Babies, bathwater, and best practices
Rethinking planning, budgeting, and forecasting

If everyone is thinking alike, then somebody isn't thinking.

—George S. Patton

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How we got here

The basic tools of accounting—double-entry bookkeeping, income statement, and balance sheet—can be traced to Venetian investors who funded trade expeditions to Asia during the 1400s. These were valuable tools for high-risk ventures, even by today's standards.

The concept of planning and budgeting came centuries later. The word "budget" derives from the old French *bougette*, meaning a small purse. In the mid-1700s, Great Britain's Chancellor of the Exchequer was said "to open the budget" when presenting his annual statement. The term was extended to private and commercial finances in the late 1800s.

At the beginning of the 20th century, business leaders made a defining choice that sowed the seeds of today's frustration. With outside investors demanding audited financial statements, managers began to rely on external financial reports as measures of internal performance. They believed it was too time-consuming and expensive to produce two sets of manual reports.

The voice of reason?

Most organizations don't have to dig very deep to find people who don't like planning, budgeting, and forecasting. You might even be one of them. The stress associated with these activities can be enough to wear down anyone's resolve. With business units protesting in one ear and executive management grumbling in the other, it's no wonder finance leaders may be tempted to listen to some pundits' advice and abandon these activities altogether.

But while the complaining may be frustrating, it can also provide clues to what may not be working. Time-consuming manual processes. Endless budget iterations. Wasted technology. Conflicting goals. Poor decision-making. These are the things you could easily do without.

But don't get carried away. Companies count on finance leaders to be their voices of reason—cool in the heat of battle, skeptical in the face of exuberance, and above all, focused on creating value. In the final analysis, planning, budgeting, and forecasting is a powerful tool – perhaps the most powerful tool—for informing and executing your business strategy.

If planning, budgeting, and forecasting isn't delivering the value your business expects, it may be time for a good scrubbing. But don't throw it out.

You make the rules

Regulatory reporting and compliance is a requirement that is not likely to get lighter anytime soon. It's one area where the rules are the rules—and you have to live with them no matter what.

But when it comes to planning, budgeting, and forecasting, *you* make the rules. If your organization's practices aren't creating value, the person responsible is the one you see when you look in the mirror.

When you think about it, some of the pain you're feeling may be self-inflicted. There's a good chance that your organization handles planning, budgeting, and forecasting more or less the way it always has. And along the way, you've accumulated a sea of reports and a puddle of insights.

What's stopping you from eliminating obsolete practices and creating new ones? The ball may very well be in your court to create a new approach that can lead your organization forward without undue risk or wasted effort.

Down the drain

Abandon the notion that something or someone is standing between you and planning, budgeting, and forecasting that works.

When you don’t know where you’re going

If planning, budgeting, and forecasting activities are chewing up more value than they create for your organization, take a step back and look at your company’s strategic plan.

When organizations don’t have a clear business strategy, it’s challenging to make effective planning and budgeting choices. People may focus on scratching their own backs instead of adopting a shared vision of what’s important to the organization as a whole. That tends to generate confusion, inefficient iterations, lost time, and little value.

An effective strategic plan translates your business strategy into a simple story about your organization’s future. You know that story is clear when people around you understand what leadership has chosen to do—and not do. This clarity is the foundation for planning, budgeting, and forecasting that works.

Down the drain

If your business strategy doesn’t lay out clear priorities, push back with hard questions about what your company has chosen to do—and not do.

Start here.

Strategy
What businesses are we in? How will we compete? Which choices will make us more money?

Planning
How will we align resources with our strategy? How will we measure our progress?

Budgeting
How will we ensure accountability and encourage behaviors needed to execute the strategy?

Forecasting
How will we adjust to reflect changing conditions?

How much to spend?

Even a company with a clear strategy can have trouble planning how much to spend on what. Dispassionate decisions can be difficult to reach when it seems that everyone is defending their own project or functional area. Effective companies sidestep the arguments by choosing among three basic planning techniques for allocating their money. Each technique requires different inputs:

1. Internal and external factors that influence your business (driver-based planning)
2. Expected return on investment (choice-based planning)
3. Percentage of overall budget or other point of reference (spend-based planning)

Which technique should you consider? That depends on what you're planning.

Spending decision	Possible planning techniques		
	Driver-based	Choice-based	Spend-based
Business operations *COGS and other operating costs*	✓		
Investments and discretionary spending *Capital, marketing promotions, R&D, IT projects*		✓	
Transaction processing *Accounts payable, payroll processing*	✓		
Corporate functions *Finance, HR, Legal*			✓

The worst of “best practices”

Companies often hire outside advisors to come in and benchmark their planning activities against best practice metrics. For many businesses, this type of comparison may not add much value.

Many benchmarking activities may be focused on helping you become more efficient at getting to that final number faster. They may help you compare your level of detail, number of iterations, and cycle times to the top-quartile companies in their database. But planning shouldn’t be a one-size-fits-all process. It’s not primarily about efficiency; it’s about effectiveness.

Effective planning is tailored to the organization. *You’re* making choices about how much money *you’ll* spend—and where—to support your business strategy. How an individual company does that depends on size, complexity, industry, and business model. It also depends on exactly what you’re planning.

That’s not to say that benchmarking doesn’t have value. If your approach to planning is not working, benchmarking could help build a case for change or jumpstart improvements. But don’t expect a magic answer that will solve all your problems.

Down the drain

Benchmarking isn’t a panacea. The only practices that count in planning, budgeting, and forecasting are the ones that help you drive the participation, behavior change, and accountability you are looking for.

Sandbagging

Nobody likes sandbagging, but for many, it has become a common practice in planning and budgeting. It's a tug of war that's reinforced by leaders who freely pull rank when the numbers don't meet their expectations.

Some companies confront sandbagging head-on by reinventing their planning processes to gain broad commitment to the final targets. It often works like this:

- Executive leadership kicks off the new process during face-to-face meetings with business unit managers.
- Finance presents preliminary enterprise targets and managers weigh in on volume, revenue, and cost targets.
- More group and one-on-one meetings are held throughout the process to negotiate, review, and adjust the plan to align business unit and enterprise targets.
- During working sessions, managers debate tactics, challenges, and opportunities that could affect the organization's ability to hit the targets.

When everything is on the table, the dynamic between executive leadership and business unit managers can shift from adversarial posturing to negotiating ways to meet goals and execute strategy. That's conflict that works.

Down the drain

Face-to-face target negotiations with all cards on the table can eliminate the need for top-down adjustments—and sandbagging.

What they say. And don't say.

Executive leader	Business unit manager
We have to satisfy the board and shareholders. *It's our job to hit our targets.*	**We have to run the business.** *It's also our job to keep our people motivated and engaged.*
We need to be aggressive. *We have to set stretch goals.*	**We need to be realistic.** *What happens if I stretch and still fall short?*
We'll build in some cushion at the top. Not to worry. *Give us the numbers we need now. We'll adjust on the back end.*	**That's a great idea.** *In fact, I'd better build in my own cushion, just in case.*
This is about the company as a whole, not any particular unit. *We expect everyone to make the numbers.*	**I'm evaluated based on my unit's performance.** *Right, but "everyone else" may be sandbagging.*
Trust me. *I need realistic spending projections so I can predict our overall performance and reallocate budgets where needed.*	**Trust me.** *I know how it works: use it or lose it.*

Too little. Too much. Just right.

Many finance people love detail—the more the better, it seems. But what's driving this interest in lots of detail? Is it needed to plan better, to execute, or to make course corrections? Or are details collected to have answers at your fingertips, just in case the board or CEO asks questions?

Finance should distinguish details needed to make decisions from those collected "just in case." An effective approach to discern the difference is to focus first on the question that needs to be answered.

- **Where are we headed?** Easy access to a few key details can help you predict shifts in the company's overall financial trajectory. Identify and track the three to five factors—internal and external—that have the biggest impact on the business. A consumer products company may keep a close eye on sales volume, marketing spend, and the cost of key raw materials.

- **How will we get there?** To direct the business, you need access to the right level of detail to know how money is being spent and the value it's generating—perhaps even down to the individual customer or product and service level.

Finance should produce as little or as much detail as needed to make smart business decisions. With every step to the right of the decimal point, the cost of knowing may increase and the value of knowing may decrease. Every organization has its own sweet spot where these considerations balance out.

Down the drain

More detail doesn't necessarily mean better decisions. Create an efficient system that provides access to the right information when it's needed.

How far is the horizon?

Does your business need a 12- or 24-month plan? Should it be rolling? Maybe yes. Maybe no. It depends on your operating model.

One vertically integrated manufacturer with a 10-week build cycle works from a six-month plan that they reforecast monthly. They use a separate 12-month forecast for capacity and capital investment decisions.

Another manufacturer has a completely different operating model. They don't own their supply chain, which allows them to have a three-month planning cadence. They order finished goods from suppliers each week to fulfill expected sales. Their forecast for the next quarter is revised each week when they pull inventory from their supply chain.

Granted, your business's operating model may be very different. You'll need plans and forecasts tailored to the time horizon for the operating decisions you need to make. Consider planning out only as far as you can see—or as far as your decisions require.

Into the fuzzy future

Some strategic decisions require you to look into the future to identify possible disruptions—both good and bad—that could impact your products, customers, and markets. You'll need to assess the resilience of the organization to survive and thrive under each plausible scenario. This, of course, is easier said than done.

The farther out in time that you look, the fuzzier your view becomes. With that horizon, bottom-up input from the business unit managers probably won't help. They're focused on next quarter or next year—and are probably more focused on the short term than you are.

When you need to make decisions within the context of this fuzzy future, the most effective approach may be the use of predictive models. Today's analytic tools allow you to generate scenarios to question old assumptions and stimulate new thinking by churning through internal and external data without an army of statisticians.

The bigger challenge will be earning the confidence of your executive leaders and stakeholders. To do that, consider starting small, and using model-based forecasting as a gut check to support target setting.

Meanwhile, you can build experience using data to create meaningful scenarios and to gain insight into ways the company can prepare for its future. As your foresight approaches 20/20, you can gradually gain buy-in and help your company create more value over the long haul.

Down the drain

Challenge the idea that professional experience and intuition are reliable substitutes for fact-based decision making. It takes all three.

Stop the insanity

For decades, companies have handled planning, budgeting, and forecasting pretty much the way they always have. Each year brings the hope that things will be different this time. But the result is almost always the same. Some say that's the definition of insanity.

It may be time to rethink your approach to planning, budgeting, and forecasting. An effective approach is to focus first on high-level strategic questions, then drill down to tactical choices like level of detail, planning horizons, and internal communications. Sort what works for your company from what doesn't work. Confirm your thinking in conversations with stakeholders. Look beyond your organization's walls for valuable information and practices, borrowing those that make sense. Your goal is retain practices that add value and eliminate the rest.

Changing how your organization approaches these vital functions may not be easy. If it were, you probably would have done it already. People often get set in their ways, even when those ways may not work very well. Don't underestimate the time it will take to do it right—and be prepared for resistance.

That said, finance leaders today have the resources and power needed to custom-design planning, budgeting, and forecasting to meet their unique business needs. One size doesn't fit all. It never did.

We can’t solve problems by using the same kind of thinking we used when we created them.

—Albert Einstein

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