



## **Next-generation forecasting:** Performance management and rolling forecasts

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## Abstract

Faster, more accurate forecasting is essential in today's business environment, where new profit opportunities emerge quickly and require rapid, strategic decision making. Rolling forecasting – supported by performance management applications such as IBM Cognos® TM1 – can provide the kind of on-demand information and instant recalculations you need to react to changing market conditions.

## Overview

*The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails.*  
– William Arthur Ward

Traditional businesses operate on an annual budget and forecast. This course of action may have been adequate in slower business climates, but is no longer effective today. The impact of a global economy – with local factors creating ripple effects into corporate headquarters – and the impact of 24/7 business operations have created an environment of constant change.

This constant change – regardless of industry – is felt most sharply in the office of the CFO and the finance department. While decisions on business strategy, product positioning, hours of operations, and product line enhancements may be made outside of the purview of finance, those decisions should be made considering the key data finance provides. And, in conjunction, finance needs to consider the impacts of those changes to the business model.

Moving from the concept of annual financial activities into a more dynamic environment, companies are increasingly adopting the rolling forecast. Most often, rolling forecasts are updated on a quarterly basis, facilitating more rapid reaction, realignment, and readiness throughout the organization. Companies relying on rolling forecasts are those that adjust the sails, factoring in all the information on hand strength and direction of wind, size, shape, and weight of the boat, distance to port, and required speed to get there.

## Business problems

### Rolling forecast: Elements and tools

The fundamentals of forecasting are the same: using empirical and financial data to anticipate and plan for the future performance of the business. The problem with an annual forecast is that it cannot anticipate change factors in the business environment such as inflation and deflation, market growth, fluctuations in exchange rates, and the like – essentially, it just doesn't provide enough time to right a listing ship.

Instead, a rolling forecast not only anticipates the swells and troughs of business, but also does so rapidly – allowing for the corrections needed and positioning the company for long-term strategic planning.

Most companies use spreadsheets for financial analysis, management, and reporting. But the difficulties are manifold: problems of version control, lack of security, the inability to collaborate, and the mess created by hundreds of linked spreadsheets. Furthermore, as organizations drive accountability down to line-of-business managers, they are requiring non-finance personnel – who may not be as comfortable with spreadsheets as finance people – to participate in the budgeting and forecasting process. All of these factors drive organizations to move from standalone spreadsheets to performance management applications.

Most performance management applications today offer spreadsheet- or spreadsheet-like front ends for financial activities. As transparency and accountability drive greater participation in planning activities, leading performance management vendors offer customers an assortment of interfaces for planning and budgeting. The most sophisticated allow users to select the interface – spreadsheet, Web-based, dashboards, or scorecards, ensuring ease of use for all the end users.

*“Adaptive organizations focus less on annual budgets or long-term views and more on rolling views—usually rolling forecasts that always look twelve to eighteen months ahead. Rolling forecasts, if well prepared, form the backbone of a new and much more useful information system that connects all the pieces of the organization. In effect they are the aggregate of business as usual forecasts (extrapolations of existing trends), all the action plans in progress, and all plans in the pipeline.”*

*– Jeremy Hope, Reinventing the CFO*

While rolling forecasts fundamentally are about anticipation and reaction, they are also about control: Accurate action and reaction requires accuracy in the underlying data. The best way to ensure the accuracy of data is to rely on a performance management application to be the clearing house for data, the “single source of the truth.”

Unlike the Herculean efforts required to gather data and input it into spreadsheets, performance management applications can easily import data from a number of core systems – general ledger, enterprise resource planning (ERP), spreadsheets themselves, and corporate databases – presenting all the data in one place, regardless of the size of the data or frequency with which the data changes. With this capability, you indicate how data should be mapped to your planning solution and then schedule the information import – either in real time or “right time” (such as daily or twice a day) so that you always have the latest intelligence at the push of a button.

Once this information is located in the same application – the performance management application – you have the tools to start complex analysis. One key to forecasting is to understand your cost allocations. Performance management applications reflect your business model and allow you to create rules to automate the allocations, no matter how complex.<sup>1</sup>

You gain visibility into expenses and profitability by division, product line, even employee. The powerful information residing in the application can be used to generate cash flow statements – for immediate visibility into cash needs – and a balance sheet without any time-consuming reloading of data.

Performance management applications bring a great deal of accuracy, reliability, and auditability to any activity – but especially to rolling forecasting. With a performance management application, much of the updated information is imported automatically, nearly eliminating the need to re-key data, or move data from spreadsheet to spreadsheet. This significantly reduces the risk of error.

Additionally, some performance management applications offer even greater assurances, by delivering cell-level security (ensuring only authorized people can view, manipulate or change specific information) and by providing an automatic audit log of who changed what and when. These features enable executives and managers to “rest well at night,” assured that the information is accurate, secure, and holds up to an audit trail.

Quite simply, what is near impossible to do in linked spreadsheets is simple to do with performance management applications.

Let’s look at a real-world scenario.

#### **Case study: International hotel chain**

An international hospitality company with more than 100 upscale full-service hotels and resorts struggled with financial data collection and analysis. Created through mergers and acquisitions, the international firm had “inherited” three centralized accounting operations and a number of stand-alone property operations. This resulted in collecting data from many different sources, and manually inputting that data into various and redundant reports.

As the company consolidated its financial data and operations on a single performance management platform, it realized the opportunities provided: a performance management application is the perfect foundation for a rolling forecast.

*By changing its business processes, supported by performance management technology, a hotelier can readily adjust its forecasts to reflect the current environment.*

The hospitality industry is notoriously volatile – world security concerns, weather, the health of the economy, and the success (or lack of) of business sectors all impact the rates charged and potential occupancies. An annual forecast simply cannot adjust for changing geopolitics, heavy or light hurricane seasons, or sudden interruptions in business, such as the recent casino closings in New Jersey.

Adding to forecasting complexity is the fact that most resorts are not just hotel rooms – they include restaurants and retail shops. After forecasting occupancy, the company must then look at the other areas of the property and project multiple related costs, including:

- Number of cleaning personnel needed
- Revenue per restaurant
- Staffing per restaurants
- Kinds and quantities of food per restaurant

Similarly, the demographics of a particular property, season, or even guest group, will impact many of those variables.

By changing its business processes, supported by performance management technology, the hotelier can now adjust its forecast to reflect the current environment. Just as trimming the sails of a boat helps to better determine its speed and the time needed to reach port, this hospitality company now has the tools to make adjustments to continue to reach its business goals.

## Business drivers

### Dos and don'ts for rolling forecasting

Rolling forecasts need not be as oppressive and unpleasant as the annual budgeting and forecasting cycle. In fact, if implemented well, a rolling forecast, with a performance management platform that automates and streamlines the process, can be the proverbial well-oiled machine.

Once you've integrated your disparate information systems in a single performance management application to serve up all the complex and detailed data, you are ready to move forward with rolling forecasts.

Here are some Dos and Don'ts, provided by a specialty pharmaceutical company employing innovative strategies for its pharmaceutical products through its internal and financial management. These tips come directly from the CFO and Senior Director for Planning and Decision Support.

- **Do** involve the senior management team early.
- **Do** start with the basics: revenue and P&Ls and major markets or divisions.
- **Do** incorporate driver-based forecasts. They are easier to input and facilitate topdown KPI and goal setting.
- **Do** increase participation. Rolling forecasts facilitate the process and enables greater participation.
- **Do** link accountability to those in control.
- **Do** train system users. Training puts you in front of them and enhances buy-in. Training also serves as a forum to discuss user requirements and agree upon common definitions.
- **Do** make sure there are IT systems in place that can support your implementation and processes. Where possible, you want to pre-populate the forecast to reduce both the time for manual entry and the possibility of errors creeping into the forecast.

- **Do** continually improve your processes to ensure that user- and company needs are being met.
- **Don't** underestimate the significance of the change. Many of your team members, colleagues and executives have decades of experience with the annual process. This pattern, as well as your own business processes, are ingrained in how people work. Studies have shown that when corporate processes are changed, one-third of people will willingly embrace those changes, one-third will resist those changes, and one-third will leave the organization. To avoid this, you need to understand this is a significant change in mind-set. Instead, focus on the value of the activity – reduced effort for the budgeting process.
- **Don't** ask for excessive detail, especially at the initial roll-out. You don't need actuals – you need information for forecasting.

#### **A word on best practices**

Top-performing companies use best-practice processes in planning, budgeting, and forecasting – and the results are evident, according to recent research conducted by IBM and Houston-based American Productivity and Quality Center (APQC), a nonprofit process improvement and benchmarking organization.

For example, reduced planning, budgeting, and forecasting times can lead to improved business results. “Decreased cycle time is naturally associated with decreased process costs. In addition, assumptions about the business environment or market behavior made 90 days before a budget is completed are much more likely to be incorrect than assumptions made only 30 days in advance,” said Lisa Higgins, the COO of Houston-based American Productivity and Quality Center (APQC).

Another result: Companies that produce rolling forecasts complete the budgeting cycle in 60 days. Those who forecast for year-end or quarter-end need 85 days.

*From “Can the Budgeting Competency Gap Be Narrowed?” by Tad Leahy, Business Finance Magazine, February, 2006.*

## The solution

The companies noted above use IBM Cognos TM1 as their solution for financial and operational planning, reporting, and analytics.

They also use the data management/transformation capability, Turbo Integrator, to pull information directly from multiple sources into TM1, meeting the requirements of on-demand information, rapid recalculations, a single, consolidated information source, and transference of a common business model.

## Conclusion

While more strategic decision making and rapid reaction to changing market conditions are good for overall business, a faster and easier forecasting process also makes life much more pleasant for those in the finance department trenches. As one finance executive commented, “Using performance management for budgeting and forecasting means I can leave work at 4pm, instead of 4am.” With forecasting improving both the bottom line for the company and the quality of life for its employees, why wouldn’t you embrace rolling forecasting powered by performance management applications?



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### Endnotes

- 1 Rules allow real-time calculations to be performed on request efficiently and quickly.