How to implement a planning tool and get it right the first time

By David Parmenter

Contents

Introduction

A decade ago, the electronic spreadsheet was considered state-of-the-art for the budgeting process and a practical, inexpensive option for most midsize companies. However, what might have started as a simple budget model often grows into something that seems to take on a life of its own. Moreover, considering the time and effort required to turn that mass of spreadsheets into a coherent budget, a large spreadsheet model should not be considered an "inexpensive option."

With the introduction of dedicated planning tool software for all sizes of organizations, spreadsheets are not the optimal approach any longer. In this paper, I cover why implementing a quarterly rolling planning process, along with a planning tool, can give you a better annual planning process. I then introduce some fundamental practices that I call "foundation stones," that you can follow to ensure that your planning tool implementation is successful, along with a selection of forecasting techniques that will be useful to you and your organization.

A better annual plan or a quarterly rolling process

A planning tool should be designed for a rolling planning process that can generate an annual plan for as long as it is needed. In fact, I believe that annual planning, as businesses use it today, is one of the greatest mistakes companies have made since 1494, the year Pacioli wrote about double-entry bookkeeping in *Summa de arithmetica, geometria, proportioni et proportionalità*.

Why annual planning is not advisable

Although a planning tool can be used to improve an existing annual planning process, implementing a planning tool is an ideal opportunity to replace annual planning with a quarterly rolling planning process. The first writers to put annual planning to the sword were Jeremy Hope and Robin Fraser in their classic book *Beyond Budgeting*.[1]

The reason the annual planning process should be replaced is because it:

- Takes too long
- Costs too much
- Does not focus on performance drivers
- Does not link to strategic outcomes or "critical success factors"
- Leads to dysfunctional behavior, building silos and barriers to success
- Undermines monthly reporting (monthly budgets are poor targets)
- Is not designed for a dynamic company in a rapidly changing environment
- Is an "anti-lean" process

Smart organizations do not have an annual planning process anymore. Instead, they use quarterly rolling planning. This move influences the structure of the planning tool model.

The quarterly process

In a quarterly forecasting process, management determines the likely revenue and expenditures for the next 18 months. The focus is on what is happening in the forthcoming quarter but with an eye to the bigger picture six quarters out. The quarterly forecast thus updates the annual forecast but gives a view of the next financial year. Each quarter's forecast is never a cold start because management has reviewed the forthcoming quarter a number of times. Provided you have appropriate forecasting software, management can do their forecasts very quickly. The average time spent on the four quarterly forecasts during any given year is five weeks.

Figure 1 shows how the quarterly rolling process works for a June year-end organization. The dark shaded zone is the forecast for the next quarter and the most important part to get right. The light shaded zone is the second quarter, which is forecast monthly, and this forecast should be reasonably right. Budget holders will be re-forecasting this period next quarter.

The mid shaded zone is only forecast in quarterly breaks, and budget holders are told not to spend too much time second guessing these quarters. As a guide, budget holders should spend 60 percent of their time on the first quarter because first quarter numbers will become targets, 20 percent on the second quarter and 20 percent on the remaining four quarters.

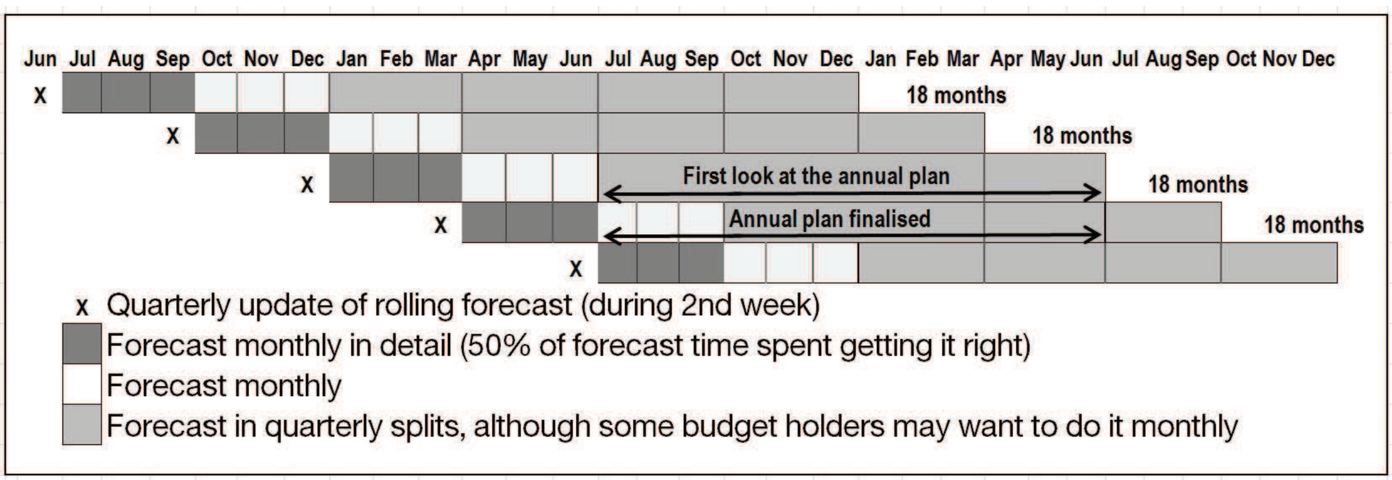

Figure 1: How the rolling forecast works for an organization with a June year-end.

December update

In the second week of December, budget holders forecast to the end of the year, with monthly numbers, and the remaining period in quarterly breaks. They obtain approval to spend January to March numbers subject to their forecast becoming part of the annual plan. At the same time, they forecast next year's numbers for the first time. Budget holders are aware of the expected numbers and the first cut is reasonably close. This is a precursor to the annual plan. This forecast is stored in the planning tool.

March update

In the second week of March, budget holders re-forecast to year-end and the first quarter of next year with monthly numbers, and the remaining period in quarterly breaks. Budget holders obtain approval to spend April to June numbers. The budget holders at the same time revisit the December forecast (the last forecast) of next year's numbers and fine-tune them for the annual plan. Budget holders know that they will not be getting an annual lump sum funding for their annual plan. The number they supply is for guidance only.

The foundation stones of a planning tool implementation process

Just as a house is built on a solid foundation, implementing a planning tool should be built on a firm base of "foundation stones" so the planning tool can reach its potential.

Abandoning processes that do not work

Peter Drucker frequently used the word "abandonment'." I think what he said about abandonment is one of the top ten gifts he gave the world. He said:

"The first step in a growth policy is not to decide where and how to grow. It is to decide what to abandon. In order to grow, a business must have a systematic policy to get rid of the outgrown, the obsolete, and the unproductive."[2]