



*cutting through complexity*

# Being the best: Inside the *intelligent* finance function

Reliable forecasting – Expect the  
unexpected



## 3.

# Reliable forecasting — Expect the unexpected

“ The key to reliable forecasting is to consider it a business process, rather than a purely financial reporting exercise. ”

From stock market incidents to *force majeure*, from customer complaints to viral consumer trends — in today's globalized, data-rich and connected world, traditional annual business plans and periodic forecasts are not enough. Organizations need a more reliable, relevant forecasting approach that is flexible, multifaceted and aligned to the changing needs of the business — an approach that can contend with the full array of possible scenarios and offer sensitivity analyses on the latest developments affecting the business today.

Executive teams typically start to plan for the next financial year anywhere from six to nine months in advance. When the budget is signed off, the assumptions no longer relate to the external environment. Huge efforts are expended to produce the plan, but it is often out of date before the relevant period even begins.

Reliable forecasting goes well beyond such traditional business planning. High-performing companies employ sophisticated business analytic tools and techniques to continuously improve their forecasts, predict and manage risk, and reveal new market opportunities. With reliable forecasting, companies can understand future scenarios, apply insights, and develop suitable strategies for response. By sharpening their focus on analyzing data, forecasting trends and supporting business decisions that improve performance, finance teams can become more forward-looking, value-adding partners to the business.

In our 2013 survey of senior finance executives, most finance functions are still more focused on their traditional scorekeeper role. That may be set to change in step with the demands of an ever faster-moving business environment. The majority of respondents expect that in the next two years, their finance teams will devote much more effort to “decision support” activities and less to “transaction processing” — and the highest-performing respondents are more likely to have specific plans in place to invest in their finance functions to enable this change.

## Enabling business alignment and longer-term views

“ Having a common KPI dashboard in place promotes alignment between business units, improving understanding of movements in all their markets and allowing them to synchronize business decisions to support the company's strategic goals. ”

The key to reliable forecasting is to consider it a business process, rather than a purely financial reporting exercise. As an interpretation of future business performance, the financial forecast needs to align the operational forecast to the key business drivers. Setting the business assumptions that drive the forecast early in the planning process and aligning them to the financial outcomes can avoid the lengthy process of reworking these assumptions later on. For this reason, a forecasting process is most effective when these assumptions and the forecast are owned by the business itself. Finance teams support the planning process as trusted business partners.

For the same reasons, forecasting targets should be owned by the business units that are accountable for delivering them. Managers should be rewarded for highlighting risks and opportunities early, reflecting them in the latest forecast views and applying improvement initiatives to drive better performance.

Business units should be accountable for delivering on their targets and for their forecasting accuracy. Accuracy can be improved by not only comparing forecasts to actual results but also by comparing them to previous forecasts. Business performance and forecasting accuracy should be continuously monitored and rewarded, using a balanced business scorecard approach.

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Input assumptions should encompass the value drivers that are most important for achieving business objectives. Those assumptions should align with the company's performance management reporting to ensure that the finance team reports and plans on the same areas that drive business value. Relevant external factors should be included to enable a strategic view of current markets and how they might move. Data analytics techniques (see sidebar) can enrich this process by integrating far-flung and disparate sets of data into the forecasting process and helping to set realistic targets.

Making the shift from traditional to reliable forecasting techniques requires a strong show of support from the company's senior management. Embedding responsibility for setting targets within business units requires an organization-wide change in mindset. To promote organizationally aligned forecasting practices and closer cooperation between business units and the finance function, a strong tone from the top is critical.

## Improving transparency and alignment across business units

Company-wide 'business cockpits' have emerged as a leading practice for tracking forecast accuracy and other performance metrics. A business cockpit provides a real-time display for all key business value drivers that can be shared across the global finance function and all business units. Having a common KPI dashboard in place promotes alignment between business units, improving understanding of movements in all their markets and allowing them to synchronize business decisions to support the company's strategic goals.

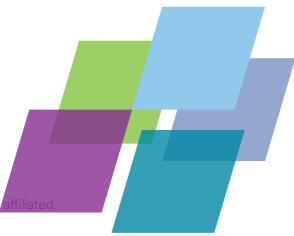
For example, a business cockpit can allow the company to anticipate when some products or markets are under- or over-performing and provide substance to investment/divestment decisions to reallocate valuable organizational resources. Consumer goods companies can use this information to improve specific product offerings in response to changes in consumer behavior and demand. Similarly, banks and financial service companies facing high regulation and capital requirements can promote better decision-making on developing new sources of revenue, and provide transparency on key risks to help enhance their efficiency in terms of liquidity and capital requirements.

Businesses in all sectors can ensure that new investments are closely linked to the organization's core purpose, avoiding investments in markets or assets that may produce short-term balance sheet improvements but are not sustainable in the long term. In short, greater transparency and more forward thinking can reduce risk and help organizations know where to invest or divest in order to help obtain maximum shareholder return at all times.

## What are business analytics?

By some estimates, the information now circulating the Internet amounts to more than a zettabyte — 1,000,000,000,000,000,000 bytes. Most analysts suggest that this quantity will increase by about 40 percent every year for the foreseeable future. Within this expanse of data, finance teams can mine a rich vein of intelligence from both traditional sources, like customer databases and analyst reports, and a wide range of new sources, like Twitter, Facebook, call center activity, wireless networks and even satellites and surveillance cameras.

Business analytics are techniques that make sense of all this data and put that knowledge to work in business planning, budgeting and forecasting. The outcomes have predictive power well beyond conventional forecasting techniques that are based on historical, static financial reports. Business analytics enable 'living forecasts' that give real-time insights into where the company should focus its efforts and invest its money so it can catch up in areas where it is lagging and spot opportunities as they emerge. Business analytics can also help companies simulate a wide range of responses to potential occurrences, from everyday market movements to extraordinary 'black swan' events.





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## Raising the bar

To derive optimal value from the forecasting process, finance teams need to go beyond their traditional range of competencies, for example, by investing in areas such as data engineering and statistics. Companies need to raise the bar for their existing finance resources, by training or hiring staff who are equipped to drive valuable insights from available data and to do so at a speed that effectively responds to the needs of the business. Finance teams also need to communicate that they are providing these outputs in their roles as trusted business partners who help develop and/or challenge strategic business decisions.

## Enabling reliable forecasting — are finance functions on track?

To achieve an optimal forecasting process, global finance leadership teams need to create and implement a comprehensive information and business process strategy that drives and delivers efficiencies across the organization. Are companies prepared to make the investment needed to implement more innovative and reliable forecasting processes and tools?

Based on KPMG's 2013 survey of global finance executives, it seems that many of the companies that we consider high performers (those with more than 10% growth in revenue and EBITDA in the past three years) are on track.

- Over half of these respondents (53 percent) plan to increase their budgets/investments in their finance function in the next two years.
- Thirty-seven percent of high performers plan to invest in decision support tools, and 33 percent plan to invest in decision support capabilities, skills and methods.
- Deployment or expansion of finance expertise is on the agenda for 43 percent of the high performers.

Respondents outside the high-performing group are somewhat less likely to be planning these investments.

Experience tells us that companies need to first get the basics of transaction processing and financial reporting right before their finance teams can transform into high-value business intelligence providers. In fact, in the eight years since we began conducting structured research into the latest trends and developments in the finance domain, we have noted that the improvement of planning, budgeting and forecasting (PBF) methods and tools has been one of CFOs' top three priorities. But somehow this recognition has not led to the expected improvements in this strategic finance area.

Presumably, the reason is that PBF tools simply were not up to the job and lacked integration with the underlying ledgers and ERP tools. Also, as the planning and budgeting cycle is typically done only once a year, and completed just before the year-end, there is often simply no time left to improve the manual PBF processes as the focus shifts to the year-end close and annual report production in the first quarter.

Nevertheless, many high-performing companies have made significant strides in improving efficiency and standardizing technology, processes and data for their ongoing PBF cycle. As a result, they already have in place much of the infrastructure they need to tap modern business analytic models and techniques and evolve their forecasting practices.

Companies that lag behind in process and technology improvements likely will follow suit, but the change will be more revolutionary. Even though, as noted, most finance functions are poised to increase their focus on business support, many of them will struggle with this transition and be challenged to catch up. In light of the tremendous cost savings and potential for market growth and competitive advantage that the revolution will deliver, finance teams can make a compelling case for investing in finance function transformation and enhancing their reliable forecasting capacity.

**In which of these areas does your organization plan to make increased, tangible investments in the next two years?**

**All respondents**

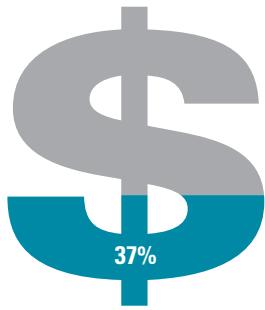


Decision support tools



Decision support capabilities,  
skills and methods

**High performers**



Decision support tools



Decision support capabilities,  
skills and methods

Source: KPMG International CFO survey 2013



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