



How to Master Business Forecasting

By: Steve Player,
North America Director,
Beyond Budgeting Round Table

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About the Speaker

Steve Player

Director, BBRT North America

Managing Director, The Player Group

- Steve Player serves as the North America Program Director for the Beyond Budgeting Round Table (BBRT) and works with BBRT member companies to implement continuous planning processes.
- He has over 25 years experience with improving performance management and implementing strategic planning processes. He is also the Managing Director of The Player Group, a Dallas, TX-based business consulting firm, and founder of the Activity-Based Management Advanced Implementation Group (ABM AIG).
- He has a new book, “Future Ready: How to Master Business Forecasting” coming out this fall. He is also the co-author/editor of four books on Activity-Based Management and currently writes a monthly “Finance Transformation” feature for Business Finance Magazine for which he interviews CFOs from leading organizations on innovative finance and planning processes.



What is the Beyond Budgeting Round Table?

- A member-based network of organizations focused on improving planning, forecasting and control, and ultimately overall performance
- BBRT helps organizations implement global best practices in planning and control
- Disseminates front-line implementation experience and identifies the keys to success
- Continuously improves adaptive planning and control to increase profits

Selected North America BBRT members

- Adaptive Planning
- Alight Financial Planning
- American Express
- American Century Investments
- Applied Analytix
- Bank of the West
- BayCare Health Systems
- The Carle Foundation
- Charles Schwab & Co.
- Cognos, an IBM Company
- Cook Children's Healthcare
- Cytotec Industries, Inc
- DFW International Airport
- Group Health Cooperative
- Hunterdon Medical Center
- IES
- Kaiser Permanente
- Kansas City Southern
- Lucile Packard Children's Hospital
- MasterCard International
- MD Anderson Cancer Center
- Mutual First Credit Union
- PPL Electric Utilities
- The Palladium Group
- Park Nicollet Health Services
- The Player Group
- Profisee
- Promega Corporation
- RiverLogic, Inc.
- Sun Healthcare Group, Inc.
- The World Bank
- VHA, Inc.

The formula for successful change

$$D \times V \times F > R$$

Where:

D = Dissatisfaction

V = Vision for change

F = Known first steps

R = Resistance to change

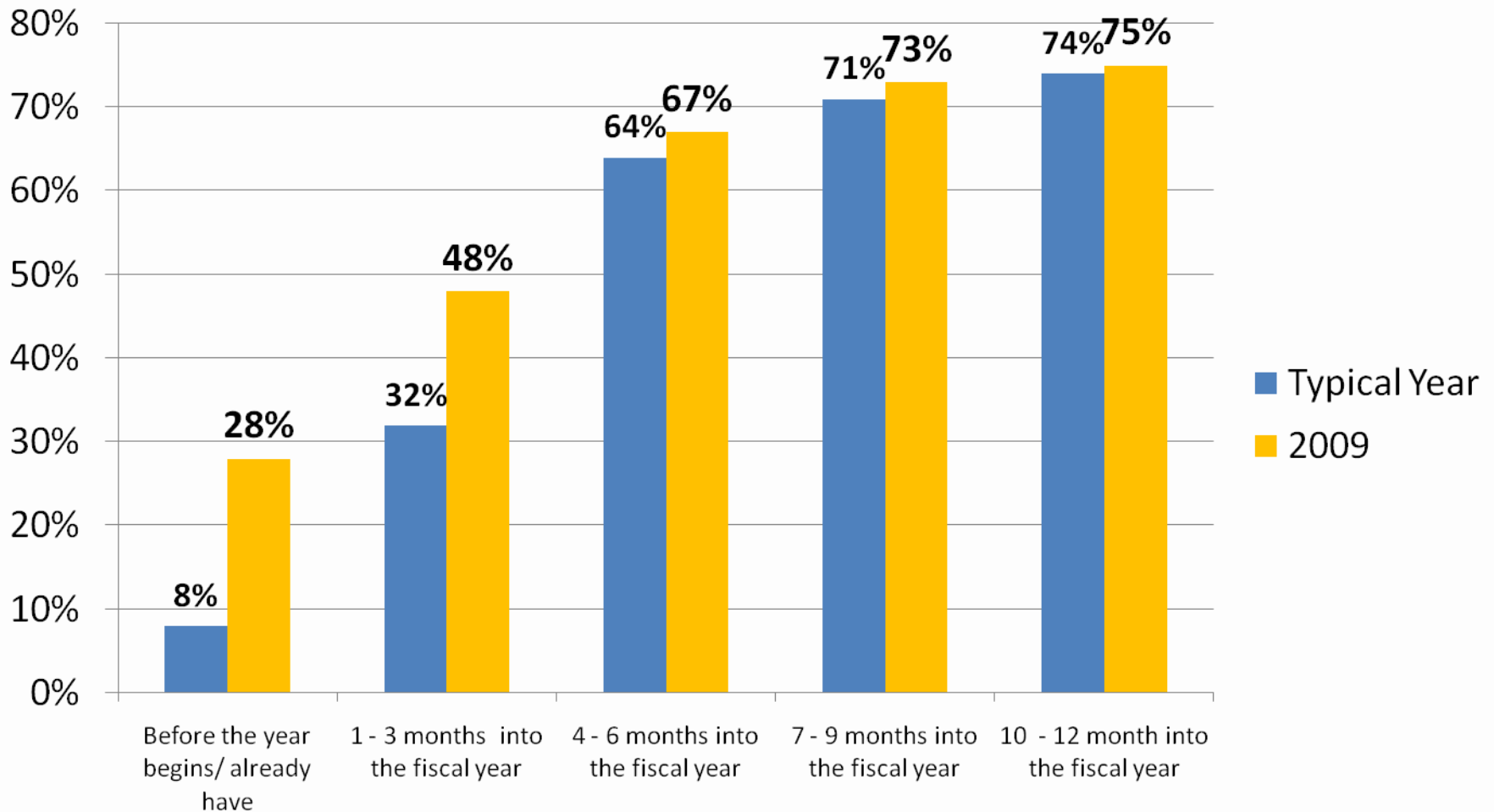
D = Dissatisfaction

Seven Key Problems with Traditional Budgeting

1. Budgets take too long to prepare (often making them out of date when published)
2. Budgets cost too much
3. Budgeting is based on assumptions that are nearly always wrong
4. Budgeting causes gaming that erodes the ethical foundation of the company
5. Budgeting triggers unnecessary spending
6. Budgeting gives the illusion of control by robbing potential
7. In the words of Jack Welch, "It [Budgeting] brings out the most unproductive behaviors in an organization..."(Jack Welch, "Winning," p. 189)

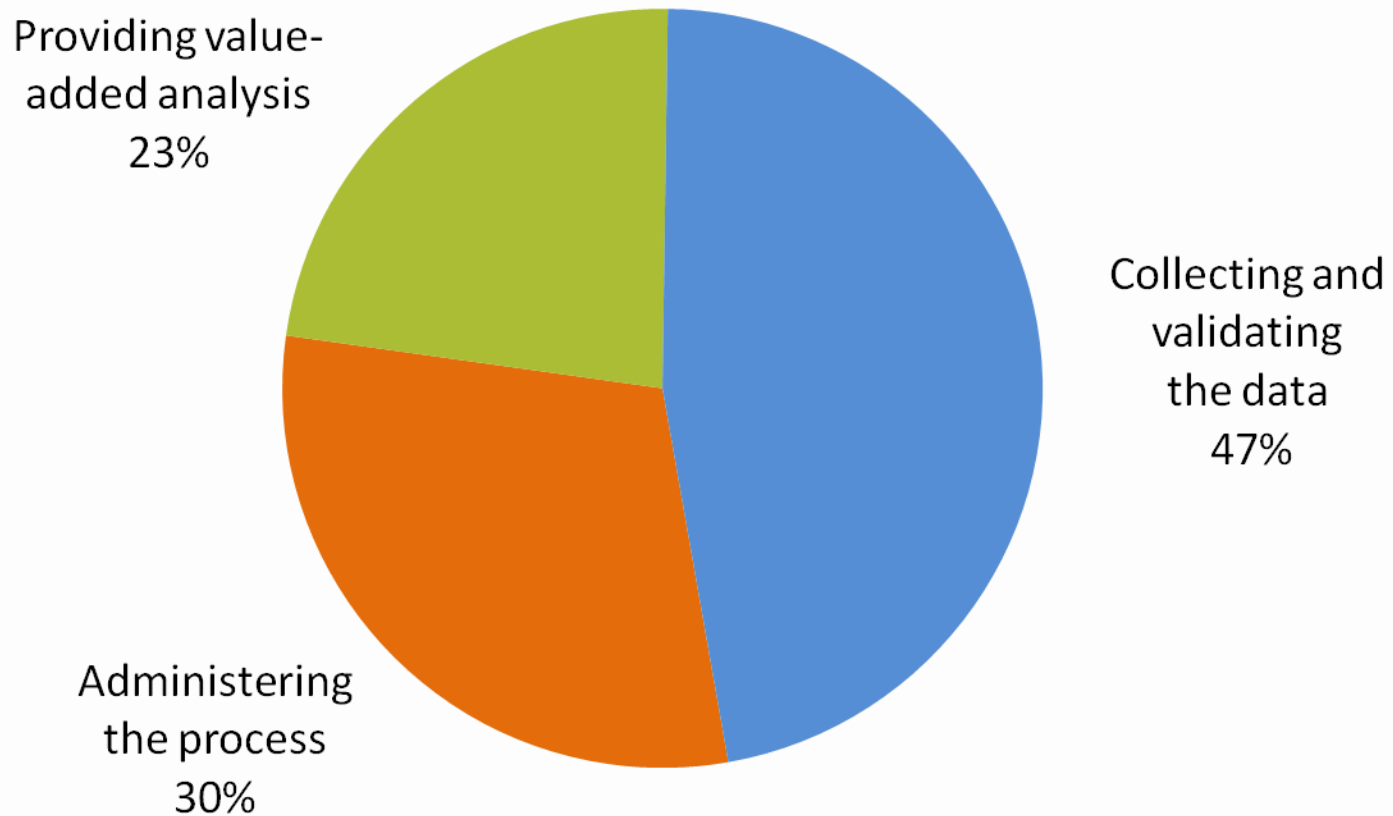
At what point do you expect your annual budget targets to become obsolete?

Budget Target Life Span



Simplify and Eliminate Redundancy

Financial Analyst Time

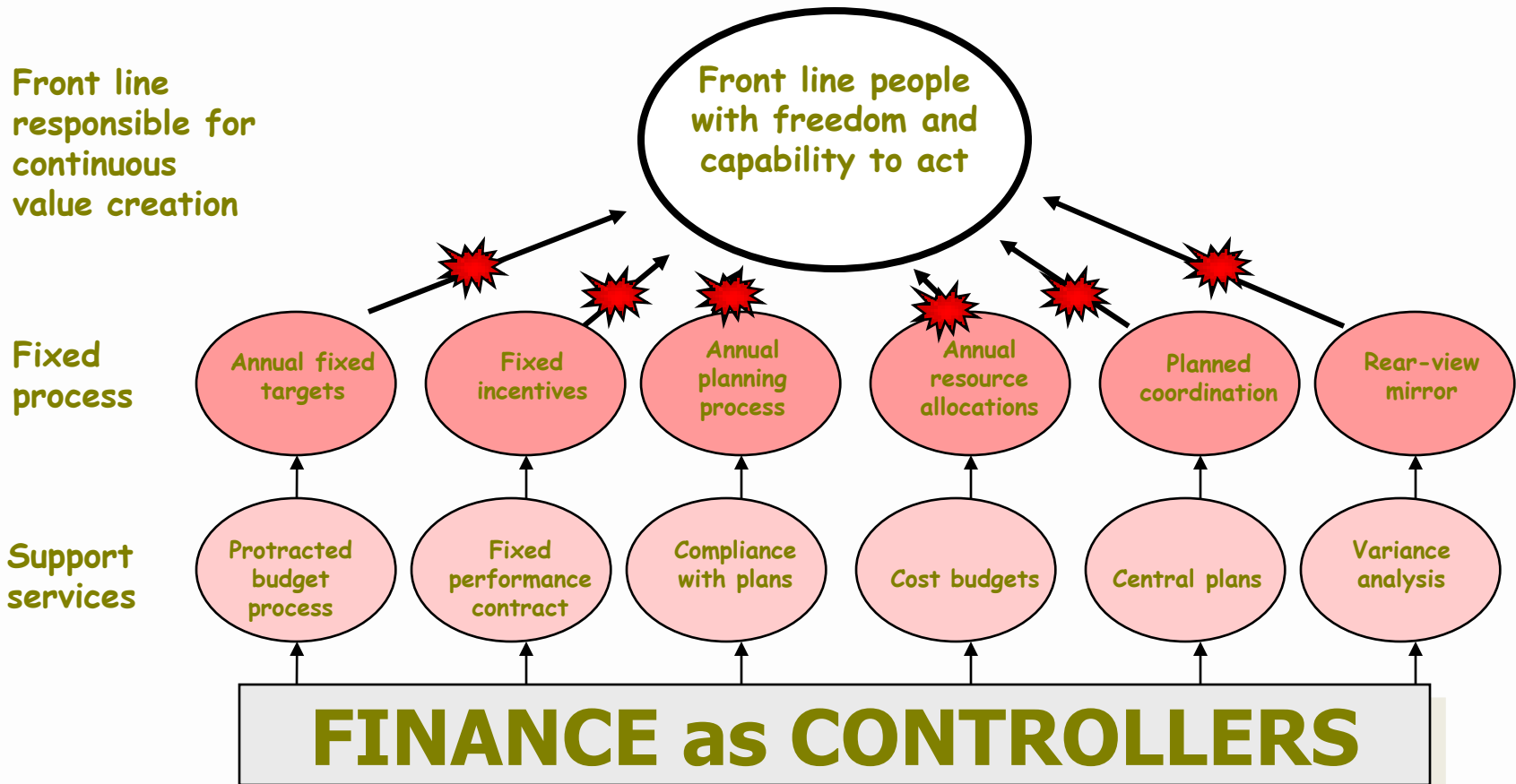


SOURCE: APQC / BBRT Research

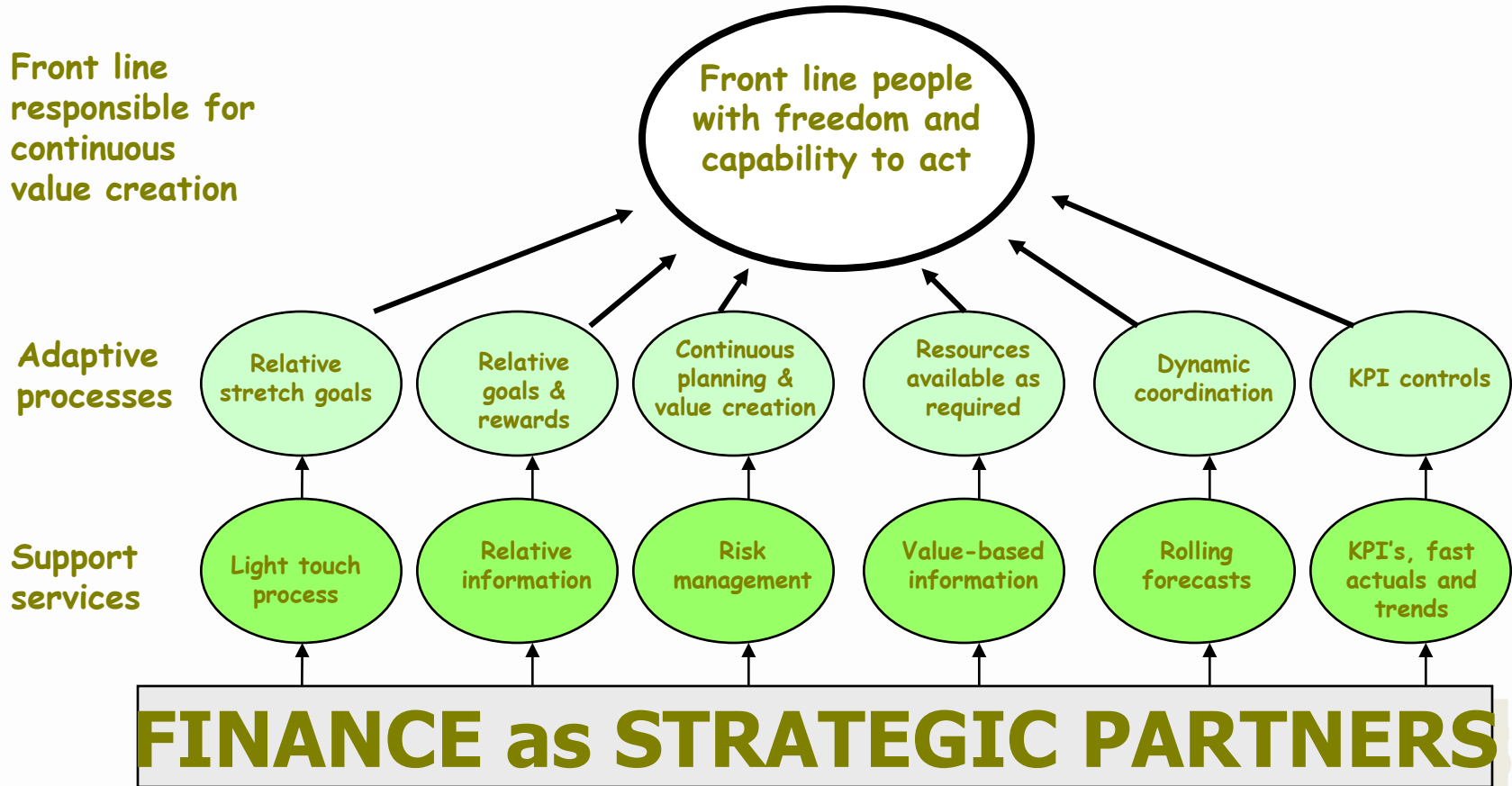
V = Vision

**MAKING THE CHANGE WITH
THE 12 BBRT PRINCIPLES**

How Finance Fails to Support Frontline People



A New Vision for Finance



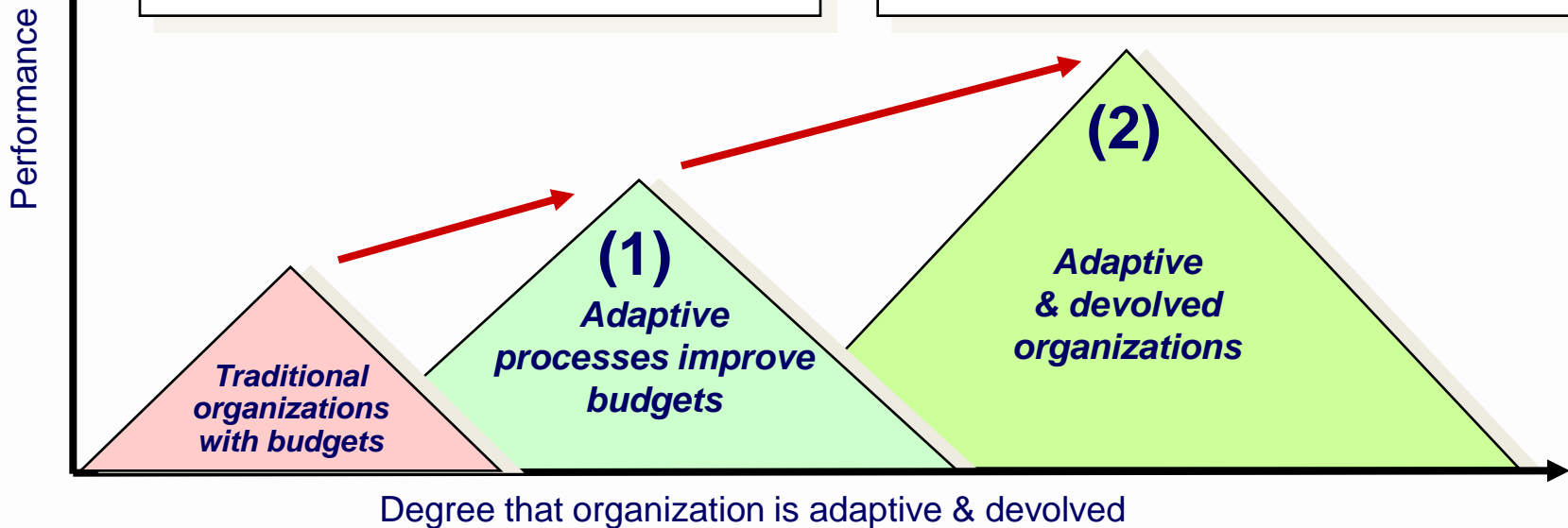
The Twin Visions of “Beyond Budgeting”

(1) THE FINANCE VISION

- **Financial case** - A lighter process, releasing more time for strategic support.
- **Strategic case** - A more adaptive process creating value continuously.
- **Cultural case** – Reduced gaming and behaviour more consistent with goals.
- **Opening the way to ...**

(2) THE LEADERSHIP VISION

- **People** - Personal responsibility culture with more capable and committed people.
- **Customers** - More innovative, lower costs and greater responsiveness.
- **Shareholders** – Sustainable competitive success and more ethical behaviour.



Relative Targets Using League Tables at Handelsbanken

From Fixed Targets

To Relative Targets

Branch to branches

(Cost/Income)

1. Branch C
2. Branch H
3. Branch A
4. Branch D
5. Branch F
6. Branch E
7. Branch J
8. Branch B
9. Branch I
10. Branch G

Region to regions

(RoE)

1. Region D
2. Region J
3. Region I
4. Region B
5. Region E
6. Region F
7. Region C
8. Region H
9. Region G
10. Region A

Bank to banks

(RoE)

- | | | |
|-----|--------|-----|
| 1. | Bank A | 31% |
| 2. | Bank D | 24% |
| 3. | Bank H | 20% |
| 4. | Bank C | 18% |
| 5. | Bank E | 15% |
| 6. | Bank F | 13% |
| 7. | Bank B | 12% |
| 8. | Bank I | 10% |
| 9. | Bank G | 8% |
| 10. | Bank J | 2% |

Comparison To

- Peers
- Competitors
- World Class Benchmarks

Source: Handelsbanken Management System

Use league tables to avoid the pitfalls

Ahlsell: Using Relative Targets with 200 Self-Managed Teams

A Sales Unit

Return on Sales Report

- Sales *100%*

Less

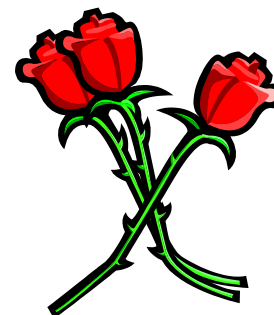
- Direct material
 - Stock losses/obsolete
- = Gross margin

- Rent
 - Staff
 - Bad debts
 - Depreciation
 - Interest on capital
- = Net margin *13%*

All Sales Units

“The Premier League”

(Over 13%)



- *Return on Sales (ROS)*
 - *Growth in profits*

“The Qualifiers League”

(Under 13%)

- *Return on Sales only*

Seven Common Symptoms of Forecasting Illness (Pitfalls to Avoid)

Common Symptom #1

Semantic schizophrenia:

confusion about the aims, purposes and characteristics of good forecasts



Common Symptom #2

Single point tunnel vision:

an unhealthy obsession with a particular forecast number



Common Symptom #3

Delusions of accuracy:

the mistaken assumptions that it is possible to be perfectly accurate and that lower errors are representative of better forecasts



Common Symptom #4

Nervous system breakdown:

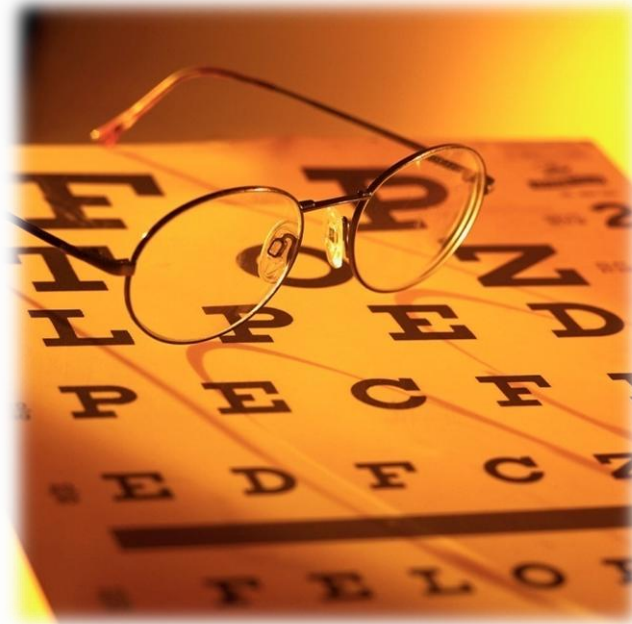
misguided attempt to improve forecasts by going into more detail and analyzing forecasts obsessively



Common Symptom #5

Visual impairment:

the failure to provide enough forward visibility and discern trends in performance



Common Symptom #6

Lack of coordination:

the tendency to generate a proliferation of competing forecasts



Common Symptom #7

Socio-pathological behavior patterns:

the unwitting encouragement of behavioral patterns that are damaging to the forecast process and to the health of the organization as a whole



Do's & Don'ts of Rolling Forecasts

10 common mistakes & best Practices

1. Forecasting to the wall
2. Confusing forecasts with targets
3. Demanding forecast accuracy
4. Relying on Excel spreadsheets
5. Excessive detail
6. Relying on “probability-based forecasting”
7. Immediately assuming a growth forecast
8. Treating forecasting as a “special event” rather than an on-going part of monitoring the business
9. Picking out time horizons for all forecasts with the same interval
10. Failing to learn from your forecast record

Bonus: 5 More Best Practices

1. Track your trends for forecasting over time
2. Constantly identify ways to become more adaptive
3. Understand key drivers
4. Focus on threats and opportunities
5. Engage in scenario playing

Forecast accuracy tools coming from BBRT

- Dissatisfaction with the quality of forecasts is a common complaint, irrespective of the sophistication of the processes used
- One root cause is the inability to measure the quality of the process and so put in place measures to improve performance
- The Forecasters Toolkit provides a set of simple tools based on rigorous statistical methodologies to help users measure, manage and build forecast processes

*EASE OF
USE*



Minimal
instruction
necessary



Hands on
guidance and
instruction
necessary



Formal
training
essential

Forecasting Toolkit

Diagnostic tools to test the health of your process

Single point forecasts

Forecast Bias Indicator

What it does: Gives you a rating of the bias in a set of forecasts.

How it is used: Works out the average forecast with a pre-procedure.

How it might be used: To quickly set a level (compliance Policy).

Forecast Run Indicator

What it does: Gives you a signal for identifying forecast process exhibiting bias.

How it is used: Sets out the next steps to take if the same sign indicative of bias.

How it might be used: As a rule of thumb for identifying the process is good.

Forecast Error Ratio

What it does: Gives you a signal for level of forecast.

How it is used: Sets out the next steps to take if the same sign indicative of bias.

How it might be used: As a rule of thumb for identifying the process is good.

Forecast Quality Indicator

What it does: Gives you an objective rating of the quality of a forecast process.

How it is used: Compares the spread of forecast data with the spread of actual data. The greater the spread of the forecast the poorer the forecast process.

How it might be used: To give a fuller measure of forecast performance. To identify where the forecast process (as opposed to behaviours around forecasts) needs to be improved.

Range forecasts

Range Forecast Error Indicator

What it does: Gives objective guidelines for Range Forecast accuracy.

How it is used: Works out what percentage outcomes should fall within the middle 50% of the range forecast if the Range Forecast is to be considered sound.

How it might be used: To give an early warning of failures in the Range Forecasting process.

Range Forecast Quality Indicator

What it does: Gives you an objective rating of the quality of a Range Forecasting process by taking into account the sample size.

How it is used: Works out the probability of a sample of Range Forecasts being consistent with a process capable of meeting the target rate (90%).

How it might be used: To quickly identify whether the Range Success Rate is acceptable.

Beyond Budgeting™

Tools to help build forecasts

FORCK

Range Forecasting Methodology

What it does: Gives you...

How it does it: Works out...

How might it be used?:

Statistical Forecasting Methodology

What it does: Creates a statistically based forecast - using a robust Excel based methodology.

What does it look like?:

How it does it: Uses Mathematical and Statistical techniques to forecast.

Tools to help you manage your process

FIT

Forecast Bias Performance Guide

What it does: Gives you the ability to target for forecast bias given a desired level of confidence.

How it does it: An Excel tool which takes into account the historic volatility of forecasts and works out the range of acceptable values for use for a set sample size and specified degree of confidence.

How might it be used?: To set realistic and reasonable targets.

Forecast Error Chart

What it does: Gives you a set of ranges (based on historic forecast accuracy) which represent limits within which unbiased forecasts should fall.

How it does it: Based on historic forecast error works out the ranges within which 90% of individuals forecasts should fall if there is no bias.

How might it be used?:

Forecast Credibility Corridor

What it does: Gives you a set of ranges (based on historic trends) within which your forecast should fall - with a defined set of probabilities.

How it does it: Takes a Moving Annual Total and works out typical rates of change for this market/business over different horizons.

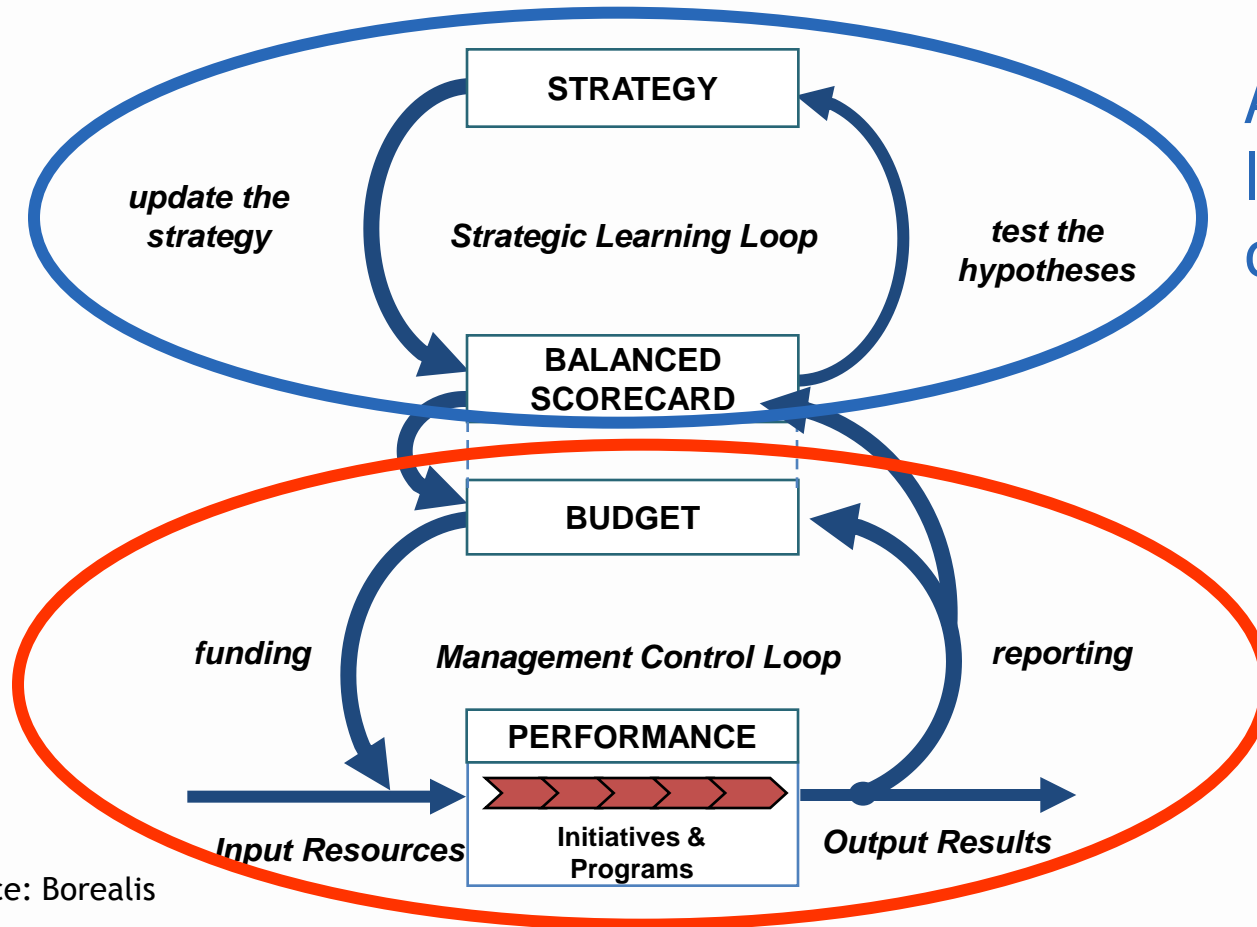
How might it be used?: To test the credibility of forecasts you produce. To test the credibility (and potential bias) of forecasts you receive. To focus attention on the significant elements of forecasts.

Three Case Studies to Illustrate

1. Millipore
2. Southwest Airlines
3. American Express

Role in the Management Process: Example Using Balanced Scorecards

From Fixed Annual Plans

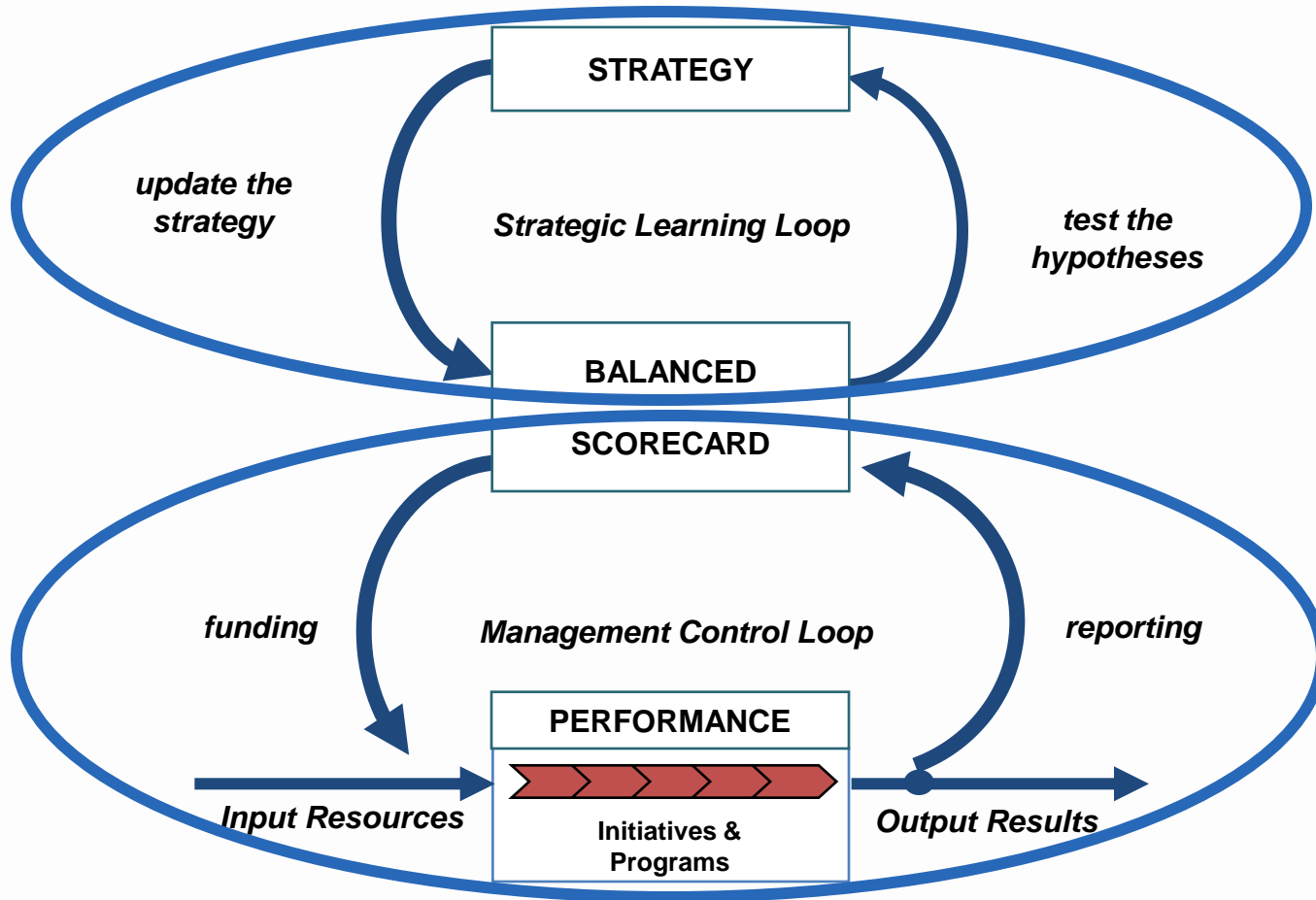


A world of front line freedom & capability to act

A world of top down control & fixed performance contracts

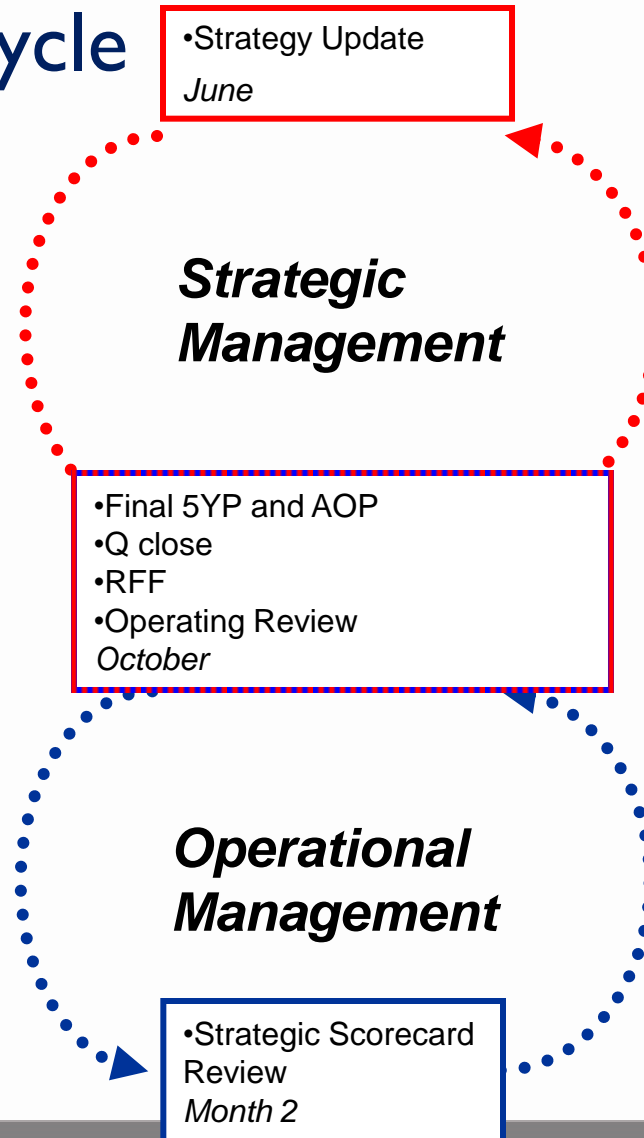
Source: Borealis

To Continuous Planning



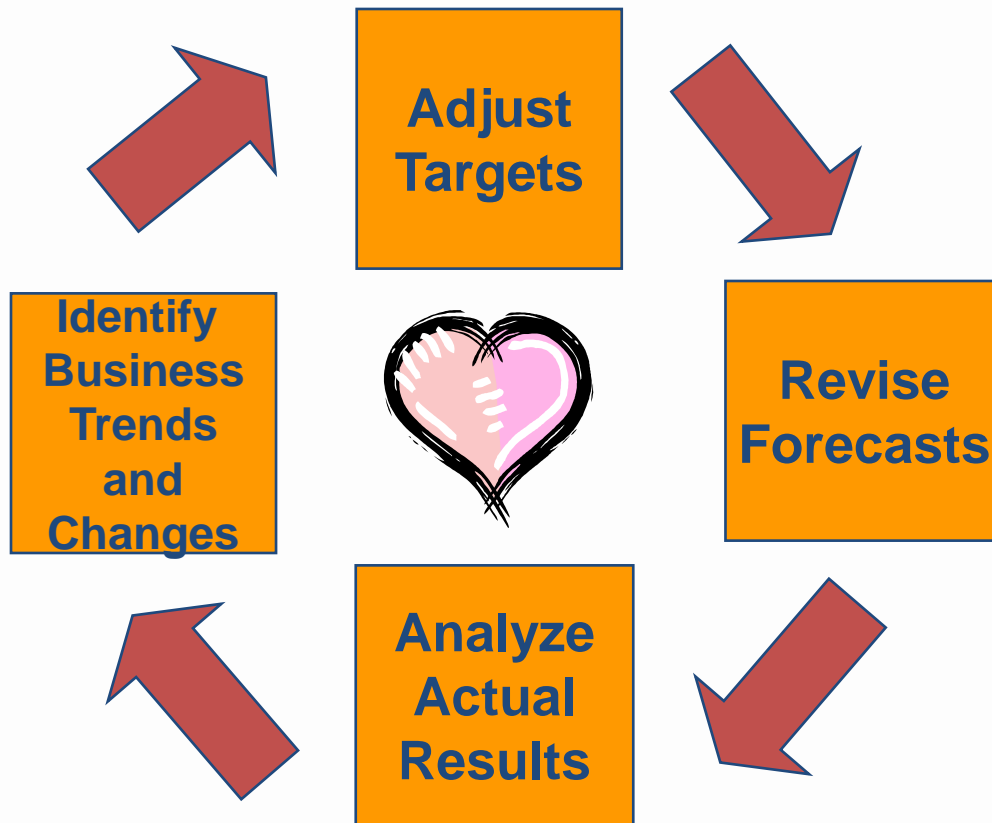
Source: Borealis

I. Millipore Corporation -- Strategy Execution and Planning Cycle



Processes meet in Q4
AOP = RFF October

2. Southwest Airlines



- Align Planning resources around the business
- Establish a “rhythm” to the process
 - Allow flexibility to adjust plans
 - Push for action plans to drive toward targets
- Ensure technology facilitates the process
 - Planning systems enable the process, not the other way around

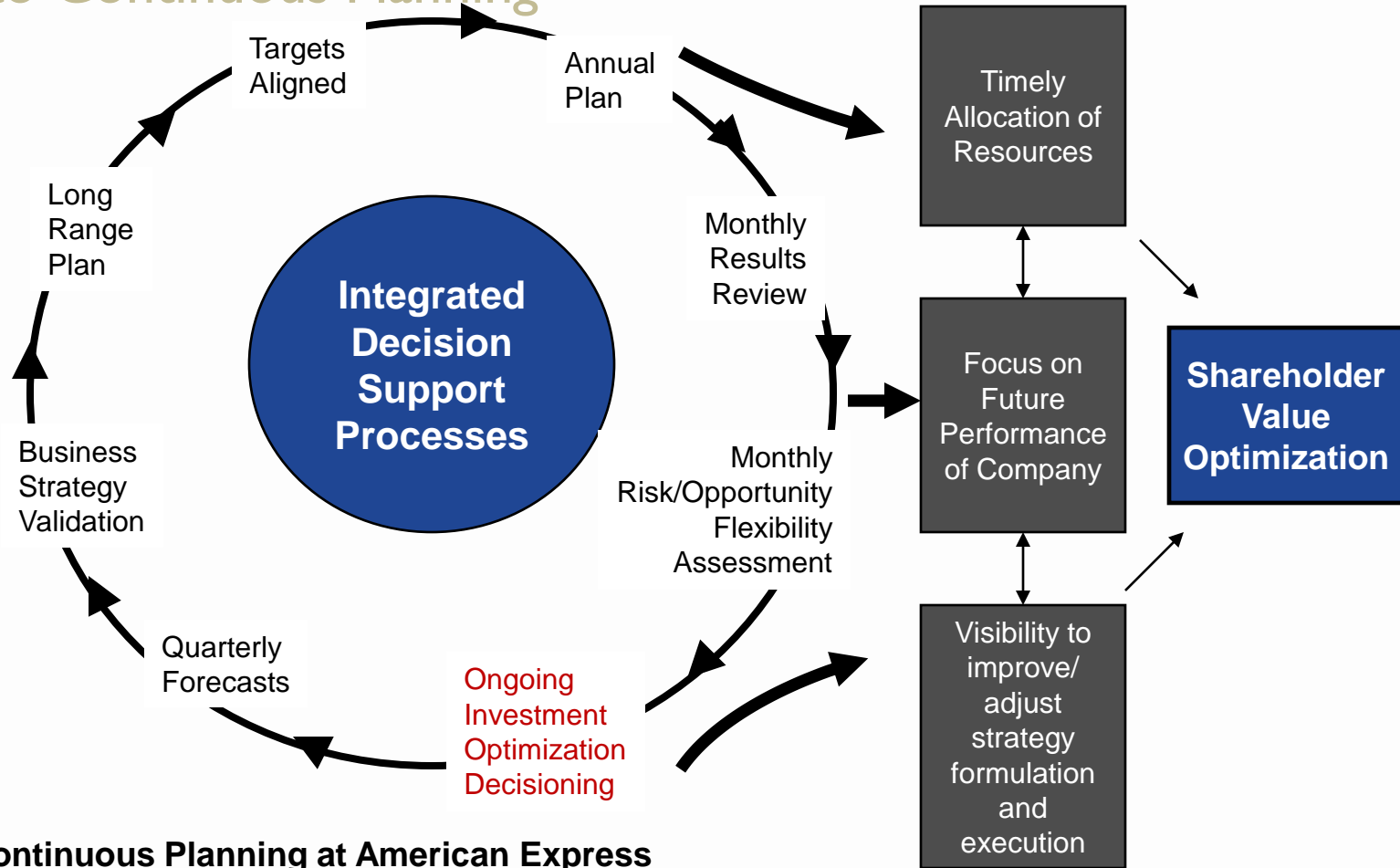
3. Identify Key Business Drivers

American Express:

Transform to Continuous Planning

Enablers:

- Finance/Business Collaboration
- Robust Tools/Technology
- Information
- External Visibility
- Application of Six Sigma Principles



Case Example A: Continuous Planning at American Express

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- Coming Soon! Book on forecasting:
Future Ready: How to Master Business Forecasting
- Contact Director of BBRT Member Services, Tiffany Wolford
 - tiffany@theplayergroup.com
- Attend the 9th Annual BBRT Conference in Dallas on April 21-23, 2010.
www.regonline.com/bbrtconference2010



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