are also cited as key data sources. Organizations





in the United States rely on actual data moving forward with forecasts. Companies reporting in from Europe, Asia-Pacific and Latin America are much more likely to use business simulations when preparing forecasts.

Aggregating that data and generating a comprehensive picture of the entire enterprise is critical. "In the past, it has been very difficult to get the right data," says Holbert. "Most people are using departmental solutions to capture transaction data. There is data from sales, HR; there [are] multiple silos of data that can be hard to aggregate. Most companies now are moving toward a consolidated structure."

If the data is off, the forecast will be off. While it is incumbent on the finance staff and the office of the CFO to measure the accuracy of the forecasts on an ongoing basis, they're not the ones to be held most accountable for arriving at that degree of accuracy. Operations, production and sales staff need to be held more accountable for their input into forecast accuracy.

Business unit leaders and operations officers can more readily estimate production, and sales can more readily estimate sales. Estimating how many items a plant can produce within a given month or how many sales the sales staff can generate from a given client list is easier to estimate accurately than the ebb and flow of the entire financial dynamic. The finance staff is more the driver of the back-end reporting and processing functions.

When comparing actual data from business results to the forecast, data is critical. The availability, timeliness, accuracy and usability of the actual business performance data are imperative to determining the existence and/or degree of any discrepancies. It is essential, yet can be difficult, to identify the causes of discrepancies between forecasts and actual business results. The possible causes for those discrepancies could include insufficient collaboration between the financial analysts responsible for generating and updating forecasts and the IT and business unit staff responsible for more tactical data and business updates.

Discrepancies can also result from out-of-date or incomplete data, or even CFO and finance staff creating forecast numbers that cast a positive light on their role. It is difficult at best to accurately identify the source of discrepancies between business results and what was forecast.

Slightly less than half (47 percent) of the global research respondents rate as excellent their organization's ability to retroactively understand whether forecasts align with actual business results. This closer examination of how forecast numbers map to actual results is essential for improving the accuracy of forecasts over time.

Look Ahead

Forecasting is driven by many levels of pressure, some subtle and some not so subtle. The manner in which the finance staff and operational and IT staffs approach this process is largely the driver of efficient and accurate forecasting. Those three components of people, processes and technology must all be working together.

Holbert suggests that enterprises continue forecasting using the same processes with which they're familiar. "It sounds complicated, but it's easier than you think. There's no reason to fundamentally change your forecasting process. Use the same metrics, but add a couple of things and that will illustrate how your forecasts can grow more accurate period by period."

The forecast should drive the business, and in turn, the business should drive the forecast. "It's a seesaw," says SAP's Holbert. "They both influence each other. The forecast should drive the business and the results should influence the next forecast. It's a circular action."



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