Demolishing barriers to success

David Parmenter says that quarterly rolling planning (QRP) is the most important management tool of this decade

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QUARTERLY rolling planning removes the four main barriers to success that an annual planning process erects - an annual funding regime where budget-holders are encouraged to be dysfunctional, a reporting regime based around monthly targets that have no relevance, a three-month period where management are taken away from making money, and a remuneration system based on an annual target. The only thing certain about an annual target is that it is definitely wrong - it is either too soft or too hard for the trading conditions.

The critical building block for the QRP is the quarterly rolling forecast (QRF). This article is part of a series that will explain why QRP is the most important management tool of this decade and why the rolling forecasts of the past are a different beast to the 21st century QRP.

Although many organisations are using forecasts to monitor performance they are, in many cases, flawed from the start, for some or all of the following reasons:

- due to poor tools and expediency the forecaster (budget-holder or analyst in finance) uses the budgets of the remaining months as a guide to future expenditure
- the forecasts do not involve the budget-holders as it would be a nightmare to use the budget Excel models, so they are prepared centrally by the finance team with little or no consultation at the coalface (I call these top-top forecasts)
- the forecasts are updated monthly, an unnecessary timeframe creating much number noise
- forecasts only go up to year-end even though the new business year may be starting in the near future, and management is still only focused on year-end.

There is an answer: quarterly rolling planning.

What is a QRP process?

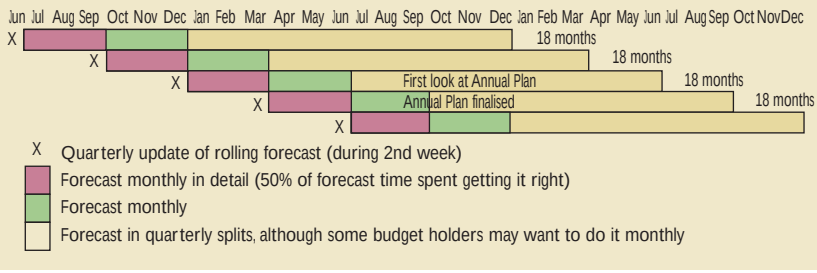
The quarterly forecasting process is where management sets out the required expenditure for the next 18 months. Each quarter, before approving these estimates, management sees the bigger picture six quarters out. All subsequent forecasts, while firming up the short-term numbers for the next three months, also update the annual forecast. Budget-holders are encouraged to spend half the time on getting the detail of the next three months right as these will become targets, on agreement, and the rest of the time on the next five quarters.

A quarter's forecast is never a cold start, as the forthcoming quarter has been reviewed a number of times. Provided you have appropriate forecasting software, management can do their forecasts very quickly - one airline even does this in three days! The overall elapsed time of the four forecasts is as little as five weeks - compare this to your annual planning cycle, that on average takes 8-12 weeks.

The key points of a rolling forecast are:

- budget holders provide an annual plan through the bottom-up QRF regime but are not assigned those funds - this is done on quarter-by-quarter funding
- monthly reporting is more meaningful, as it measures performance against the most recent forecast and not a monthly split of the original annual plan ▸

Figure 1: How the rolling forecast works for organisations with a March, June, September or December year-end



- each subsequent forecast is still expected to put the ball through the annual-plan goalposts, the difference being that the ball carries on to the next field (into next year) – i e you're always looking forward 18 months
- forecasting is carried out on an appropriate planning tool that can handle a bottom-up forecast once a quarter - Excel is not, and never has been, an appropriate tool for a key company system.

The difference between QRF and QRP

A recent study of over 200 US organisations found that 80% of them expect to have QRFs in place by 2005. Many of these will be using these forecasts as a funding regime and thus they will have a QRP process.

QRF on its own simply gives management a better picture of the future. Organisations then report against the forecast and the budget. In other words, they still have not tackled the main issue holding back their organisation - the annual planning process and its undesirable offspring, the monthly budget. Organisations who gone the extra steps and thrown out the annual planning process entirely have converted their QRF to a QRP process.

The QRP process:

- allows an adaptive performance management structure, responsive to the fast and dynamic world we work in
- forces management to look forward on a regular basis - a continual planning process
- replaces the monthly budget with a more up-to-date monthly target
- radically improves monthly reporting - you now report against a meaningful target.

The features of a QRP process

There are a number of key features of a QRF and these are set out below.

It is a bottom-up process.

Most forecasting models, built in Excel, tend to be a top-top approach: consultation is often restricted to people who are removed from the coalface and thus tend to have a very skewed view of the future - in some cases they simply reiterate the misconceptions that the head office wants to believe.

A proper rolling forecasting regime is a bottom-up process and is consistent between the various different functions – in other words, production is being based on forecast demand rather than the other way around. A bottom-up process also helps ensure that there is a general consensus in the longer-term view.

It creates the annual plan goalposts.

Let's get one thing straight: the standard annual planning process takes too long, is not focused on performance drivers, is not linked to strategic outcomes or "critical success factors", leads to dysfunctional behaviour, builds silos and is a major barrier to success.

In contrast, the QRF process allows you to set quick annual-plan goalposts but throw out the flawed monthly budget yardsticks and annual appropriation to budget-holders.

I use a rugby analogy to explain the difference between the two systems. The annual plan is the establishment of goalposts at the end of the field, the budget process is where we set 12 x 10-metre lines to report against (see figure 2). The two problems with the current situation are that first, the 10-metre lines (the monthly budgets) are wrong as soon as the year has started, and second, there is no need to pass the agreed appropriation on to budget-holders based on their annual plan.

It creates a quarter-by-quarter funding mechanism.

The key is to fund budget-holders on a rolling quarter-by-quarter basis. In this process the management says, "Yes, we know you need $1m and we can fund it, but how much do you need in the next three months?" It will come as no surprise that a budget-holder can be much more precise for the funding requirement for the next three months, in this case say $225,000. The "ground staff" then draw these lines on the field and management become very accountable about progress (see figure 3). With QRP, the approval process is quicker as management are only approving the funding of the next quarter and can adjust the quarter-by-quarter funding as the conditions and environment dictate.

Some organisations are recognising the folly of giving a budget-holder the right to spend an annual sum and at the same time saying "If you get it wrong there will be no more money". By forcing budget-holders to second-guess their needs in this inflexible regime you enforce a defensive behaviour, a stock-piling mentality. In other words, you guarantee dysfunctional behaviour from day one! A benefit of QRP is that it highlights "free funds" for new projects earlier on in the financial year, as it is harder for a budget-holder to hide

Figure 2

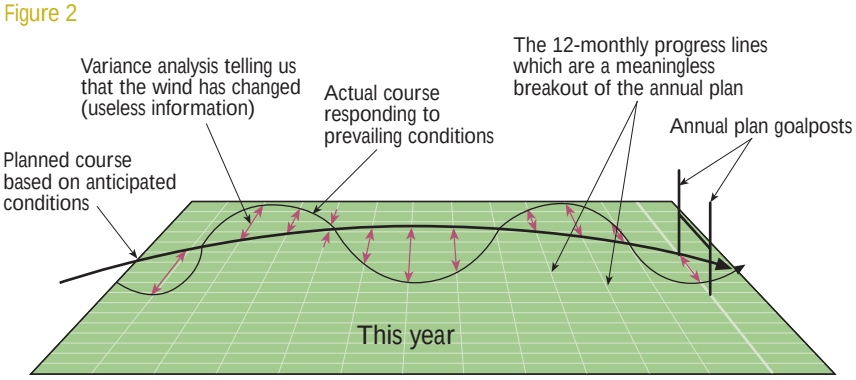
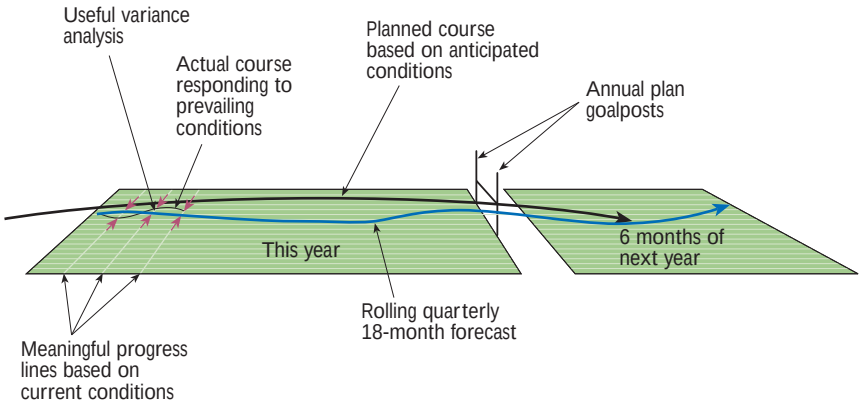


Figure 3



surplus funding in the next quarter's allocation.

The released funds can fund new initiatives that the budget-holder could not have anticipated previously. This will get around the common budget-holder dilemma of "I cannot undertake that initiative, though we should, as I did not include it in my budget". Under QRP, the budget-holder would say "I will put it in my next update and if funds are available I am sure I will get the go-ahead".

This more flexible funding environment will have good buy-in from cost centre managers, as long as the regime is communicated clearly and frequently.

It is based on a planning application – not Excel.

Forecasting requires a good robust tool not a "No 8 wire" spreadsheet, built by some innovative accountant and which now no one can understand. If you have not already upskilled in this area you need to do so immediately.

Acquiring a planning tool is the first main step forward. This is particularly important as in my view there is no room for top-top forecasts, prepared by management without consultation with budget-holders. They exist only because organisations use Excel, a nightmare for a bottom-up process. To do bottom-up forecasting every quarter you need a bolted-down system.

Excel is a great tool for an expense claim at the airport. It is not and never should be a building block for your company's key systems.

As a forecasting tool Excel fails on a number of counts:

- it has no proper version control - we have all burnt the midnight oil pulling our hair out wondering whether the spreadsheets are the correct versions!
- for every 150 lines in your forecasting model there is a 90% chance of a logic error, according to a recent study
- it lacks robustness (show me a CFO who can be confident of the number an Excel forecast churns out!)
- it cannot accommodate changes to assumptions quickly: e g how would you cope if the CEO asked "What is the financial impact of stopping production of line x (and I need to know by close of play today)?"

QRP software tools are being built all the time. The table below suggests just some that would be worthy of research.

It is based around key drivers.

One of the key features of a forecasting tool is that it needs to be based on the key performance drivers that management

PACKAGE NAME	WEB ADDRESS
Business Planning and Budgeting	www.peoplesoft.com
Camelot	www.descisys.com
Cognos Planning (previously Adaytum)	www.cognos.com
CorStrategy	www.corvu.com
Everest	www.outlooksoft.com
GEAC Performance Management Suite	www.beaconit.com.au
Hyperion Planning	www.hyperion.com
MIS DecisionWare	www.misag.com.au
Mondelio	www.mondelio.com
Olapworks	www.olapworks.com
Oracle9I Developer Suite	www.oracle.com
OA systems - crystal reports	www.oasystems.co.nz
Perceive	www.perceive.com.au
Predictive Planning	www.gfg-group.com
Proclarity Analytics	www.bipredict.co.nz
QSP Performance Manager	www.qsp.com.au
Sage WinForecast	www.sage.co.uk
Strategic focus	www.strategicfocus.co.nz
TARGIT	www.targit.com
TMI	www.applix.com www.cortell.co.nz

may need to know. In-depth interviews with senior management, coupled with some brainstorming, will quickly identify the main ones, which may include:

- the impacts of contraction, e g stopping production of one line, selling a business
- the impacts of growth through acquisition
- business from key customers and supply requirements from suppliers
- key economic indicators, interest rates, inflation
- exposure to volatile markets
- plant capacity limits.

If you have second-guessed the likely management requests and have designed the model around them you will have a planning tool that can quickly and robustly model the implications of such changes.

It is based around a quick process.

QRFs should be performed within five working days, with the exception that the fourth-quarter forecast, which creates the annual goalposts, will have an extra week for additional negotiations and quality assurance. QRFs can be quick because:

- planning tools enable instant consolidation
- the model is robust and doesn't have multiplicity of formulae within it
- numbers preparation can be done in advance (e g personnel costs)
- the quarterly repetition aids efficiency and effectiveness
- repeat costs can all be standardised (e g Wellington-Auckland flight costs can be the same figure for the whole year).

It is a rolling 18 months – not 12, 13 or 15 months.

I advocate an 18-month rolling forecast regime, as it has some substantial benefits that include:

- you see the full next year half-way through the current one, so the third quarter forecast, for example, can set the goalposts for next year's annual plan
- the QRF is consistent each time it is performed, as opposed to always looking ahead for two financial years (the QRFs will vary between 13 to 23 months)
- your annual goalposts are never set with a cold start.

It is a quarterly process, not monthly.

Only businesses that are in a very dynamic environment would need to forecast monthly. One has to remember that for every event that goes your way, there will be another event in the future negating the positive impact: it is not worthwhile changing your year-end forecast because of, say, the loss or gain of a large customer. These changes are better picked up on a quarterly basis - this will help ensure less oscillation in your year-end numbers.

Organisations in a dynamic environment do not need to get all budget-holders to participate in their monthly re-forecast. You may be able to limit this extra monthly work to sales and production with the major, all-embracing cycle still being quarterly. ■