

AFP Guide

# Driver-based Modeling and How it Works

1 Identify the **Key Business Drivers** that Move the Needle and Drive Outcomes



Units Sold

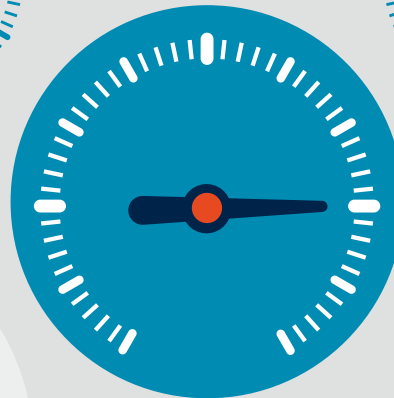


Inbound Calls



Labor Utilization

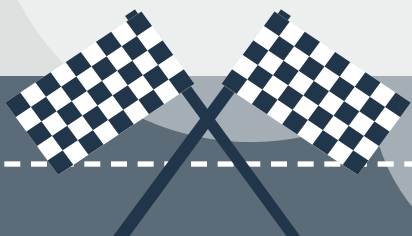
MATERIAL PRICES



Brand Awareness

2 Drive **Financial Performance** at your organization

“By identifying the trend, you can act more quickly. You can better understand the cause/effect between **driver and results**, and therefore understand the impact of every decision you make.”



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## EXECUTIVE SUMMARY

Facing greater market volatility, a fast-changing business environment, and a constant push from senior management to improve the planning process, more FP&A teams are incorporating driver-based modeling into their forecasting methodology. “Technically, the definition [of a driver-based model] is building a model that has any kind of calculation that references some other variable, i.e., a driver,” said Mitch Max, CEO and president of BetterVu.

In the case of FP&A specifically, according to Sholape Kolawole, EPM transformation associate principal at The Hackett Group, “Driver-based modeling is a way to leverage operational metrics that have a mathematical relationship with financial outcomes, particularly revenue or expense items in the P&L or the balance sheet.” Thus, he said, “driver-based planning is the process of using those metrics to drive outcomes. It’s about what moves the needle and identifying the operational/financial relationships.”

According to Pras Chatterjee, senior director of product marketing at SAP for Enterprise Performance Management, the key is to look at the number and metrics and identify what they’re comprised of. “Numbers are not just absolute,” he said. “You’ve got to understand the different variables that comprise the numbers and see how granular you need to go based on those drivers.” Price X quantity is the most basic model. “But you can go deeper than that,” he said. “For example, look at turnover, sales-force attrition, etc.”

For FP&A, the concept brings a multitude of benefits. Not only does it help the group increase the frequency and accuracy of the forecast, but it also engenders closer collaboration with business leadership. After all, while finance must lead the effort, it cannot uncover key drivers all by itself. It needs to work directly with business owners to

identify the drivers that have the most impact on financial performance. In addition, driver-based models give finance the ability to better support management decision-making and provide actionable information. As FP&A professionals seek a more strategic role in the organization, they can add tremendous value by providing critical business-driver data to management with plenty of time to take action to change and improve corporate performance.

“One reason we see an uptick is that companies are dealing with a lot of uncertainty and volatility,” said David Axson, managing director of Accenture’s Strategy, CFO & Enterprise Value practice.

“Historically, companies used historic data to trend their financial budgets and forecasts. They used last year’s data to predict next year’s performance. That’s no longer sufficient,” he said. “Companies need to look at activity that’s occurring now to see what’s driving financial performance in the future.”

Ultimately, as more companies move to a rolling forecast, realizing it’s no longer sufficient to look forward only to the end of the year, driver-based models will become more commonplace. Simply looking out 12 months does not give companies enough time to course-correct, as the recent AFP FP&A Guide, “Implementing a Rolling Forecast: Success Factors and Pitfalls,” outlined. 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 executives to make important decisions on how to allocate key resources in order to drive continued profitability.