Moving target: What it takes for annual planning to hit the mark

As finance leaders prepare to embark on the annual planning process, they may want to push a new issue to the top of their agendas: the annual planning process.

The unprecedented events of recent months—the COVID-19 pandemic that few, if any, corporate financial plans foresaw—have clarified the need for infusing the conventional planning process with greater agility. As many CFOs have likely learned, businesses need the capability to revise their plans and adjust their assumptions to accommodate the impact of real-world events.

Moreover the multitude of overlapping issues clearly demands a different approach. At a time of economic instability, organizations face a steadily rising number of additional challenges including: constant scenario development and modeling; lack of confidence in future projections; the urgent need for decisions about courses of action; an unclear decision-making framework, particularly around capital allocation; and time-and-resource-consuming manual iteration.

Complicating matters, many CFOs are still in survival mode. In fact, in the Q2 2020 CFO Signals™ survey, finance chiefs say their management teams are more focused on ensuring viability and adapting for near-term performance than on evolving their company for success post-crisis (see Figure 1). Still, the planning process will kick off for many in the next few weeks or months. In this issue of CFO Insights, we will discuss the elements that go into creating a plan of action and additional steps finance chiefs can take to ensure a future-ready plan.

Creating a plan of action
Organizations leverage annual financial planning for many purposes beyond the challenge of trying to accurately predict future market and consumer behavior. The assumptions underlying projections of revenue and cost help align organizational priorities and strategic investment opportunities, identify staffing levels and related expenditures, project revenue drivers and associated expenses, and identify economic goals by which leadership and the broader organization will be compensated.

Never has the process been so crucial on all those fronts. And as organizations prepare to plan for FY 2021 during the pandemic, the following strategies can help mitigate uncertainty to yield a more useful financial plan, as well as improve the process:
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• Seek feedback from business units before disseminating targets. Leading organizations typically begin the planning process by setting strategic guidance, translating that guidance into targets, and disseminating those targets to business units. But global organizations may want to consider a different approach this year. While financial markets are globally connected, the speed and manner at which countries are responding to the crisis is not. As such, global FP&A teams may be better served by having local teams submit ranges based on the likelihood of potential outcomes. Corporate FP&A can then integrate those numbers into their targets, yielding a more realistic, effective outcome. Initiative and driver-based approaches to developing these ranges can help to more directly translate the guidance and targets into actionable plans.

• Adopt a probabilistic, range-based mentality for building scenarios. Many organizations have business units submit a select number of targeted scenarios (e.g., high, medium, low) before identifying the most likely scenario and finalizing a single set of financial results. Rather than trying to arrive at a single number, organizations should consider identifying a range of outcomes with special consideration paid to the bottom of the range (i.e., worst-case scenario). Leading organizations will use observed volatility to bolster ranges with assigned probabilities, allowing leadership to plan for a wide variety of outcomes while considering the likelihood of occurrence. Additionally, factoring in multiple modeling approaches across statistical, driver-based, optimization and trigger-based contingency models can help an organization be prepared to understand and project impacts at multiple levels of possible performance outcomes.

• Strengthen scenarios through driver-based planning. Leading organizations use driver-based plan logic to tie financial outcomes more closely to underlying economic and organizational drivers. In times of increased volatility with minimal historical precedent, driver-based plans have an inherent advantage over their simpler, trend-based counterparts. Organizations should look to expand driver logic, as appropriate, throughout the planning process and rely on input from those in the organization who are closest to each respective driver when establishing scenarios and plan ranges (see sidebar, “Scenario planning: A COVID-19 checklist”). Now, perhaps more than ever, the plan will be as dependent on external economic drivers as on internal ones (see CFO economic expectations, Figure 2). For example, setting GDP as an external driver and given an observed 10% decline in GDP, a company can expect its topline to fall within a specific range. As GDP shifts throughout the year, forecasts can be adjusted based on actuals and to validate the predicted ranges. Additional approaches to consider can include exploring more logarithmic or exponential trending curves, as well as approaches that bias a moving or weighted average for recency. Modeling based on historical
and comparable events can also prove valuable in these instances, even if the macroeconomic event itself may seem unprecedented. In addition to the materiality of the line item, reviewing planned items to take an honest look at levels of spend or considering zero-based approaches can also yield savings during difficult times.

- Enable “stage-gate” review cycles that allow for adjusted focus based on the changing environment. Reviews of financial plans typically take place over two or three staged rounds. During each round, the executive team reviews plan figures in totality. But those review conversations and meetings can be lengthy and unproductive. While the figures may change, the questions are often the same. What growth rate did each business unit assume? Why are expenses continuing to grow when our strategic guidance called for keeping figures flat? During such dynamic times, an end-to-end review cycle may yield ineffective discussions or lack feasibility from a timing perspective.

Instead, organizations should concentrate each review session on a specific target, motivated by the current operating environment (e.g., a shift in focus from profitability to liquidity, portfolio prioritization, and short-term expense management). By focusing the conversation on a specific goal, organizations can have the meaningful, targeted deliberations required to execute in a more analytical fashion.

Building a future-ready plan
In addition to those procedures, CFOs may want to take the following steps to build a sustainable planning process that is also more robust, flexible, and shock-resistant:

- Institute a rolling, monthly forecast. Many organizations perform a quarterly forecast, if they execute a forecast at all. Now, finance executives are increasingly expecting a forward-looking view of the financials updated on a monthly, if not on-demand, basis. Shorter planning cycles can boost accuracy. Organizations should consider forecasting key line items and underlying drivers, on a monthly basis including topline drivers, revenue growth, and operating profit. Given changing market conditions, identifying core drivers and metrics by which organizations evaluate forecast-to-actuals variance on a monthly basis will prove more valuable than executing a detailed plan.

- Identify value-add activity. Many organizations are reconsidering the areas and depths to which they are going to plan this year. They are also thinking about the timing of their planning cycle (e.g., delaying to gain more confidence in the environment before starting), deferring major decisions or allocations, providing higher-level and contingency-laden budget assumptions, and setting timetables to revisit any plans on a recurring basis into 2021, almost in a rolling plan/forecast type of effort. Given this context, there is an opportunity for organizations to evaluate what activities truly add value and to streamline and refocus efforts traditionally spent on the iterative planning process to realize a more agile approach that can be used starting in 2021.

- Consider the impact that changes to the financial planning process will have on incentive compensation. Implementing the strategies described may have implications for how compensation will be tied to actual versus plan performance—a common corporate practice. It’s crucial for changes in financial planning to flow through to planning and executing incentive compensation.

- Accelerate digital capabilities. Technology can also play a significant role in easing the burden of target setting, scenario analysis, iteration, and any required resetting of the baseline. Certain technologies are particularly helpful in planning, such as those that can help ingest new data and drivers and score their relevance automatically. Moreover, embracing digital capabilities, such as algorithmic and driver-based mechanisms to enable scenario modeling agility, is now more consequential than ever. In times of uncertainty, identifying and discussing potential scenarios in a scientific manner will help organizations prepare for the future.
To successfully deliver a future-ready plan, CFOs need to challenge existing mechanisms by which they are integrating, analyzing, and modeling vast quantities of data. Enhanced capabilities—from investing in technology to inviting front-line functions to participate—will be necessary to rapidly digest and assign value to evolving sources of information and to incorporate them into planning and forecasting models in an efficient and scalable way.

Using these short- and long-term strategies can bolster planning capability and unlock the value that is uniquely attributable to financial forecasting and its ability to inform strategic decision-making. At this time next year, CFOs hopefully won’t feel nearly as shell-shocked—and the rigorous planning process they put in place will have kept them and their organizations on target.

Scenario planning: A COVID-19 checklist

Two special issues of CFO Insights offered checklists for finance executives in 10 different areas, including scenario planning (see Part I and Part II, of “COVID-19 checklist: Practical steps for the immediate, midterm, and long term.”). As the following checklist illustrates, planning for different economic, health, and big picture scenarios may determine how well companies recover.

1. **Weigh multiple futures.** Test multiple futures, brainstorm different “what if” outcomes for what may occur within a defined timeframe. How might customers or competitors respond to a specific set of developments?

2. **Monitor events.** Track relevant developments as they unfold to continually reassess the company’s strategic direction and periodically assess whether the futures you anticipate are still the most probable.

3. **Maintain strategic optionality** by investing in interoperable and portable digital tools, rather than locking into one platform that may not support the company’s ability to plan and analyze the business as it grows.

4. **Fund the most probable version of the future** (when that becomes a little clearer). The actual future will almost certainly surprise us, but companies can still study the range of possible outcomes, narrow the list to the most probable candidates, and prioritize resources to ensure optionality against a “matrix of maybes.”

5. **Don’t just virtualize, digitalize.** Once data about work is collected, it can be used to enable AI tools to perform some tasks. Such automation can not only reduce costs and boost productivity, it may also buffer companies from having to completely shut down again.

6. **Prepare for long-term changes in demand.** Recognize that the problem of dwindling demand may not magically evaporate when the shelter-in-place decrees end. Build pattern-recognition skills within teams to capitalize as that demand shifts.

7. **Prepare for a reshaped competitive landscape.** Pre-pandemic, mounting corporate debt, fueled by access to cheap money in the US, left some balance sheets dangerously frail. If the post-pandemic world finds those businesses struggling to service their debt, supplier and customer landscapes could be recomposed.

8. **Recognize sector reorganization.** In the medium-term, the global economy may have to press pause for some time, fueling the growth of certain sectors (think makers of remote-office technology) at the expense of others.

9. **Prepare for the next normal.** If business as usual, or close to it, hasn’t returned in, say, six months, the changes in work styles may calcify into the next norm; the shift to virtual may preclude a return to what will seem like outdated ways of working.

10. **Anticipate more rounds.** It will be hard to tell when the pandemic is over. Prepare for the future by building strong scenario-planning capabilities and prioritizing resistance and resiliency in the face of not just this virus, but also future viruses.
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