



Navigating disruptors in financial planning and analysis

March 2021



COVID-19, declared a pandemic by the World Health Organization in March 2020, has disrupted the global economy and financial markets, presenting unique budgeting challenges to Financial Planning and Analysis (FP&A) teams. FP&A teams are challenged to adapt to the fast-changing macroeconomic climate to properly measure the impacts of budgeting due to COVID-19.



Current state of budgeting and forecasting

The current state of the FP&A budgeting process is lengthy and difficult to generate a single view of the future. Forecasting typically is an informal speculation on how companies believe their business will evolve with various levels of review and sign-off before the budget is formally approved. Business unit managers typically have different views and expectations for the budgeting and forecasting processes. Therefore, we see companies struggle with budget adjustments when responding to sudden and dramatic changes to the macroeconomic climate, such as COVID-19 and tax changes.

This pattern has been exasperated within the retail sector as retailers are facing disruptions in the global supply chain, mandatory closure of nonessential businesses, operational cost increases, and decline in demand as consumers are more reluctant to spend disposable income due to COVID-19.



Budgeting and forecasting practices

FP&A teams are encouraged to formally develop concrete macroeconomic considerations and business scenarios in the forecasting and budgeting process. One suggestion is that teams should adopt a single budget with supplemental concrete alternative business plan considerations based on plausible future scenarios (e.g., dramatic change in short-term demand, etc.). This scenario planning process challenges companies to identify a handful of events that would trigger a shift from the primary scenario to an alternative scenario.

Zero-based budgeting encourages teams to start the process wholly from scratch, assuming different end points. Operating and capital expenditures are then prioritized, according to their alignment with the revised strategy and business model. Breaking down the budget into discrete funding decisions makes it easier to choose among competing claims on scarce resources. Leading practices of zero-based budgeting include the prioritization of costs and capital expenditures into funding channels, while ensuring they remain aligned with strategic goals. Zero-based budgeting is recommended only for areas with the highest potential savings, given the level of time and resources required.

Most companies prepare informal earnings forecasts on a monthly or quarterly basis. However, given the disruption in the market from COVID-19, leading companies have adopted practices such as compiling rolling 12- to 18-month forecasts, for the most important financial variables. This formalized approach increases the visibility of the process, so CFOs can act when forecasts start to diverge from actual performance.

This structured process can become a big cultural change for companies that are not accustomed to this kind of collaboration on their budgets. Specifically, managers are held accountable for their promises, and must collectively adapt to the fast-changing macroeconomic climate.

Due to the extreme uncertainty of COVID-19, many companies have set aside their annual budgeting process, and switched to a more tactical quarter-by-quarter process. The quarterly budgeting approach allows companies to allocate their resources in real time, to make better forecasts, and to review their performance at the end of each quarter. This approach allows companies to address problems more quickly.

However, in the long run, quarterly budgeting can stunt growth by overemphasizing the short term. CFOs and companies are recommended to return to long-term annual budgeting, as soon as the company starts to stabilize.



Other considerations

The pandemic has caused companies to monitor and review key performance indicators (KPIs) in greater detail, due to the rapidly changing business environments. Today's focus on cash and risk management requires a reevaluation of metrics relevant to the quality, liquidity, and returns of assets. Executives are encouraged to constantly assess the quality and health of KPIs in order to identify any deterioration.

Many companies do not provide the correct employee incentives within the budgeting process to achieve a dynamic and realistic budget. Companies are encouraged to structure incentives using relative targets, such as: market share, cost metrics, or health indicators, excluding uncontrollable variables. Such targets are relatively insensitive to macroeconomic conditions and thus motivate managers to continue to build the business, regardless of the macroeconomic factors.

The time the budget process consumes must decrease dramatically. Many companies budgeting process begins in September and ends in February or March. Companies can speed up the pace of budgeting only if they can substantially increase the amount of top-down guidance from the CFO, synthesizing tracked KPIs, and eliminating formal bureaucracy.

Companies that have found success in accelerating the budgeting process have conducted negotiations between top managers and the divisions during the first iteration and allowed the divisions to manage the budget's implementation from the front line.

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Business unit managers in many companies believe that deep specifics reflect greater accuracy. At the level of individual units, it is hard to disprove that idea. However, business unit leaders also tend to produce a conservative budget so that they can meet or exceed expectations. The resulting company-wide numbers can be inaccurate when unit level numbers are aggregated; which negates the time spent developing specific budget insights. In many cases less data can be more meaningful data if executives restrict the projections of business units to top-line estimates and/or key KPIs.

We understand choosing an adviser that has the technical skills and practical experience to provide sound and objective advice is of utmost importance during these volatile times. KPMG's professionals have experience in dealing with the challenges faced by market participants in such volatile times and can help you think through complex valuation topics.

KPMG is here to help

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