



ASSOCIATION FOR
FINANCIAL
PROFESSIONALS

AFP® GUIDE TO

Implementing a Rolling Forecast: Success Factors and Pitfalls

FP&A Guide Series

Issue 9





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Introduction

The world moves faster and the economy has become less predictable. In such an environment, companies are realizing that the traditional fiscal year-end forecast has become less useful. Only seeing through to the end of the year leaves the company exposed to threats, such as price changes, volatile stock markets, regulatory changes and currency fluctuations. It is a process more akin to meeting the budget than foretelling the future direction of the company; the forecast becomes more about whether the company will hit its targets versus the reality of where the company and its market will be going forward and the steps management can take to ensure its success.

For FP&A, an annual forecast provides no means of adding substantive value to the conversation taking place at the strategic level of the organization. In contrast, a rolling forecast allows FP&A professionals to play a leading role in strategic discussions and communications by providing management with a range of possibilities that are dependent on market conditions or the actions of competitors. The benefits they provide increase lead time for senior management, thus allowing them to make important decisions on how to allocate key resources in order to drive continued profitability.

A Shifting Landscape

The typical financial forecast horizon today still doesn't extend beyond the current fiscal year, according to Philip Peck, vice president of the Peloton Group. "Emphasis on the near-term planning horizon, where decisions focus on meeting quarterly or year-end targets to satisfy external stakeholders, often outweighs longer-term considerations, including assessing the impact of how decisions today can positively or negatively impact longer-term performance," said Peck. "This mindset also often limits the attention directed toward constantly exploring, understanding, and creating action plans around future competitive risks and opportunities."

Another critical challenge to the process involves the level of G/L account detail used to generate the forecast: "Many organizations are essentially forecasting at the same atomic level of detail that is used during the annual budget cycle," said Peck. "Forecasting at a low level of detail directly leads to long cycle times, manually intensive activities, and much higher levels of effort."

From an overall forecast purpose and philosophy perspective, there is often confusion between competing pressures to meet near-term budget targets vs. providing accurate, high-quality forecast estimates. The question becomes: How do to balance management's performance expectations with a realistic, pragmatic view of the future?

Another aspect that makes the traditional forecast less useful is that a typical forecast often gets disconnected from real operational planning; it tends to be purely a financial exercise with limited input from the people closest to the operational drivers impacting current and future performance, according to Peck. "From a resource allocation perspective, many forecast processes offer minimal ability to allocate and reallocate resources as this process typically occurs once a year during the annual budget cycle. The bank is only open once a year," said Peck. "They also often heavily rely on disparate Excel spreadsheets and black box algorithms without common expectations around key business drivers, forecast assumptions, and the underlying forecast modeling logic."

"The complexity, uncertainty and volatility of today's business environment demands a more agile, dynamic, continuous planning process,"

Peck said. "Unfortunately the methods, tools, and processes most companies rely on today are no longer sufficient. Most organizations still rely on the traditional budgeting process to support many business requirements and related planning activities, including target setting, detailed operational planning, cost control, resource allocation, capital spending, and incentive compensation. Yet long gone are the days when a standard, rigid annual budgeting and planning process steered the business with only predictable and minimal budgeting changes throughout the calendar year," he said.

While most organizations update their operational plans periodically and provide updated financial forecasts, "these processes are fraught with numerous fundamental issues," Peck cautioned.

Increasingly, senior management is looking to FP&A for answers that go beyond the fiscal year-end, and "we see more companies adopting a rolling forecast," said EPM Transformation Associate Principal Sholape Kolawole of The Hackett Group.

Increasingly, senior management is looking to FP&A for answers that go beyond the fiscal year-end, and "we see more companies adopting a rolling forecast," said EPM Transformation Associate Principal Sholape Kolawole of The Hackett Group.

A recent analysis of benchmarks performed by The Hackett Group showed that 33% of companies intend to implement a best practice rolling forecasting over the next few years. Another 22% are planning to implement a version of a forecast that extends beyond 12 months, which in essence is a form of a rolling forecast. "Combined, we see 55% of companies surveyed planning to shift to a rolling forecast," Kolawole said. "Companies are realizing that there are a lot of benefits particularly in this environment of competitive pressure and fast-moving markets. They understand the value of seeing farther out," he said.

Added Mitch Max, a partner at BetterVu, a performance and risk management practice consultancy, “As a general rule, there’s a lot more activity in the past five years and movement toward rolling forecasting,” said Max. While he’s been involved in Beyond Budgeting “from the get-go,” full implementation of the Beyond Budgeting framework has been very slow to catch on in North America due to what Max describes as “an inherent resistance to giving up the budget.”

“Rolling forecasting is a way to coexist with the budget that still allows for agility and change, while de-emphasizing the amount of effort that goes into creating the annual budget,” said Max. “The process is a little more pragmatic than the European ideals that spawned the Beyond Budgeting framework. I believe this will continue to evolve.”

“What I’ve seen among our users is that there’s more of a resolution to have a rolling forecast using a planning solution,” said Pras Chatterjee, senior director of product marketing for Enterprise Performance Management at SAP. “One of the key challenges is the usage of the rolling forecast,” he added. Finance wants to implement the forecast to gain better insight into the future, but there needs to be more adoption across the entire enterprise to embrace the results. “Realistically, most corporations look at the immediate calendar year and year-end target. People don’t care about the rolling forecast. For the rolling forecast to affect business change there needs to be a cultural shift,” stressed Chatterjee. “No amount of technology can resolve that.”

“There are a number of factors that are driving greater interest in rolling forecasts,” said David Axson, managing director for CFO and enterprise value at Accenture Strategy. “One is that there’s no reason why companies should arbitrarily tie their forecast time horizon to their fiscal year so that at the end of the first quarter they forecast nine months into the future, but at the end of the third quarter [they] only [forecast] three months,” he said. “Business cycles are not tied to the accounting calendar. The time horizon has to change. Some companies do a rolling forecast every 90 days, and some do it every month. Some forecast out 12 months and some forecast out 24 months, depending upon the decision-making time horizon. Whatever you do,” he said, “the forecast needs to provide the

basis for an effective allocation of resources and a more intelligent prioritized view of the business.”

Some projects may not produce a return within the year but are valuable nonetheless. “A forecast that spans beyond one year can capture those results at the right level of detail,” said Axson. “Companies also recognize that predictive ability declines the further out they try and forecast. Simply forecasting every period in the same level of detail doesn’t produce reliable results.”

According to Steve Morlidge, director at Satori Partners and co-author of “Future Ready: How to Master Business Forecasting,” people are moving toward driving the financial forecast from the operational forecast. In operations, managers already look beyond the current fiscal year because it’s driven by the supply planning lead times, e.g., material, production schedules, and capacity planning. The mentality is already established. It’s a relatively easy next step to a rolling forecast. “Also operations have a strong theoretical mindset. They recognize the logical reason that a year-end forecast doesn’t work; they’re not tied to the financial year in the same way,” he said.

“Improving the traditional budgeting process, enabling more dynamic resource allocation and reallocation, reducing planning and forecasting cycle times, providing ‘what-if’ modeling and analysis around key business drivers, and enhancing forecasting capabilities all go hand in hand,” Morlidge said.

Peck acknowledged that a lot of companies suffer from year-end tunnel vision. As the financial year comes closer, they shrink their forecast horizon down to just those few months remaining. “If your forecast only goes to the end of the fiscal year, your vision becomes increasingly near-sighted until almost totally blind by the end of the period,” Peck said. “What’s worse is that everyone quickly realizes that the entire exercise is not about forecasting the right numbers. Instead they recognize that the entire process has become about validating whether you are going to hit the year-end targets.”

When that happens, people stop telling the truth and start telling management what it wants to hear. “Many times this results in an exercise that is worthless. It merely revalidates the drive to hit the targets. This leads directly back to sandbagging and a process that is all about obfuscation,” Peck said.

The question companies should ask themselves is: what's the real problem they're trying to solve? What are they trying to do with their forecast? "The forecasting process needs to be about seeing forward. You really need to revamp the management control process," said Peck. The forecast process should be focused on optimization and driving results. The forecast process is not about forecast accuracy. "It's about helping you change the activities to change the results. The forecast helps communicate what the business is about and what can be done to optimize results," said Peck.

As opposed to the calendar-driven budget that focuses on a one-year fixed time horizon, a rolling forecast framework reflects an extended time horizon beyond the current calendar year where operating and financial plans are updated on a frequent basis. The actual length of the time horizon varies depending on a number of factors that include the industry, business cycle, product life-cycle, ability to predict and influence the future, and several other factors. A company in a very dynamic business climate may have a continuous 12-month rolling forecast, while a company that is capital intensive and has a longer decision-making cycle with multi-decade projects could have a much longer planning and forecast horizon.

The Benefits of a Rolling Forecast

One of the basic differences between a traditional forecast and the rolling forecast, according to Kolawole of The Hackett Group, is the horizon. A traditional forecast covers the entire calendar year, January to December, and is handled monthly or quarterly. With a rolling forecast, companies extend the forecast "beyond the wall," and the right time horizon differs by industry. It can be 18 months or 24 months, as dictated by the volatility of the business. It can be run quarterly or monthly. "It breaks the barrier of the fiscal year," said Kolawole.

According to Morlidge, the biggest source of confusion lies between the forecasting horizon and forecasting cycles (the frequency of reforecasting). "By my definition, a rolling forecast maintains a constant horizon, be it 12 months or 18 months," Morlidge said. "You always look that many months ahead; it's not forecasting to the end of the calendar year." According to this forecasting expert, "People

are moving away from that kind of forecast because they've seen that it doesn't make much sense."

"Partly," he said, "that's driven by the environment and greater volatility. Partly it's driven by a changing mindset that recognizes that while the calendar year end is an important reporting milestone, it shouldn't constrain the way that the business is planned."

"The main difference between a traditional and a rolling forecast is the number of periods remaining," said Larysa Melnychuk, director of the London FP&A Club and AFP consultant. "In the traditional approach, the forecast goes out only to year end and, therefore, the number of months to forecast decrease as the year progresses. In a rolling forecast, it may always be five periods forward. It's always the same number of months or quarters rolling forward."

Therefore, a rolling forecast expands planning horizons and improves the quality of forecasting and decision-making. The traditional approach doesn't give companies any flexibility. In November, companies see ahead only one month. Next year, they start from scratch.

"The rolling forecast expands the visibility," Melnychuk said. "We're basically prepared to act on the forecast. It puts corporates in a better position to make better decisions. Rolling forecasts improve forecast accuracy, reduce timing of the planning process and therefore improve decision-making and profitability of the company," she said.

According to Max, when most people think about forecasting, their main reference point is the annual budget. "People operate as if that's a forecast. They haven't necessarily adjusted their mindset," he said.

For companies that want to adopt a monthly rolling forecast, a very different approach is required. People don't have time to repeat a budget process 12 times a year. As organizations squeeze finance resources, it is harder and harder to add new capabilities. "For most finance organizations, by the time the team gets through month-end close, they have, at most, two weeks slack time to prepare for the next close. People don't have long cycles to devote to a full consultative, bottoms-up build of a forecast. A different approach is needed," he said.

A true rolling forecast looks beyond the fiscal year, which is critical in order to shift from a budget-based model to an actuals-based approach.

The most common approach is to look 18 months out. “You need to have a process that is agile and self-running, based on key drivers,” Max explained. “The key benefit of a rolling forecast is that it enables management to make intelligent decision quickly about what’s going on in the business.”

The biggest benefit of a rolling forecast is related to the lead time required for making business decisions, according to Morlidge. “The reason why you forecast is that there’s a lag between making a decision and the impact,” he said. “It’s just like driving a car; you have to look ahead at least as far as the stopping distance, otherwise you risk a crash. This is the theoretical justification for rolling forecasts: in order to properly manage performance, you need forward visibility that matches the length of time it takes for any decision to be translated into results.”

“It doesn’t matter whether the forecast is produced using driver-based methods or not; the principle remain the same,” said Morlidge. Rolling forecasting does not demand a particular technique, but driver-based methods have some benefits. “From a common-sense standpoint, the farther you look, the less knowledgeable you are, so precision is neither necessary nor desirable,” he explained. “Consequently, it makes no sense to have a highly granular forecast. Also, if you use a rapid cycle time, month or quarter, you need relatively light processes, which also drives people toward driver-based forecasts.”

“Using rolling forecasts also allows you to more dynamically allocate resources, i.e., redeploy capital to where the returns are,” said Steve Player, managing partner of the Player Group, and North American program director of the Beyond Budgeting Roundtable (BBRT), and co-author of the book, “Future Ready: How to Master Business Forecasting.” “Its focus should be about creating a more agile organization.”

“One of my biggest concerns is with organizations shifting to rolling forecasts too quickly,” said Player. “While many organizations are excited about using rolling forecasts to eliminate budgets, they don’t think it through. They need to ask themselves: how does moving to a rolling forecast relate to our target setting and action plans? What are we really changing, and how do we expect behavior to change as a result?”

It’s most common to see is an organization start by adopting a 5-quarter rolling forecast. Using five quarters allows companies to see into the next year.

If a company bases its financial planning on the calendar year, it would have four quarters of actuals and five quarters forecasted out into the future.

“After a year or two, we often see these companies shift to a 6-quarter rolling forecast,” said Player. “If you look at such an organization mid-year, you find that it has two quarters of actuals and five quarters forecasted out, with the first two completing the current year and three quarters forecasted out into the upcoming year.” Many organizations want to see the upcoming year as soon as possible, so they forecast a sixth quarter. Once you start forecasting five rolling quarters, it’s easy to shift to six, which gives you greater visibility, according to Player.

“How far each organization looks depends on the company and its business,” Player said, such as how fast the organization can change direction or turn, as well as how fast and how often things in the business environment change. “We’ve seen monthly forecast updates, quarterly forecasts, and ad hoc updates. Frequency of update depends on how fast things are changing,” he said.

“The most common approach is to forecast six quarters out. This way, by mid-year there’s a full fiscal year outlook for the next year, which can help seed the budget for the coming year without duplicating efforts and starting from scratch.”

Added Accenture’s Axson: “The most common approach is to forecast six quarters out. This way, by mid-year there’s a full fiscal year outlook for the next year, which can help seed the budget for the coming year without duplicating efforts and starting from scratch,” he said. “You don’t want those processes to be separate. You want them integrated, organized, built on common metrics and the same level of detail.”

In fact, said Player, “companies don’t need to update everything included in their forecast detail every time they do a forecast update. More critical and more volatile items typically need to be reviewed much more frequently. However, if you have items that do not change very much, don’t waste time on what’s not critical.”

“From my perspective, the rolling forecast process provides significant value by enabling agility, responsiveness, and improved decision-making such that organizations can continually adapt and respond to changing business conditions,” said Peck. “The rolling forecast provides a consistent forward-looking view across the horizon where companies have better visibility around the issues and opportunities ahead of the curve and can adapt, course correct, or change direction as needed. With the rolling forecast, companies are far better equipped to revisit strategic and operational tactics in light of new business scenarios and can dynamically align resources accordingly. The question they face is: What actions can I take today (and tomorrow) to adjust to the fact that performance is not turning out how I expected? It means they can do course correcting now—it’s the more dynamic aspect of continuous planning and optimized resource allocation.”

A critical guiding principle at the foundation of a well-designed forecast and reforecast process is that the forecast output per se is not the ultimate objective, according to Peck. “The real objective is to leverage the forecast outputs to make decisions and take action based on the best estimate of your anticipated future financial performance.” In the near-term, it can mean quickly realigning resources and capacity with fluctuating demand to help achieve current-year financial objectives. Medium-term actions could include providing enhanced guidance to external stakeholders to proactively manage market expectations. And longer-term strategic actions could address competitive positioning, internal capabilities, and revisiting the core operating model, according to Peck.

A well designed rolling forecast process should provide the key inputs and financial baseline for most all other planning processes, including long-range plans, strategic planning, target setting, initiative development and prioritization, capital planning, and the annual budget, according to Peck. “The rolling forecast can seed the budget and significantly reduce the time and effort required to complete the annual budget. In essence, organizations can have continuous forecasting providing the most realistic estimate of future performance based on the best external and internal information that we have,” he said.

According to SAP’s Chatterjee, “One of the things we often see, with many customers who are new to planning solutions and are working with Excel or an older solution—whether it’s SAP or one of its competitors, is that they can stop acting as aggregators of data and be financial leaders.” One of their primary goals is to be a contributor to the business, to act as a steward of where the organization is headed. “Without a rolling forecast to provide that guidance, finance cannot act as a strategic partner.”

“Best in class companies clearly have a rolling forecast,” Chatterjee said. “Many clients that are initial adopters of the system and are moving from legacy solutions do not move to a rolling forecast as a first step, however. “First, they work on automatically aggregating data to make their day-to-day job easier, according to ChatterjeeNext, they use predicting analytics and rolling forecasting to look forward into the business. “The true financial analyst sits in the front of the boat vs. the back of the boat (analogy that Brian Kalish used). When you adopt a culture of rolling forecasts you have the ability to act on that forecast and steer the business,” Chatterjee said.

“Having that forward view allows you to plan the business better,” said Chatterjee. “Traditionally, companies create a five-year strategic plan in July of where they want the business to be. That gives them a clear target. However, that plan does not cascade into the annual plan that’s typically handled on a bottoms-up approach, which is very time consuming and takes place between July and October. It’s very ground-up level. The rolling forecast doesn’t need to be a granular processes. As a result, finance professionals can spend more time doing strategy rather than data aggregation,” Chatterjee said.

It all comes down to the scope of the process. Organizations might be challenged by too high a level of granularity, but forecasting is not an exact science. No one can predict the future. After all, who could have predicted the direction of the dollar, or oil prices? Companies that have a rolling forecast in place can act very quickly on what’s happening, and include KPIs that interplay to allow them to give guidance immediately. In this fast changing climate, CFOs want the guidance today—not three days from now. Making them wait is not going to add to the value of finance.

Practitioner case study:**A.P. Møller Maersk Group**

Denmark-based A.P. Møller Maersk Group began its life in 1904 as a shipping company and has since grown into a \$50 billion conglomerate with worldwide operations and 150,000 employees. It has grown beyond containerized shipping into adjacent industries, including ports and container trains, as well as oil exploration and oil services. “We have a very diverse portfolio,” said Matthijs Schot, head of performance analysis. For the most part, the business is very asset heavy, with the exception of its logistics business.

“What we have done with the business units is make them individual businesses. They are separately listed. The group is a thin layer above the business units,” said Schot. “Treasury and investor relations is handled at the group level,” he added. “For the most part, the business units are very autonomous.” However, the allocation of capital is handled centrally. “We have three or four processes in our business where we have quarterly rolling forecasts, target setting from an FP&A point of view and capital allocation.”

The company began performing a rolling forecast in 2010. Prior to that, they were doing budgets on an annual basis with small adjustments, first at the group level, and now handled at the business level and incorporated into their regions across the world. “It’s quite a challenging process but a good one,” Schot said. “Especially with the dynamics of the changing business environment in the oil business. It helps us deal with that volatility.”

The company’s rolling forecast is reviewed quarterly. Each business unit submits a P&L, cash flow statement, balance sheet, and seven KPIs. From each data set, they extract the 4-month actuals and 4-month forward. The data is then compiled into one report, which is used by the Group CFO and CFOs of business units, for looking at the trends of performance of last four quarters and expectations for the next four.

Given the nature of its long-term asset business, A.P. Møller Maersk Group’s capital allocation is done on a 5-year basis. However, the process is dynamic. “When we go through the process, we don’t earmark a bag of money for next year. It’s based on a

pre-approval system for which investments fit into the strategy at the time. When it comes to launching a project, we ask: is this still relevant? It is easier to answer with a project. The bank is open throughout the year,” said Schot.

Target setting and performance are handled on an annual basis. “We try to make to make relative KPIs and still stay current,” said Schot. “If your forecast changes a lot throughout the year, we look at relative measures. EBITA margin compared to peers. If the market is producing a 5% return, we would drive to do 5% above our peers.”

“The advantage we have is that the budgeting process at A.P. Møller Maersk Group was such a difficult process that involved rollup from legal entities and very detailed processes. The CFOs of the BUs complained about the resource requirements and the limited value of the process, so the solution we offered is a rolling forecast,” Schot said. “It’s much higher level and quarterly. There was a need and willingness to change the old process, which was cumbersome,” he said. “A month after you finished it, things had changed.”

“It also helped us that we had executive sponsorship,” he said. “Also, the effort matched the point where the organization was at the time. The company has just transitioned from a family-owned to a public company. This rolling forecast and decentralization of decision-making was a good fit. There was momentum,” Schot said.

“The other thing that helped us is that we started in 2010 after the financial crisis,” Schot said. “There was a lot of volatility in the environment. A static forecast provided little value. The container trade was in a constant 10 percent growth market. Everybody had 10% growth. The 2008 crisis caused growth to suddenly stop. People realized that the static forecast no longer made sense.”

On a quarterly basis, the company performs a 4-quarter forecast. “We try to stay away from the calendar year,” he said. “We in FP&A look at the last four quarters, and we process five quarters. We also do a like-to-like forecast comparison: we take the last four quarters and compare them to first four in order to do a quick variance analysis.”

FP&A consolidates the information from eight business units to create the rolling

forecast, thereby providing guidance regarding opportunities in the following year. “It’s also a form of performance management; it allows the business to see how they’re performing and what the outlook is,” said Schot.

The assessment of actual targets and the assessment of the performance of the BUs is each done on a different time period. It’s shorter for the container business than for the oil business, where projects may span 10-15 years. “We match the targets to the nature of the business,” said Schot.

“The benefit of a rolling forecast is that you get a fresh view every quarter,” Schot said. “It gives you the ability to see the impact of current changes. If you set up a budget, it’s outdated a month or two after you start. A rolling forecast allows you to make adjustments. It allows you to be more flexible.”

Critical Success Factors

Experts list the following two factors as critical to the success of a rolling forecasting program.

- **Align the forecast with the market and the company’s industry dynamics.** The more volatile the market, the more frequent the forecast and the shorter the time horizon. For example, airlines may need a shorter time horizon than stable manufacturers. “The volatility and the market dynamics should dictate how far out companies should look and how frequently they should forecast,” said Kolawole.
- **Implement a top-down, driver-based model.** “The last thing you want to do is increase the burden on the folks doing the forecast,” Kolawole said. Employing a driver-based approach is one way to avoid this. The idea is to really figure out what moves the needle, then make sure that there’s a connection between that and the forecast. This can be handled by a Center of Excellence, with business unit (BU) representation to help figure out the right assumptions. It can go a long way toward simplifying the process.

“To succeed, most companies that turn to rolling forecasts move away from the atomic level of standardized forecasting by focusing on a business

driver-based forecast,” said Axson. It’s sometimes a difficult analytics process but often provides the best basis for a good rolling forecast.

Companies need to also keep an eye on the drivers they’ve identified to make sure that they haven’t changed. For example, years ago in the mobile phone industry, the time people spent on the phone directly affected how much they paid each month for the service. With the introduction of a flat rate for service, the variable payment went away and hence the driver of revenue was no longer based on minutes of use.

According to Peck, the foundation of a good rolling forecast is a robust, driver-based modeling framework and capability. Driver-based planning uses operational driver models to predict financial results. These models are essentially equations that represent the mathematical relationships between key operational drivers (e.g., volume, rates, utilization, conversion ratios, and brand awareness) and anticipated financial outcomes. Focusing on the operational drivers enables an organization to understand, plan around, and influence the critical elements that have the greatest impact on financial performance.

“Instead of forecasting the same atomic G/L account level of detail typically used for the budget, the forecast should focus on the key operational business drivers impacting business performance,” said Peck. By focusing on the “critical few” instead of the trivial many, driver models enable an efficient and far less cumbersome forecast process focused on the business levers most relevant for analysis and decision-making. Some organizations have taken their driver-based models to the next level by incorporating unstructured data to further enhance visibility into both external and internal drivers of demand, supply, revenue, cost, competitive and consumer behavior, and other key business elements, according to Peck.

A key benefit received from leveraging a driver-based rolling forecast framework is the ability to complete a very robust “what-if” analyses and scenario planning based on changing the underlying driver value assumptions. Given the nature of the driver models and the power of modern enabling technology, companies can generate hundreds of scenarios, explore and understand the characteristics around each scenario, and then develop action and contingency plans accordingly. “Over time, the driver model

algorithms can be refined through experience and advanced statistical analysis,” said Peck.

“Building a driver-based forecast is the real game changer,” concurred Max. “However, it’s not commonly understood.” A lot of companies forecast revenue and think of it as a driver. Revenue is a result, not a cause. The question is what really changed in the business activity that will impact revenue, expense, the balance sheet and cash flow. “Recently, I’ve been looking at two classes of models for driver-based forecasting,” said Max. “A standard model is purely transactional, such as retail sales transactions. The other approach involves models that look at the future based on an underlying book of business,” said Max.

For example, finance companies might look at loans that are being brought in. The loans are assets with a life cycle associated with it, be it three years or six months. At the end of the life cycle, there is termination activity. “You have a baseline of activity and assets that produce revenue and, of course, incur expenditures,” Max explained.

Another example is health care providers with chronic patients. “There’s a life cycle of care that begins when the patient enters the network. He or she gets treatment over the life of their illness,” he said. “You can build retention curves around that by using a combination of analytics and data and look at the patient’s history, i.e., what are the attributes and what can we learn from the past to project what the volumes will be going forward, and how that does affect revenue and costs?”

Practitioner case study: Euroclear

Euroclear, the financial services company, is a platform that settles different transactions. It’s a very risk averse and stable business. Starting in 2012, the management committee asked to look beyond the current fiscal year, and the company began running a rolling 18-month forecast, according to Jose Gozzi, manager of FP&A. “The forecast is refreshed three times a year. The third forecast also covers the budget for the next fiscal year. The forecast includes the lines of the P&L that cover revenue for the group, as well as all different costs: administrative and direct,” Gozzi said.

It also covers the various business entities (12 legal entities). Additionally, there are three

different internal departments that contribute: the client facing group (operations); the IT group (because of its importance, they do zero-based forecasting bottoms-up three times per year); and the support divisions, which include finance, marketing and HR. For the first forecast, all the divisions do a classic bottoms-up forecast, as well as the budget.

“In terms of revenue drivers, the company looks at markers like the number of transactions, market outlook, and type of transactions,” Gozzi explained. “On the cost side, headcount is one of the most important drivers—60 percent of the cost is headcount driven,” he said. To this end, “We have a payroll model to collect data and model it. Different parameters based on inflation, etc. for each country in which we operate, driven by regulatory constraints and the level of competition.

“On the IT side, the big drivers are the projects we embark on and our contracts with the European entities for application development. These mandates are based on assumptions and guidelines. We estimate the rate: that’s another important driver,” Gozzi said.

In regard to infrastructure, the rolling forecast is basically the capital base and depreciation. “We have a lot of maintenance costs for our infrastructure,” said Gozzi. “We make assumptions about the cost of support using contracts. It’s very directly driven by outstanding support contracts.”

When implementing the new forecasting approach, Euroclear didn’t encounter any substantive obstacles, according to Gozzi. It was mostly a question of the maturity of each division. IT was already very mature and had the processes in place. Others, like operations, needed to formalize their approach a little more regarding what is likely to happen next year. “Once they understood why we do it, they gained the skills,” Gozzi said.

“The forecast is our GPS; it provides direction of where we’re going,” he explained. “What’s important is to see increase in new business, and to understand how that will affect cost and keep in line with revenue, anticipate that in advance and mitigate that increase to achieve greater profits. Without the farther outlook, it’s difficult to take action and drive the business.”

Additional success factors include:

- **Take it in stages.** “We don’t advocate a big bang approach,” Kolawole said. “A staged rollout is generally advisable, selecting one or a few business units to start. Then you go from there. Balance process discipline with responsiveness,” he said. Finally, it’s important to maintain process discipline, but also be prepared to do off-cycle forecasting and have the capability to respond to changes in market conditions by reforecasting when something happens off-cycle.
- **Alter your compensation method.** “If you tie goal-setting targets to equal forecasting targets and link compensation to reaching those targets, you will find many managers doing a lot of sandbagging,” said Player. “The key is to separate target setting from forecasting. Targets define where your organization wants to go; they are aspirational. But the forecasting process should not be aspirational. Instead, forecasts should be realistic projections of where you really think you’re heading. It needs to be a realistic, not an optimistic, picture.”
- **Decide who should be involved.** “It’s very important to decide who participates in the forecasting process,” said Melnychuk. “Good rolling forecasting should be participative, but the balance is important: who should be the key participants?” The people who have a role to play in operations need to be trained. “When they’re not, it creates a lot of problems,” she said. “It’s easy to centralize the process in FP&A and train the group rather than a lot of business people.”
With a driver-based model, you can involve less people—25-30 is too many, according to Melnychuk. Businesses are different. Compared to static forecasting, companies typically have a lot of detail and involve a lot more people, which takes more time and creates inefficiencies. With driver-based modeling, you can manage with less details. “You find the 20 percent of the drivers that describe 80 percent of your business and focus on those. As a result, a lot less people need to be involved, which saves time and creates greater inefficiency.”

- **Link to strategic and operational decisions.** Outputs of each rolling forecast cycle should be used to inform and influence ongoing strategic management and operational performance reviews. Risks and opportunities identified during a rolling forecast should trigger “what-if” analyses and scenario planning around the key business drivers, according to Peck. “As appropriate, organizations can revisit their strategic assumptions and initiatives, and then make changes to their strategy execution plans. In conjunction with the strategic performance assessment and action plans, go-forward operational tactics and plans can dynamically change based on new insights gleaned from the rolling forecast. This closed-loop, continuous planning framework enables organizations to revisit strategy throughout the year, adapt and make course corrections where needed, and align resources quickly and efficiently,” said Peck.
- **Integrate with the operational planning processes.** “The rolling forecast process should be tightly integrated with core operational processes,” Peck said. “In many organizations, these core operational processes already incorporate a rolling, continuous planning horizon where the rolling financial forecast process can leverage the outputs of these existing processes. A good example are the S&OP processes used by manufacturing organizations, where demand, supply, capacity, and financial plans are all optimized as part of an integrated business planning process.”
- **Direct ownership and accountability.** According to Peck, “The goal of a forecast is to provide the best estimate of expected future performance—not create arbitrary numbers that fill a potential gap to meet the original budget target. For this process to be successful,” he said, “those individuals closest to the activities related to the core operational planning drivers should be directly responsible for providing updated, unbiased forecast driver values. Wider involvement will ensure that decision-makers gain a more accurate picture of the current position and future outlook,” Peck noted. “Finance is still responsible for the coordination,

management, and execution of the overall forecast process, but the business owners closest to the real operations of the business should own and be held accountable for the driver inputs,” he said.

- **Reporting and analysis.** Adopting a rolling forecast planning process in lieu of a traditional annual budget process is a radical departure from conventional practices and thinking, according to Peck. “For those organizations that still retain the annual budget but highly leverage rolling forecasts for the bulk of their planning, reporting, and analysis needs, the change is still very substantial. Business owners must be educated and trained around a new set of norms, expected behaviors, and baseline KPIs, where reliance on variance to budget comparisons will not suffice,” he said. “In the brave new world, the focus shifts from explaining what happened to why it happened, what will happen, and what can we do to make it happen more favorably in the future.”
- **Integrate with other processes.** Another important issue is alignment with other processes: strategic planning, business planning, and operational planning. “If a rolling forecast is not harmonized, it creates problems,” said Melnychuk. “Operational planning should feed the forecast,” she said. “It’s important to align through drivers in the system. Many companies around the globe are not there yet. The practice is called harmonized planning or integrated planning.”
- **Enable tools and technology.** Rolling forecasts rely on a series of interconnected operational driver models to generate expected financial results. This modeling environment must accommodate multiple, fast-paced, cross-functional forecast iterations involving robust “what-if” analysis, scenario planning, and decision-making trade-off discussions, according to Peck. Given these business requirements, it’s essential that the rolling forecast process be supported by a comprehensive enterprise information architecture platform, including

data integration and master data management; flexible and robust analytic planning; reporting and consolidation applications; and standardized end-user tools for accessing, inputting, and visualizing information.

Practitioner case study:

Direct Energy

Direct Energy is an energy retailer that services both businesses and residential homes. The company has customers in the Northern U.S. and a regulated business in Alberta, Canada. Michael Senchuk, manager of planning and analysis, is mostly involved in the Canadian-regulated aspect of the business, where he spent the last three years. Over time, forecasting has not changed dramatically. The company does one forecast in the spring and one in the fall. The fall forecast then serves as the budget for the next year.

The process starts at gross margins and ends with looking at operating expenses and the balance sheet. “We have a quasi-rolling forecast,” explained Senchuk. The company adds a full-year outlook in the fall, instead of focusing only on year-end. How far out and how frequently the forecast is depends on the nature of the business, according to Senchuk. “We’re on a weekly basis,” he said.

Whose involved in contributing to the forecast depends on the nature of the business. In the competitive businesses in the U.S., the sales teams are much more involved. In the regulated business in Canada, most of the work is handled by finance. A lot of that is also tied to what the company has to present to the local regulatory commission.

For a while, the company used spreadsheets but have now upgraded to an SAP module. “It’s a lot easier to reconcile,” said Senchuk. “It compresses the time it takes to produce the forecast, especially for the balance sheet. I see a lot of value in a rolling forecast as it provides a heads up on what’s going on in the future horizon. Things are always moving.”

Practitioner case study:**National Retailer**

"I wouldn't necessarily call it a 'formal' rolling forecast, but we're headed in that direction," said the director of FP&A at a retail company. "We're updating our forward look and using that outlook heading into the budget forecasting. We have streamlined it. We look at an 18 months horizon"

Their forecast is driver-based. One example of a key driver is inventory flow. "The buyers need to make decisions six-nine months in advance. We're basically taking what some groups were already doing informally, getting those forecasts aligned with the rest of the organization, and pulling a P&L forecast from that," he said. "Our buying cycle is such that there are a lot of activities that impact us beyond the current year. We had people doing that on an ad hoc basis before. Now the entire organization has embraced it. This brings much greater alignment, which means clarity, accuracy and efficiency."

"We have a good sense of variability and fixed cost and investment in and out each month," this FP&A director said. "The 18-month outlook is revised quarterly, while the annual forecast is updated monthly."

After the process was taken up by the entire organization, "We have been getting better and better," he said. While the process took hold in 2013, it's taken a little while to get into the rhythm, according to the director. Their biggest challenges were learning to work together and ensuring that each group learned to think in financial terms. Marketing was comfortable providing revenue numbers but was not providing associated costs. "It was financial rigor that everyone needed to get accustomed to," he said. How each quarter played out was not a big concern. "While we stumbled initially, now the process is much more collaborative and financially oriented," he said. "If it's not grounded in numbers, don't even talk to us," the FP&A director said. "That took a little time for people to understand. It takes a little while to get used to the concept."

10 Common Pitfalls

Given all the benefits of a rolling forecast, "One would think that the balance of companies would have adopted this approach," said Peck. "But according to multiple studies, the adoption rate is somewhere between 30 and 50 percent to date." Why is the adoption rate for rolling forecasts so low? What are the root causes when organizations have failed in their attempt to implement a rolling forecast in the past?

1. Maintaining the same level of work.

According to Peck, the primary reason that a rolling forecast implementation fails is that the organization treats the rolling forecast cycle just like another budget cycle. The amount of work for FP&A and the business is essentially the same. In essence, they are now creating a "black hole of budgeting" 4-12 times per year.

"One of the key hurdles companies face is that a rolling forecast is not just about elongating the current process," said Kolawole. "That may run into opposition because the forecasters already thought it was painful enough as-is, and making it even longer will only make it more painful." If done right, implementing a rolling forecast means fixing the current process, enhancing it and driving faster by using a simpler process rather than a more difficult one, which can dramatically simplify the process of selling rolling forecasts internally.

2. Getting good data and good tools.

Perhaps one of the biggest obstacles, according to Max, is getting the data to line up the way people want it to. "To make it work, you need to know what the drivers and data are that you need to build the models." If you just say you're doing a rolling forecast and don't devote the necessary tools and budget to it, it won't work. A proper level of support, technology, data and people are required to make it work. Plus, you need multidimensional analytics. "Companies need to build dimensionality into their forecasting models that actually work," said Max.

3. Figuring out the drivers.

“The other big obstacle is figuring out the drivers and the forecast based on those key drivers,” said Max. “Figure out what empirically makes a difference: What are the drivers that have the most material impact on the forecast? What’s interesting is that when you ask executives what matters, invariably it’s not necessarily the right answer. Do the analytics to see what drivers have the most impact. That’s technically one of the most important things to do,” Max said.

4. Know what’s required to run the business.

There’s also confusion around what a rolling forecast will fix and what it won’t fix, according to Kolawole. “That’s partly because managers confuse the process of project planning, how it’s funded and executed (operational), and the forecasting process. The planning process for projects happens regardless of the forecast. The key is in identifying the level of detail that’s required day-to-day to run the business.”

5. Don’t start with a blank sheet of paper.

“The rolling forecast shouldn’t be a blank sheet of paper,” Kolawole said. “It should be seeded with the prior forecast. A lot of that is technology-driven. If the right drivers are identified, it should be easy to roll those forward and also use that to replace the budget. In addition, the rolling forecast should be based on the 3- to 5-year strategic plans and incorporating macro indicators, such as economic forecasting and big projects. There’s a natural feed there.”

6. Delink compensation from forecast.

“Another potential problem is that people get compensated based on whether they deliver the results presented in their rolling forecast,” said Accenture’s Axson. That’s a recipe for failure because it will affect the honesty of the forecast. The target and compensation need to be separate from the forecasting process.

Melnichuk agreed. “The problem in mixing the two is that it gets political,” she said. “When people feel their performance evaluation is tied

to it, the rolling forecast is no longer objective. The reason we need it, is to want to see what is likely to happen and be able to play out different scenarios. This is where we’re likely to be. If people mix performance management with forecasting, they are likely to be emotional about it as bonuses are connected to the performance. As the result, the accuracy of forecast will suffer.”

7. Integrate the forecast with other processes.

A pitfall for many companies is that they don’t integrate the new forecasting process with legacy processes, according to Kolawole. The Hackett Group advocates using the Q3 or Q4 forecast as the pseudo budget. Eliminating the budget can make people nervous because of other aspects tied to the budget, like compensation. But leveraging a snapshot of the forecast for budget purposes is key.

8. Get finance involved from the get-go.

From an operational standpoint, it’s important that the finance team get involved from the beginning, according to Kolawole. Manufacturing, marketing and sales also have to have a seat at the table. Finance guides and dollarizes the impact of sales and marketing initiatives and, at the end of the day, there are no surprises.

9. Change the mindset.

“Another forecasting pitfall is exhibited in companies with well-established budgeting process that are accustomed to an annual cycle,” said Morlidge. “They don’t have planning assumptions in place to feed a forecast beyond the year-end. For rolling forecasting to work well, the entire organization needs to work with a consistent set of horizons and a consistent cycle. This obsessive focus on year-end numbers often leads to a connection between targets and compensation for performance evaluation. If people are only interested in that year-end number, they are less likely to provide objective input beyond that 1-year horizon, particularly if the forecast is used to help set targets for the following year.

“There needs to be a clear distinction between target and forecast,” Morlidge explained.

“With companies that are stuck in a budgeting mindset, any changes to the forecast are viewed as bad. It’s viewed as inadequacy of control, or failure to understand the business. This can lead to changes being suppressed, thereby robbing the rolling forecast of its usefulness.”

10. Have the right tools.

It’s important to find the right tool that supports what you’re trying to do. A lot of people simply try to do it with consolidation tools or Excel, which doesn’t recognize the degree of collaboration that’s required to produce a good rolling forecast, the dimensionality and change. “You need an agile, dynamic environment,” said Peck.

Conclusion: 5 Implementation Tips

A rolling forecast can be an effective tool for FP&A to help promote its strategic role within the enterprise. It can arm it with information that allows management to make better and more agile business decisions about how to steer the organization going forward, while saving time on other processes like the annual budget. But, of course, it’s not a panacea, and many companies run into difficulties—be they technical or cultural—when trying to put in place a rolling forecasting process.

Here are a few tips for those up for the challenge:

1. Measure the baseline.

“Do an internal evaluation to understand how broken, or not, your budgeting process is,” said Kolawole. “Separate the business and the forecast. Find out whether you have the same people wearing multiple hats; pure separation helps ensure integrity of the process.”

2. Get the right tools. “

Never underestimate the importance of technology,” said Kolawole. Technology can help with the seeding process, scenario analysis, modeling the drivers to identify drivers, and making changes to particular levers.

3. Understand and communicate the benefits.

According to Kolawole, adopting rolling forecasts is a strategic opportunity for organizations to transform their planning and performance management capabilities. By implementing the rolling forecast methodology and its core enablers (driver models, forward-looking reporting and analytics, enabling technology), organizations can gain greater visibility into the business, better anticipate and influence future outcomes, optimize the allocation of scarce resources, and improve the quality and accuracy of forecasted results.

4. Pinpoint specific business needs.

Transitioning to this framework and satisfying the full array of business needs currently being met by the traditional budgeting process is not an easy task, especially as it pertains to target setting and incentive compensation. “This is why most organizations make the transition in a phased approach where they look to rationalize, streamline and improve their existing budgeting and forecasting processes and augment these processes with a driver-based rolling forecast. As part of this transformation, they clearly delineate which planning-related process supports specific business needs. And, as with all processes and organizations that mature over time, some organizations have been able to incorporate innovative incentive management structures and make the full transition to a rolling forecast while completely abandoning their traditional budgeting process.

5. Take it one step at a time.

No matter what path you take—a more measured approach or a complete break from the traditional budget—you can transform the budgeting process from one that merely allocates financial resources to one that optimizes the management of resources. The end result is a dynamic, continuous planning and forecasting process that delivers a true competitive advantage and superior business results.



About the Author

Nilly Essaides is Director of Practitioner Content Development at the Association for Financial Professionals. Nilly has over 20 years of experience in research, writing and meeting facilitation in the global treasury arena. She is a thought leader and the author of multiple in-depth AFP Guides on treasury topics as well as monthly articles in AFP Exchange, the AFP's flagship publication. Nilly was managing director at the NeuGroup and co-led the company's successful peer group business. Nilly also co-authored a book about knowledge management and how to transfer best practices with the American Productivity and Quality Center (APQC).



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General Inquiries AFP@AFPonline.org

Web Site www.AFPonline.org

Phone 301.907.2862