CFO

Let It Roll

WHY MORE COMPANIES ARE ABANDONING BUDGETS IN FAVOR OF ROLLING FORECASTS

BY RUSS BANHAM

>> It is a staple of financial advice, regularly offered by everyone from Suze Orman to your parents: if you want to keep your finances on track, make a budget and stick to it. After all, that's what big companies do, right? >>

Not necessarily. For a growing number of businesses, that pearl of fiscal wisdom has lost its luster. Some companies have abandoned the exercise altogether: Unilever parted with its annual budget in 2010, with no tears. So did Norton Lilly International. Statoil and American Century Investments have scrapped their budgets; others are expected to follow suit.

Meanwhile, other companies continue to execute a budget but, for the most part, manage the business without it. Instead, they use rolling forecasts, flexible budgets, and event-driven planning.

Call it a sign of the times, literally. "It makes no sense to use a 19th-century tool to manage a 21st-century company in a volatile global economy," contends Steve Player, an expert on budgeting and planning and the North American program director at the Beyond Budgeting Roundtable, a shared-learning network. New planning processes, he says, are altering the role of the CFO in remarkable ways. "In the old days, the CFO sat in the back of the ship recording what happened. Now, the CFO stands on the bridge looking forward and adjusting for variables."

Certainly, new ways of budgeting and planning are needed. According to a recent survey of 273 companies by Accenture, only 11% are fully satisfied with their planning capabilities, compared with 17% 2 years ago and 20% 10 years ago. Budgets do provide a level of detail (excruciating detail, some would argue) that can help shape incentive-compensation plans and capital-markets communications, but far too often the end result of what is often an arduous process is simply shelved and forgotten.

That reality was driven home by the recession, which saw many carefully prepared budgets capsized by volatile stock markets, commodity prices, and exchange rates. "More than two-thirds of respondents said their planning accuracy had diminished because of economic volatility," notes Robert Bergstrom, senior manager of Accenture's finance and performance-management practice.

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Indeed, these days a budget is practically past its expiration date the moment the ink dries. "We used to have what we called the annual plan, and we'd spend six months of the previous year putting it together," says Neal Vorchheimer, senior vice president of finance for North America at consumer-products giant Unilever. "As soon as the budget was approved it was out of date. So we decided to do away with it."

Going with the Flow

In lieu of a traditional budget, Unilever now relies on an eight-quarter rolling forecast. The company, whose parent recorded 2010 revenues of $54 billion, forecast demand for all of 2011 and 2012 in January, while keeping in mind the fact that change is constant.

"We're using bottom-up forecasting to come up with the best view of the eight quarters on a rolling basis," says Vorchheimer. "We get inputs from the sales force, supply chain, marketing, and finance that we align with our innovation plan, which is drawn from our conversations with customers. Each month we update that quarter's forecast based on events that have occurred, such as the recent uptick in oil and other commodity prices, and make changes accordingly."

Business units are intimately involved in this process, providing a constant flow of data on sales and expenses. Armed with this information, Vorchheimer says he can "bet the winners," pulling money from one area that is stuck in the mud and giving it to a more fleet-footed unit for product development, advertising, or promotional uses. "You're trying to continually optimize the mix of where you're putting your discretionary investments," he says. "Previously, the business units were committed to this arbitrary annual number in the budget and were of the mind-set that they had to stick to it. Now, every division has a target, and it is our job in finance to continually help them reach it."

Another, much smaller company, Norton Lilly International, has also traded its budget for a rolling forecast. "When we did our last budget [in 2009], we looked back at the end of the year and compared our actual performance versus the forecast, and if there were any lingering questions over the efficacy of the budget, they went away then," says Jim Burton, CFO and chief operating officer of the independent shipping agency, with 2010 revenues of more than $50 million.

Last year Norton Lilly adopted a rolling 12-month forecast of revenues and pretax margin goals—the costs that business units must commit to based on anticipated revenues. While business-unit leaders are still held to an annual margin goal, "every unit has to make a certain margin each quarter, which is then combined at the corporate level," Burton explains. "It is up to them to control their top line and their expenses. Each month they must report to me on their dashboards the assumptions they made about the business, revenue, and costs, and then follow up on related performance—did things play out the way they thought, or has something changed?"

If it looks like a business unit will fall short of the margin goal, its leader is responsible for creating a contingency plan, such as cost-structure changes. "I'm fine with them flying first-class so long as they make the margin," Burton says. "But if the dashboard is lighting up red and it looks like they're not going to, then they'd better fly coach."

No More Sandbagging

Statoil, the large Norwegian oil-and-gas producer, decided to abolish the traditional annual budget in 2005. "We still do what the budget unsuccessfully tried to do for us: target-setting, forecasting, and resource allocation," says Bjarte Bogsnes, vice president of performance-management development.

"We used to try to force these three purposes into one set of budget numbers, which created serious problems. For example, how can you expect an unbiased sales forecast from a sales manager if that number also will become a target? And how can you expect unbiased cost or investment forecasts from the organization if those forecasts also serve as an application for resources, and everybody sandbags?"

Separating the three decisions has enabled the company to set targets that are more ambitious, intelligent, and motivating, says Bogsnes. As a result, the forecasts are less biased, and resource allocation is more dynamic and self-regulating. "The 'bank' is open 12 months a year, not just six weeks in the fall," he says. "By making resource decisions as late as possible instead of in an annual budget, we have better information—not just about project attractiveness but also about our capacity to fund or man new projects."

Encouraged by positive results from abandoning the budget, Statoil recently decided to abolish the calendar year as a planning tool and introduce a business- and event-driven management process in its stead.

At American Century Investments, an asset-management firm with $110 billion of assets under management, annual budgets created undesirable behavior, says CFO Jon Zindel. "People would manage to the budget and spend because it was allocated, or not ask for resources, because they were held to coming in at the budgeted numbers," he explains. "Consequently, if there was a good project to allocate resources to, it would fall through the cracks."

American Century has moved to a quarterly forecast, in which it undertakes a six-quarter forward-looking view of its business at the end of each quarter. "We then determine whether to add new projects or adjust our plans based on discussions of trends in the industry, regulatory changes coming at us, and competitive or economic issues," says Zindel. "Resources are allocated based on actual demand, which is constantly monitored.

"We're a highly adaptive firm now," adds Zindel. "We're no longer making a bunch of assumptions in a budget about what will happen, and then being wrong by some factor."

In Defense of the Budget

Despite the drawbacks of the traditional budget, many companies are not prepared to do without it, even as they adopt rolling forecasts. For them, budgets still serve a purpose. For example, Farbman Group, a full-service commercial real estate organization, has retained its annual budget along with a rolling forecast. The budget is "outdated the minute it's done, but it still keeps people focused on the end game," explains Andy Gutman, CFO and treasurer. "Like the old adage says, you can achieve 80% of your goals if you write them down."

Two years ago, Gutman instituted a 12-month rolling forecast at privately held Farbman Group. Each month he reviews it against the actual numbers reported by the service divisions and each of the properties. "I'm up-to-the-minute on where we are today if some financial crisis were to hit," he says. "For example, if a major tenant were to go out of business, I could tee up management to raise the rates on some leases or squeeze operating expenses in some area. With a traditional one-year budget, losing 10% of revenue in the middle of the year because of a tenant's bankruptcy provides no framework to take action."

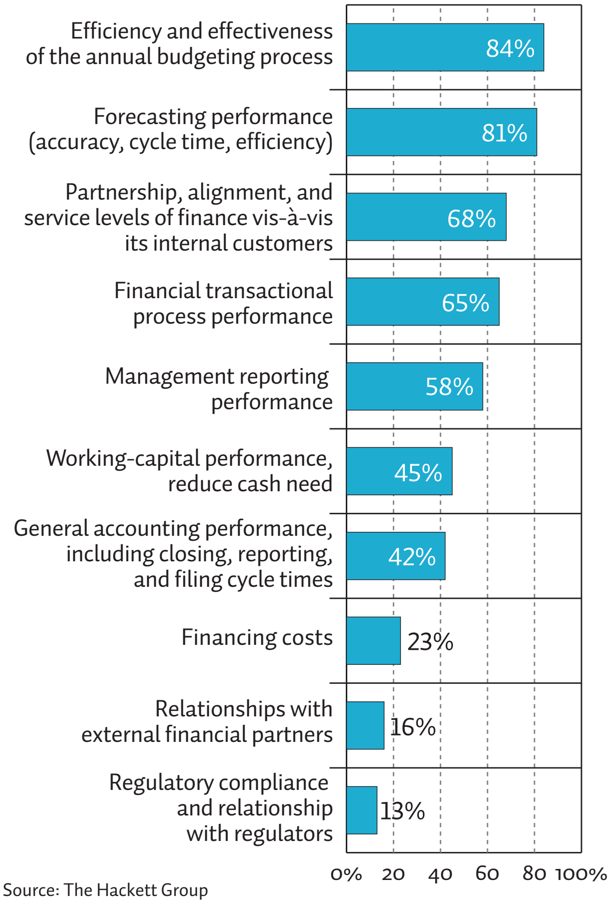
Clements International, a global insurance brokerage, also finds that a traditional budget is too regimented to provide the flexibility needed to make quick decisions. "You lose sight of the fact that the strategic view is never revisited during the year," says CFO Tarun Chopra.

Like Farbman Group, Clements still maintains a budget, which is built from the bottom up with business-unit data, but follows guidelines set at the corporate level. But then, "we do quite a bit of scenario testing, considering things like a commercial contract that may not be renewed in the middle of the year, and then overlay this on the base plan," says Chopra. "Other scenarios might be the success of our acquisition strategy or a government contract we're hoping to get and don't. Even before the year begins, we've thought about these issues and planned for them so that if they happen, we know how to adjust accordingly."

When something affects business at Corning, it, too, has a flexible budget to accommodate the impact. This is a far cry

Top Priorities

More-effective budgeting-and-forecasting abilities are top-of-mind for CFOs this year.



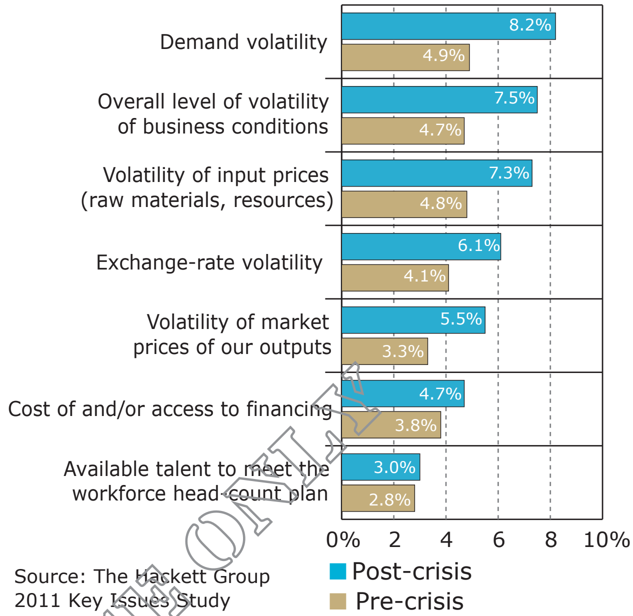
Source: The Hackett Group 2011 Key Issues Study from the days when the 160-year-old maker of specialty glass and ceramics stuck to a traditional budget. "We used to put together a budget and then everyone did everything they could to make sure it was achieved," says Tony Tripeny, senior vice president and corporate controller at Corning, which had revenues of $6.6 billion last year. "Now we realize that a budget isn't what it used to be."

Corning still pulls together a budget, but its significance has waned. "We do rolling forecasts that we update each month to address what we think will happen for the rest of the quarter," Tripeny explains. "Based on this analysis, we will go to the business units and say, 'What are you going to do differently? What actions are you going to take, and how is that different from what we had assumed with the budget?'"

So, why have a detailed budget at all? It has specific benefits, replies Tripeny. As an example, he cites the relationship of a budget to Corning's resolve to be the lowest-cost producer in its markets. "During the budget process, we set up specific objectives, like targets for manufacturing costs," he says. "Even though the business might change during the year, it normally doesn't change enough to alter the manufacturing-performance targets. From a control standpoint, a budget still has value, but it shouldn't guide how you manage the business, which is about perceiving what's ahead and acting on it quicker than the competition."

Coping with Uncertainty

The increase in various forms of economic volatility is driving companies to rethink their approaches to budgeting and planning.



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A New View of the World

Solo Cup Co. also continues to formulate a budget, although its use for operational purposes has been deemphasized. Last year, the privately held manufacturer (annual revenues: $1.5 billion) implemented a new planning process that integrates demand more tightly with supply and inventory. "It gives us a view of the world that goes well beyond budgetary boundaries," says George Chappelle, Solo Cup executive vice president and COO.

Each month the company takes the demand forecast from the previous month and compares it with actual results. If it sells more or less than it had predicted, the company analyzes whether the numbers represent a true increase or are a one-time event. "Based on this analysis, we reforecast the next 18 months and develop a new inventory plan based on the demand, which then drives a new production plan," Chappelle says.

Solo Cup continues to execute a budget to communicate company performance to the board of directors and external constituents, says Chappelle. "But, we don't view the budget as a meaningful way to run the business," he adds.

Bob Bukala, CFO at advertising media company Geomentum, says that one way to flex with a volatile business climate is simply to talk it through. Each Monday, he meets with the division managers of each of the business units to examine the project pipeline and assess which moves are and aren't paying off, and where resource commitments and investments should be made. As he says, "While a budget gives you the end game, which is useful, I manage this business dynamically, every Monday morning, without it." **CFO**

RUSS BANHAM IS A CONTRIBUTING EDITOR OF *CFO.*