

Forecasting with confidence

Insights from leading finance functions

ADVISORY





“

Leading organizations widely acknowledge that forecasting is at the heart of the performance management process, and is potentially a significant driver of business value and investor confidence – a view this research confirms.

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Scott Parker

Head of Financial Management
KPMG International

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Due to rounding, graph totals may not equal 100 percent.

About the research

KPMG International commissioned the Economist Intelligence Unit to write *Forecasting with confidence: Insights from leading finance functions*. The report is based on the following research activities.

- The Economist Intelligence Unit and CFO Research conducted a global survey of 544 senior executives. Thirty-five percent of respondents were based in Europe, 30 percent in the Americas and 29 percent in Asia Pacific. The survey reached a very senior audience; over 30 percent of respondents were CFOs. Fifty-nine percent of respondents were from organizations with over US\$1 billion dollars in annual revenues and respondents were drawn from a cross-section of industries.
- The survey results were segmented and analyzed in various ways to shed light on whether top performing organizations take a different approach to forecasting. In particular, the report analyses responses from organizations with high levels of forecast accuracy (within five percent of actual results over the past three years) compared to those that had a wider margin of error when forecasting over the past three years.

To supplement the survey, the Economist Intelligence Unit conducted a program of interviews with senior executives as well as academics and experts in the field. We are grateful to the following participants for their valuable time and insights:

Professor S.P. Kothari
Billard Professor of Management
MIT Sloan School

Bjarte Bogsnes
Project Manager
Statoil

Jean-Sebastien Couillard
CFO
Toronto-Hydro Corporation

Simon Gibbins
Group Financial Controller
Shire Pharmaceutical

Tom Lewis
Assistant Director, Policy and Technical
Chartered Institute of Public Finance and
Accountancy (CIPFA)

Dr Christian Mielsch
Chief Administrative Officer
Metro Cash and Carry

Richard O'Brien
Co-founder and Partner
Outsights

Steve Roder
CFO of Life Operations – Asia Pacific
AIG

Paul Rogan
Group CFO
Challenger Financial Services

Peter van Rossum
CFO
Unibail Rodamco

Guy Rudolph
Director of Business Planning
Vodafone

Ewen Stewart
Analyst
ABN Amro

Jim Sutcliffe
CEO
Old Mutual

All graphs in this report are sourced from research conducted by the Economist Intelligence Unit 2007.

This report follows on from a previous report written by KPMG in cooperation with the Economist Intelligence Unit, called *Being the best: Insights from leading finance functions*. Copies of *Being the best: Insights from leading finance functions* are available from any of the contacts listed on the back of this report or your local KPMG advisor.

Foreword

As CFOs continue to look for ways to enhance the competitiveness and value of their businesses, they are increasingly turning to performance management processes and information to transform the enterprise and identify opportunities for growth. Although forecasting is traditionally considered a “financial exercise,” leading organizations widely acknowledge that it is at the heart of the performance management process and potentially a significant driver of business value and investor confidence – a view this research confirms.

In an effort to understand how CFOs are using the discipline of forecasting to improve business decision-making and support their effort to provide guidance to external stakeholders, KPMG International commissioned the Economist Intelligence Unit (EIU) to examine how leading organizations enhance the reliability and confidence of forecasts and, as a result, create measurable business value.

Although the majority of respondents regard forecasting as more art than science, the survey shows that those that tackle forecasting as a science are the ones that are getting it right. The survey also found that when conducted rigorously, forecasting can

become a critical management capability enabling the business to drive and sustain long-term value. Success depends largely on the discipline applied to supporting processes; the integrity of financial, operational, and external information; and the support of leadership and organizational culture.

The following results provide insight into how the CFOs of leading organizations use the forecasting process to identify opportunities to drive business improvement, determine growth strategies, and reinforce external stakeholders’ confidence in the business with the transparency, visibility, and integrity of their financial projections.

We encourage you to share this report with your leadership team. We believe it can serve as a road map in two ways: first, as a means of helping businesses identify opportunities to transform their performance management capabilities via the forecasting process; and second, as a source of insight into improving the reliability of forecast information used in communicating with investors and other external stakeholders.

We hope you find this report useful in your efforts and we look forward to discussing it with you.

Scott Parker

Head of Financial Management
KPMG International

Executive summary

All organizations use forecasts to predict and manage their future performance. But although organizations invest significant time and effort in this important task, only one in five currently produce a forecast that is reliable.

This new research report by the Economist Intelligence Unit is based on a global survey of over 540 senior executives involved in the forecasting process from a cross-section of industries, including 168 CFOs.

The research builds on a previous report by KPMG International in cooperation with the Economist Intelligence Unit. In *Being the best: Insights from leading finance functions*, senior finance professionals from a range of global organizations cited planning, budgeting and forecasting as (1) the key area in which CFOs were most dissatisfied with their current capabilities and (2) their top priority for improvement in the next three years. With this in mind, KPMG International has commissioned the EIU to provide insights into some of the latest trends and challenges in this field.

The report's key findings include:

Unreliable forecasts cost organizations money. Over the last three years, only one percent of firms have hit forecast exactly, and just 22 percent have come within five percent either way. On average, forecasts have been out by 13 percent*. Executives in the survey estimate that such errors have directly knocked six percent off their share prices over the same period, a significant part of which resulted from investor reaction.

The impact of poor forecasting has a deeper effect through its impact on strategic and operational choices. Although other factors are undoubtedly at play, firms with forecasts that came within five percent of actual saw

share prices increase by 46 percent over the last three years, compared with 34 percent for others. Clearly, good forecasting pays.

The process needs fixing. Finance executives in the survey point to three main process areas where improvements need to be made to enable more reliable forecasting. The first priority, cited by 42 percent of respondents is the need to use technology to automate the forecasting process. A similar proportion believe scenario planning would be a useful tool to understand future developments that could impact the forecast.

Finally, 40 percent of respondents also believe rolling forecasts would be highly beneficial in improving their performance in this area.

Data used for forecasting are often inaccurate or incomplete. Almost half of surveyed organizations believe the reliability of their financial data is merely adequate or worse; a majority think the same of their non-financial data.

Organizations largely focus on internally generated data at the expense of gathering broader market data: for example, only 40 percent use government economic reports in their forecasting processes. Tellingly, two of the four areas where organizations say they make forecasting errors are consumer demand and economic drivers – both of which could be helped by the use of readily available external data.

*Calculated as the mean absolute deviation from actual results.

Separating the best from the rest

To see how organizations could improve their forecasting, it helps to consider the efforts of those with the best records. In our survey, the most accurate forecasters – those that, over the last three years, had actual results within five percent of forecast – make up 22 percent of the total. They differ from the rest in some important ways.

1 They take forecasting more seriously

The most accurate firms:

- hold managers accountable for agreed forecasts – 87 percent to 76 percent;
- incentivize managers for forecast accuracy – 25 percent to 12 percent;
- use the forecast for ongoing performance management – 53 percent to 46 percent;
- use their forecasts to help with formal earnings guidance – 24 percent to 16 percent.

2 They look to enhance quality beyond the basics

The most accurate firms:

- are more interested in further scenario planning and sensitivity analysis – 51 percent to 41 percent;
- have less need to train further finance staff in forecasting – 11 percent see it as a priority as compared with 21 percent.





3 They leverage information more effectively

The most accurate firms:

- use external market reports and competitive data more often – 68 percent to 55 percent;
- have forecasts done more often by operational managers who are closer to where business takes place – 40 percent to 34 percent;
- give their internal input data a higher rating for reliability, timeliness, relevance and insightfulness.

4 They work harder at it

The most accurate firms:

- update forecasts more frequently – 58 percent do so monthly or more often compared with 44 percent of others;
- are more likely to review the figures formally – 74 percent to 64 percent;
- forecast key balance sheet indicators more – 83 percent to 78 percent;
- make greater use in the forecasting process of software more advanced than spreadsheets, such as ERP systems – 48 percent to 37 percent – off-the-shelf forecasting/planning tools – 47 percent to 34 percent – and bespoke tools – 34 percent to 20 percent.

5 They benefit their shareholders

The most accurate firms:

- attribute lower declines in share price directly to forecasting over the last three years – four percent to seven percent;
- saw shares rise faster over the same time period – 46 percent to 34 percent.

Information technology is too often a hindrance rather than a help. Over one-third of respondents considered the technology their organizations currently use for forecasting to be a notable impediment.

Nearly all organizations still use spreadsheets for some parts of the process; more worryingly, however, 40 percent of them rely solely on spreadsheets to produce the forecast. It is possible to produce a reliable forecast using these basic tools, but the survey shows that organizations with the most accurate forecasts are more likely to use more advanced software to do the job. That said, experts interviewed for the report agree that good technology won't help if the input data is poor or processes are unreliable.

Forecasting should not be the preserve of finance. It is a mistake to think of forecasting as a discipline that should be left to the finance department. Certainly financial professionals have a leading role to play, but it is essential to give the operational managers that drive performance greater ownership and

responsibility for key parts of the forecasting process. The most accurate forecasters in the survey are already more likely to do this. But there remains 39 percent of companies that do not assign any responsibilities to their business managers for this task.

Leaders demand honest forecasting.

The survey suggests that companies are much more likely to outperform rather than underperform their predictions. This suggests that managers, consciously or unconsciously, are being too conservative in their estimates.

The possible reasons run from natural human caution to “sandbagging” to protect bonuses. While outperforming the forecast may not sound like a problem, it means that important decisions such as resourcing and investment choices are being made on the basis of inaccurate or incomplete information. To make better strategic decisions, senior executives need to instill a culture where reliable forecasting is encouraged and rewarded.

These findings are strongly reinforced by the interviews and case studies that the Economist Intelligence Unit conducted with senior executives, academics and experts on the topic of forecasting. What emerges clearly is that high-performing companies usually take the forecasting process very seriously. Armed with better quality, forward-looking information, executives at these organizations are able to make better decisions about the future direction of their business.

Written by the Economist Intelligence Unit



Section I

Forecasts are inaccurate. Does it matter?

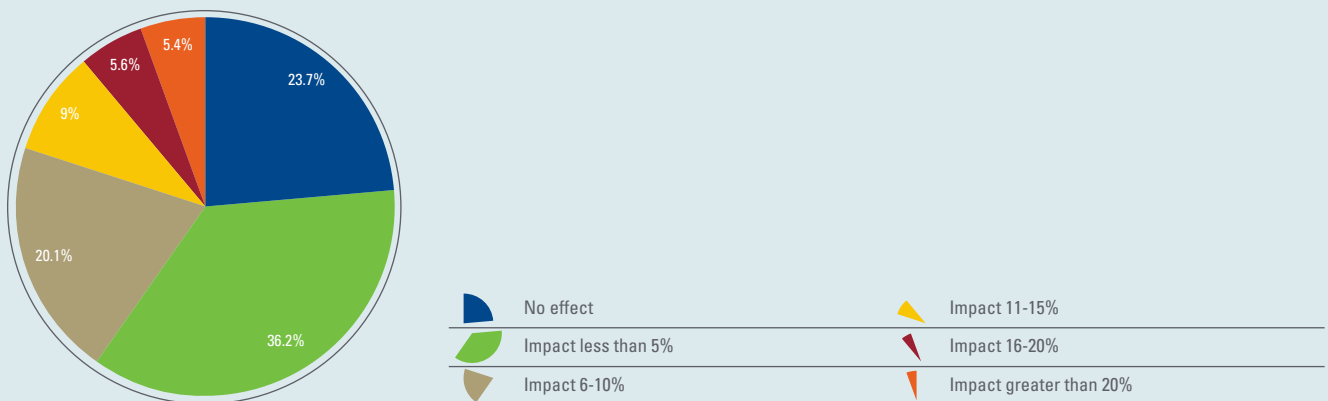
Overall, our survey indicates most organizations do not do forecasting well. Just a tiny fraction (one percent) were exactly on prediction within the last three years, and the most accurate in the group – those that have come within five percent of forecasts – make up only about one in five.

The mean absolute deviation from forecast for all surveyed organizations in the same period is an alarming 13 percent. Little wonder that two-thirds of respondents agree that forecasting is more an art than a science – and clearly one in which business needs to hone its technique.

Forecasting is, however, just a means to an end: improved performance. So how far do these flawed estimates actually matter?

The numbers suggest that poor forecasts cost money. The best indicator is market capitalization. Of those respondents who felt able to comment on how their share price had been affected by forecasting errors, the average thought that errors in this area had cost them six percent of share price over the previous three years. This cost represents a significant amount of market capital. In addition, the most accurate forecasters performed noticeably better than less accurate forecasters, growing their share prices by 46 percent instead of 34 percent.

When considering the impact of forecasting errors, approximately how much do you estimate that these have cost your organization over the last three years in terms of share price?*



*Based on the 354 respondents who were able to answer this question.

Key findings

- Only a minority of firms produce forecasts that are within five percent of actual results
- Inaccurate forecasts impact the share price
- The most accurate forecasters are able to use these estimates to underpin performance management and strategic decisions



The share price can suffer when analysts and investors react to a significant mismatch between outlook guidance based on forecasts and actual results. Organizations understand the importance of forecasts in this respect.

“If a result deviates from predictions, the share price suffers for three or four quarters.”

Christian Mielsch, chief administrative officer of Metro Cash & Carry, an international self-service wholesaler, calls forecasts “crucial to investor communication”, especially those with direct links to capital markets, and Guy Rudolph, director of business planning at Vodafone, a mobile telecommunication firm, describes them as “absolutely fundamental.”

Jim Sutcliffe, CEO of Old Mutual, a financial services group, adds that, if a result deviates from predictions, “the share price suffers for three or four quarters.” Peter van Rossum, CFO of newly-merged Unibail Rodamco, the

largest commercial real estate company in Europe, believes that “credibility is very important in a new entity. We need to build a track record.”

Some executives interviewed for this report argue that inaccurate forecasting mainly matters when a firm underperforms against the estimate. Roughly twice as many firms surveyed exceeded expectations rather than fell short, for which few would expect them to be punished. Sutcliffe, for example, also believes that, rather than accuracy, analysts “want you to beat forecasts by small amounts that don’t demonstrate a lack of understanding.” Old Mutual’s policy is to aim to come in zero to five percent above forecast (although this would still put them in the most accurate group in this survey).

Across the fence, Ewen Stewart, an analyst at ABN Amro, agrees: “The market does tend to reward organizations that are consistently conservative in forecasting with a higher rating. It is important to err on the

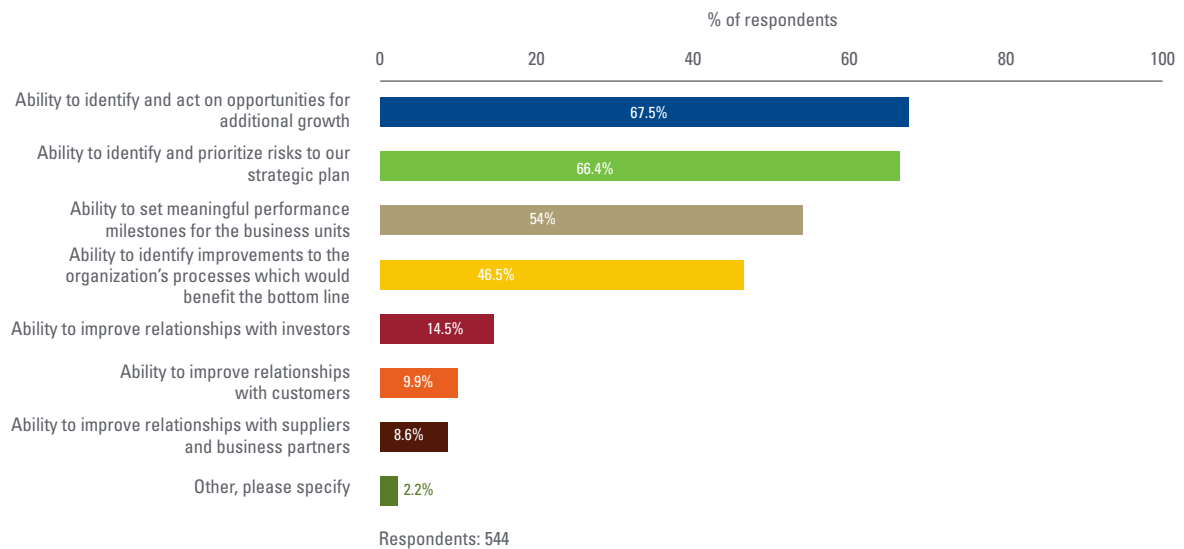
cautious side.” However, according to S.P. Kothari, Billard Professor of Management at the MIT Sloan School, a continuous record of low forecasts will simply lead investors to “adjust according to the bias. They are not going to be that easily tricked and then surprised.”

More of the accurate forecasting firms use the data in performance management.

Besides the potential impact on share price of poor forecasting, there are other benefits relating to improved reliability in forecasting that need to be taken into account. Foremost among these, according to the survey, would be improved ability to recognize opportunities (68 percent) and to manage risk (66 percent). The ability to set meaningful performance milestones for business units and to identify process improvements that could benefit the bottom line were two other important advantages of improved forecasting, according to respondents.



What do you anticipate would be the main benefits of better forecasting within your organization?



Not surprisingly, noticeably more of the accurate forecasting firms use the data in performance management (53 percent to 46 percent). Van Rossum explains that accuracy is crucial, adding that "knowing what is going to happen tomorrow is much more important than having an accurate accounting view on what happened yesterday". At Vodafone, Rudolph says, "Forecasting is how we know where our business is going, how we know how much to invest in customers and in capital."

"The forecast's key role in management of the company means it must be brutally honest whether we like what we see or not."

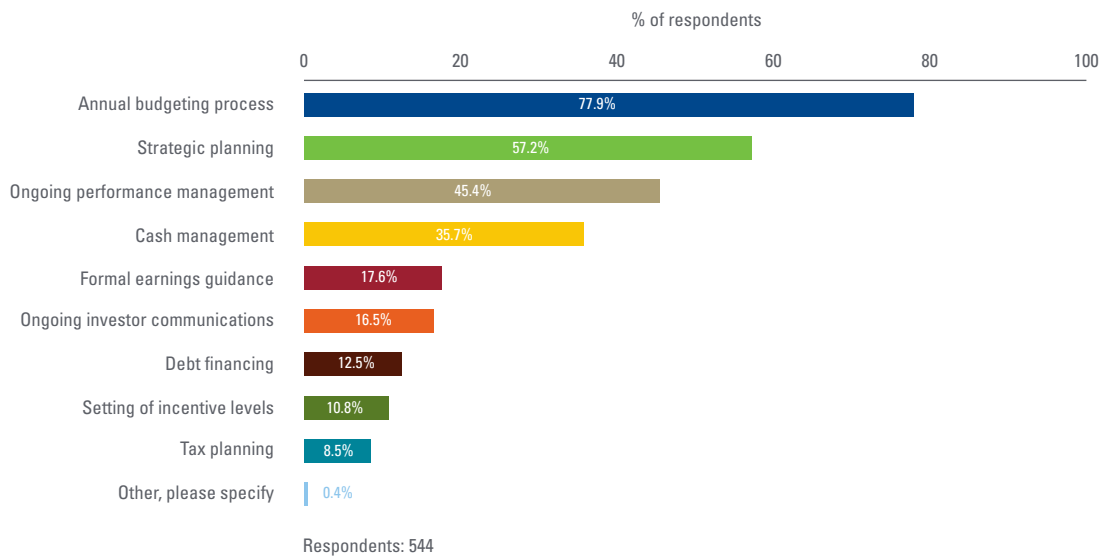
At Shire Pharmaceutical, a specialty biopharmaceutical firm, group financial controller Simon Gibbins notes that its forecasts "underpin our strategic planning." Bjarte Bogsnes, a project manager who oversaw the shift from traditional budgeting to planning based

on forecasts for Statoil, a Norwegian oil company (see page 10), comments that the forecast's key role in management of the company means it must "be brutally honest whether we like what we see or not."

Steve Roder, chief administrative officer of life operations – Asia Pacific at AIG, takes the implications further: "We use the forecast to manage our business, for taking top-level decisions. If the accuracy is not acceptable it will affect the share price eventually."



In which of the following does your organization's forecast play an important role?



When it comes to decision-making, under-forecasting is as problematic as over-forecasting. As Kothari notes, if actual sales are 20 percent higher than forecast, “how do you meet demand?”

Less accurate forecasters saw their share prices rise by 34 percent compared to 46 percent for more accurate peers – over a third more.

Planned growth is easier than seat-of-the-pants innovation, which may be why the most accurate forecasters outperform the less accurate forecasters in other areas. For example, the less accurate forecasters saw their share prices rise by 34 percent over the last three years. More accurate peers grew this figure by 46 percent, or more than a third faster.

Not all of this increase is likely to result from better forecasting, but it suggests that good forecasting is strongly correlated with good management.

Indeed, under-forecasting and over-delivering might temporarily please the investment community, and may even increase individual bonuses, but a more reliable estimate at the beginning is of far more lasting value to organizations.

Analysts and forecasts

Although our survey indicates they are more often thought of as an internal tool, financial forecasts play a very important role in investor communication. Jim Sutcliffe, CEO of Old Mutual, calls them “crucial” in this regard, as does Christian Mielsch, CAO at Metro Cash and Carry.

How are forecasts seen by the analysts with whom businesses are trying to communicate? Ewen Stewart, an analyst at ABN Amro, explains that “there is no doubt that corporate guidance is very important.” This does not mean, however, that analysts simply accept figures uncritically. They sometimes do disagree, and at the very least look carefully at the detailed numbers to determine the level of risk built into the forecast. Moreover, in certain sectors – house-building for example – macroeconomic conditions or other factors beyond a company’s control can overwhelm the most careful estimates, so analysts overlay their views on those of any business.

Stewart does not think the market is looking for any particular style of forecast. “From a macro perspective, rolling forecasts are quite useful for comparing like for like across companies, but at an individual company level, investors look more at results.” He adds that executives now realize “there is a heavy penalty for failure”, in proving the accuracy of their guidance.

The market likes companies that exceed expectations, and it is an old adage that once a company issues a warning, the probability of it warning again is higher.

A single bad forecast need not be a disaster, but does cause problems. Stewart says that market and analyst reaction depends on the cause of the inaccuracy. If a company’s forecast proves wrong, they have to explain. If it is something understandable, then investors will be lenient, but even an explicable error has side effects, Stewart explains.

The market likes companies that exceed expectations, and it is an old adage that once a company issues a warning, the probability of it warning again is higher. If a business develops a pattern of poor forecasting, analysts can become wary, and start thinking in terms of an increased risk of the company being acquired or the management changed.

Overall, executives are getting the message, Stewart believes. “Companies have become more astute in the last few years, realize their views are taken seriously, and have got better at articulating their strategies. The quality of guidance has probably improved.” He gives one note of caution, though. “In the last few years, we’ve seen pretty strong growth. Now there is more of a question mark. This means that the risk to forecasts is increasing.”

Written by the Economist Intelligence Unit

Forecasting replaces the annual budget process at Statoil

As the business environment grows increasingly dynamic and turbulent, the usefulness of quickly dated annual forecasts, budgets and targets comes into question. To address the problem, Statoil – a firm that includes in its corporate values “challenge accepted truth” – did not tinker at the edges. Rather, it joined the small but growing number of companies that have abandoned budgeting altogether for a combination of forecasts, balanced scorecards with an increasing number of relative KPIs, and dynamic resource allocation. The shift has required Statoil to revise its forecasting practice dramatically.

“You have to build the forecasts from the front line, where people have the information.”

Bjarte Bogsnes, the Statoil project manager who oversaw the changes there, explains that the traditional process “is meant to provide one figure that is a target and a forecast and a resource allocation figure. This is the best way to destroy the quality of the forecast, because other motivations tend to distort it. It introduces other agendas.”

“Forecasting is something you should do for yourself.”

Now at Statoil, targets are set relative to the performance of other companies and the forecast is simply that, a best guess about the future. What drives action on the company’s balanced scorecard is the comparison between the two.

The company has also, barring a number of common assumptions set centrally, dispersed forecasting throughout the organization in a continuous process. In Bogsnes words: “you have to build the forecasts from the front line, where people have the information. We have one forecasting principle: forecasting is something you should do for yourself.”

The results have been positive in several ways. Most important, says Bogsnes, forecasts have become better and take much less time. The combined use of forecasts and targets has also produced a more forward-looking mindset.

Bogsnes notes that the CEO is very pleased management can skip lengthy deviation analysis on old figures “and immediately go to the more interesting

discussion of what does the future look like compared to our targets, and what do we intend to do about this.” Finally, Bogsnes explains, “We tend to forget that the main purpose of forecasting is to get stuff on the radar screen soon enough to do something about it.” More frequent, less time-consuming forecasts, done at the point of use, help greatly in alerting relevant business units to looming risks and opportunities.

The combined use of forecasts and targets has also produced a more forward-looking mindset.

Looking ahead Bogsnes says that Statoil is debating further radical change, notably a move from calendar-driven to event-driven forecasting. “Forecasting would be triggered by something happening. If, for example, a unit thinks it needs to update its forecast, it should do so within a relevant time frame and in time to take corrective action.” Thus, the “calendar year would disappear as a straightjacket”, allowing flexible forecasting to be of most use in today’s fast-changing business environment.

Written by the Economist Intelligence Unit



KPMG comment: Reliable forecasting can enhance business value

Forecasting has wide-ranging importance. For leading companies, reliable forecasting is an essential component of their effort to create and sustain value in the business and they invest appropriate time and resources in its execution. Leaders use forecasting to drive performance, identify opportunities and risks, and as the foundation for communicating with investors. They recognize that without reliable forecasting at the heart of their performance management process, management information would be mired in detail about the past and key opportunities and risks are likely to be missed.

Despite the demonstrable benefits of reliable forecasting, however, many organizations continue to struggle with, and even neglect, this business-critical process. Too often, rather than treating forecasting as a core business capability, managers see it as a responsibility of the finance function, tied to a timetable and with little relevance to the business cycle.

“Without reliable forecasting at the heart of their performance management process, key opportunities and risks are likely to be missed.”

Managers who neglect the forecasting process cost organizations money in two important ways. First, they find their business information unreliable, and as a result do not use the data to drive performance and make decisions – despite having invested considerable resources to develop the forecasts.

Second, increasingly sophisticated investors are demanding more information and forecasts on organizations’ key economic drivers and perspective on future performance. Without a reliable understanding of the business’ direction, its opportunities, and the potential risks, CFOs struggle to provide investors with the transparency and insight that they demand.

Some organizations try to improve forecasting by tweaking their budgeting or other traditional decision support processes. Those that tackle these improvements in the context of an integrated performance management cycle, however, demonstrably improve shareholder value and enable the finance function to become an architect of business transformation. Reliable forecasting enables these leading companies to “sense and respond” to business conditions and make appropriate changes in real-time.

They manage risks better and anticipate and seize opportunities ahead of their competitors. Whether markets are rising or falling, these leaders can predict with greater confidence where the business is heading, thereby allowing them to rely on their forecasts to communicate with investors and analysts. As the survey demonstrates stakeholders value accurate and disciplined forecasting.



Section II

Data issues affect the reliability of forecasts

One problem many organizations face in achieving reliability is the quality of the input data. Among respondents, 47 percent consider the reliability of the financial information they use merely adequate or worse.

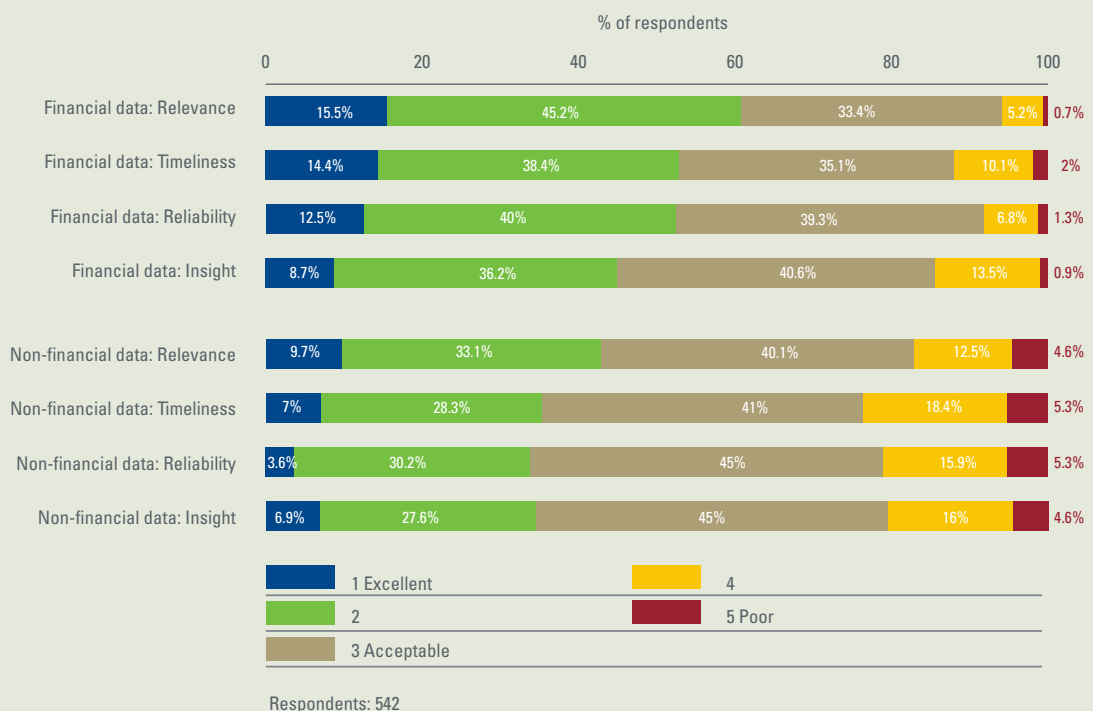
Even more (55 percent) think that the insight derived from their forecast data is at best adequate, and financial data quality is a notable impediment at 37 percent of firms.

Moreover, executives in the survey are significantly less confident about the reliability, insight and quality of their non-financial data. It is no surprise that

34 percent listed improved input data quality as a leading way to improve their faith in their forecasts.

There are several explanations for this lack of confidence in the data. IT-related issues are discussed below, but the problems go deeper than technology. Organizations are not exploiting all available data in the forecasting process.

How would you rate the following attributes of your organization's forecast data?



Key findings

- Many organizations need to improve the quality, reliability and insightfulness of the data they use to produce forecasts
- Organizations need to look beyond internal data sources to build a better picture of their future performance
- Scenario planning is emerging as a useful tool to address the uncertainty inherent in forecasting



Although the majority use internally generated historic information and scenarios, only 40 percent also consider government or other economic reports and just over one-fifth look at data on non-economic risks that could have important impacts on markets or operations.

Whatever data is fed into the process inherently contains a degree of uncertainty.

Not surprisingly, two of the four areas where organizations see most forecasting errors are ones where such external sources might help: consumer demand (38 percent) and economic drivers (29 percent). The most accurate forecasters do look further afield: 68 percent of them use market reports,

for example, against just 55 percent of their peers. Every organization interviewed for this study made use of some outside information: the trick seems to be finding easily accessible, relevant data.

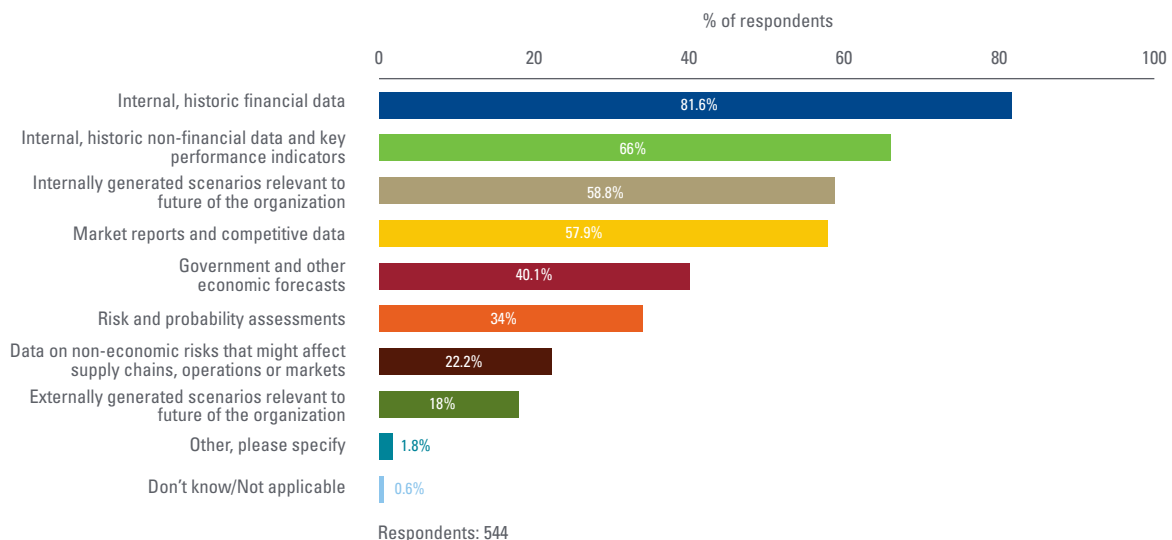
The biggest difficulty, however, arises from a conceptual problem. Whatever data is fed into the process inherently contains a degree of uncertainty.

Sometimes this makes accuracy very difficult. Unibail Rodamco's Van Rossum splits possible forecast inputs into "what we can influence and what we cannot". The latter includes, for example, the potentially volatile market value of the firm's property assets, so they leave that out of financial projections. Jean-Sebastien Couillard, CFO of Toronto-

Hydro Corporation, a large Ontario electricity distributor, similarly explains that the weather can play havoc with rigorous company projections, and Rudolph says that some consumer or competitor behaviours are not always predictable and are often irrational.

Richard O'Brien, co-founder of Outsights, a London-based strategic consultancy which specializes in scenario building, also has long experience of forecasting, having served as chief economist of American Express Bank. He remembers seeing many single figure forecasts unable to address "this horrible thing called risk which is outside your control and sometimes doesn't want to play ball." Indeed, on occasion he has seen organizations change economists rather than address difficult-to-quantify risks.

Which of the following does your organization use in formulating forecasts?



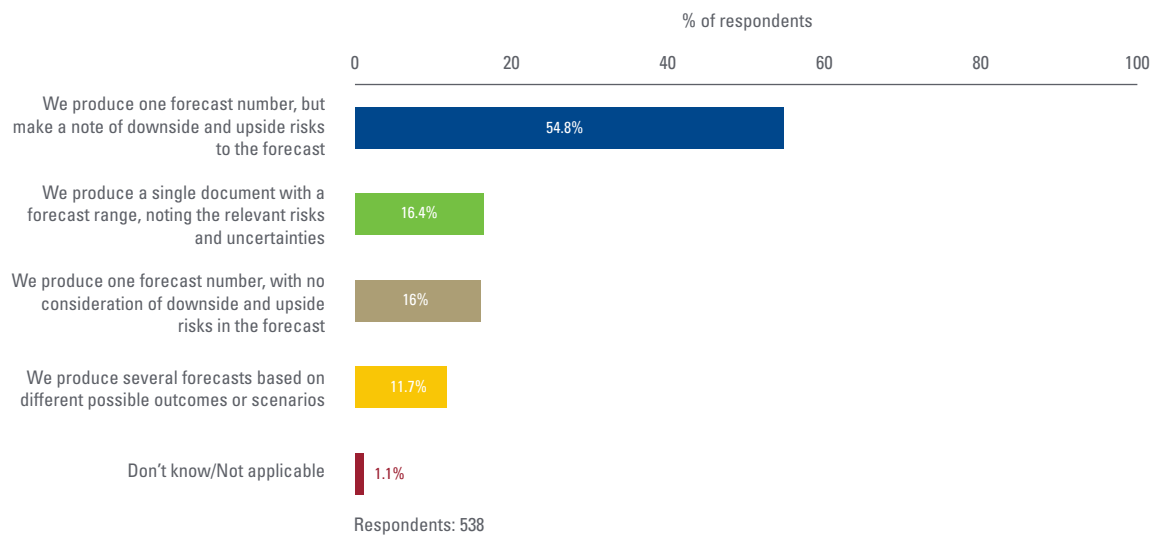
How to address this uncertainty remains a live issue. Some organizations simply ignore it: one in six of those surveyed produce a single forecast number with no consideration of upside or downside risks. The majority (55 percent) produce a single forecast number but at least try to outline the risks. Going forward, surveyed organizations clearly wish to enhance forecasts to take account of

uncertainty. In particular they seem interested in using more scenarios to prepare better for the vagaries of the future, a process that can help not just with addressing uncertainty but with feeding a much broader range of information into the forecasting.

O'Brien argues that such scenarios add a valuable new perspective to forecasting:

“Traditionally, forecasts are done by experts who are judged on the accuracy of their forecasts and their knowledge of the subject. They don't look into different areas. Scenarios let you look at things where there seems to be no connection.” It is these less obvious connections which can give insight into the biggest challenges and uncertainties facing the organization.

Which of the following best describes how your organization deals with uncertainty in the forecasting process?



Forecasting in the public sector

Public sector organizations may not need to worry about shareholder value, but they face their own challenges in using the forecasts to drive performance.

Toronto Hydro Corporation is the largest municipally controlled electricity distributor in Canada, with annual revenues of around US\$2.1 billion. Entirely owned by the city of Toronto, it has a monopoly on electricity provision there.

Accordingly, notes CFO Jean-Sebastian Couillard, “we don’t have a sales force, and don’t have to tell sales people off about forecast numbers.” Instead, he explains, what is very different for his organization compared with the private sector is the strict regulation of its prices and activities.

Couillard periodically faces a rigorous, quasi-judicial regulatory review “where you have to defend all your costs” not just to the regulator but to lawyers of other stakeholders who have the right to intervene in the proceedings. This scrutiny forces the corporation to have more discipline. In particular, the tariffs that Toronto Hydro is permitted to charge are based on forecasts of its costs. Says Couillard, “The better I am

at estimating future costs, the better it is for the business.”

“Our ability to forecast is paramount to delivering expected earnings. We’re very cognisant that if we are too aggressive (in estimating costs), we run the risk of not getting the needed rates, and if we are too conservative, the customer pays too much.”

“The budget is not just a planning tool. It also becomes a statement of intent in terms of spending and priorities, to which the organization is held accountable.”

Another issue for the organization has been its recent shift from a not-for-profit body to an organization run on business lines. The adoption of monthly rolling forecasts has required a long-term educational process so that managers now think in terms of rapid responses to risks and opportunities rather than, as previously, focusing on protecting budgets by spending everything before year-end. The current use of forecasts for strategy and performance management shows that, despite differences, the public and private sectors can each benefit from the process.

Across the Atlantic, Britain’s public service accountancy body has also been investigating forecasting’s public sector role. The Chartered Institute of Public Finance and Accountancy (CIPFA) has been conducting a study on improving public financial planning through various means, including rolling forecasts.

Tom Lewis, assistant director, policy and technical, explains that using rolling forecasts to fully replace budgets would be impossible. In much of the public sector, “the budget is not just a planning tool. It also becomes a statement of intent in terms of spending and priorities, to which the organization is held accountable.” Regularly revised forecasts therefore could not replace the yearly cycle by which legal authorization is given for spending and, in some cases, taxes are set.

However, Lewis also believes, as budgets are usually developed well in advance of the year to which they relate, the use of rolling forecasts can be a valuable additional tool for management. They can improve the effectiveness of monitoring by recognizing the context of changing circumstances as these occur.

Written by the Economist Intelligence Unit



KPMG comment

Reliable forecasting can produce business insight

Leading organizations use the forecasting process to develop insight into the business, assess future opportunities, identify risks and refine the business strategy. They enhance the quality and reliability of the forecast information in three important ways:

- 1 They incorporate the information across a number of dimensions, not just internal financials, and focus on what really drives the business
- 2 They ensure rigorous governance processes and control over data to enhance reliability
- 3 They use scenario planning and sensitivity analysis to assess and deal with uncertainty

Use financial and non-financial information

Rather than building forecasts solely around static, detailed, internal data that

are relatively easy to predict, leading organizations focus on the key dynamic internal and external business drivers that concern management – critical issues such as customer demand, competitor activity, and economic conditions. Although perhaps somewhat more difficult to obtain and predict, these measures provide greater value and insight into the business environment than purely internal details.

Ensure strong governance and control

Given that forecasting data is derived from multiple sources, and the potential for inaccuracy is high, strong governance and control are needed to ensure data reliability. Finance functions manage and monitor the processes, data definitions, and controls of the month-end close with considerable rigor, and they should bring a similar discipline to forecasting. Indeed,

leading organizations have adopted rigorous governance and control practices around their forecasting processes.

Proactively deal with uncertainty

Despite measures to enhance data quality, forecasting is still difficult and dependent on many factors. Leaders recognize these challenges and make use of a wide variety of methods of varying degrees of sophistication to deal with the uncertainty inherent in forecasting.

Tools such as range forecasts, scenario planning, sensitivity analysis, and simulations help measure and quantify risks and opportunities as well as facilitate the development and, if necessary, the implementation of contingency plans ahead of those organizations that provide static, one-dimensional views of the future.



Section III

Forecasting technology: help or hindrance?

Organizations hope that technology improvements can do much to alleviate their forecasting problems. When asked what would increase confidence in their forecasts, the most common reply in our survey was automation, cited by 42 percent. But current technology solutions often aren't working: for example, 35 percent considered the technology currently deployed a notable impediment.

One fundamental problem is that not all organizations have integrated planning systems. This can cause difficulties, especially after mergers or acquisitions when, in Gibbins's words, diverse systems "tend to be bolted on".

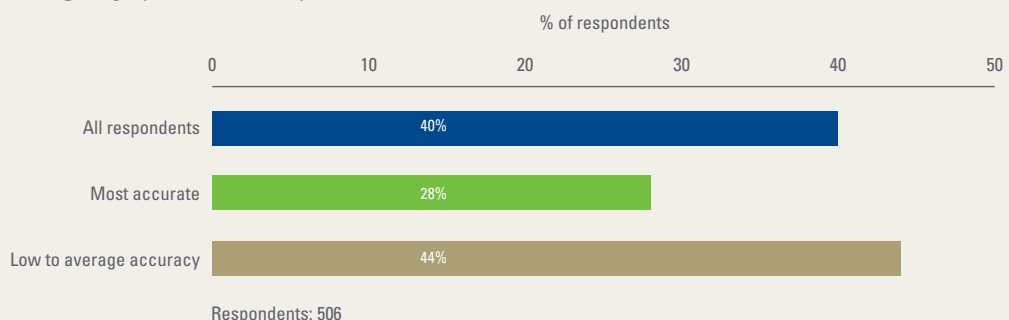
Ninety-six percent of organizations still rely on spreadsheets for at least part of their forecasting process.

Rudolph says that Vodafone, which has "polyglot" planning tools across its subsidiaries which it eventually intends to replace, in the meantime has "put a lot of effort into making sure we have

a consistent definition of what the information we are asking for actually is." Roder believes AIG's adoption of a common ERP platform will help them "end up with one version of the truth" rather than disagreements over the data.

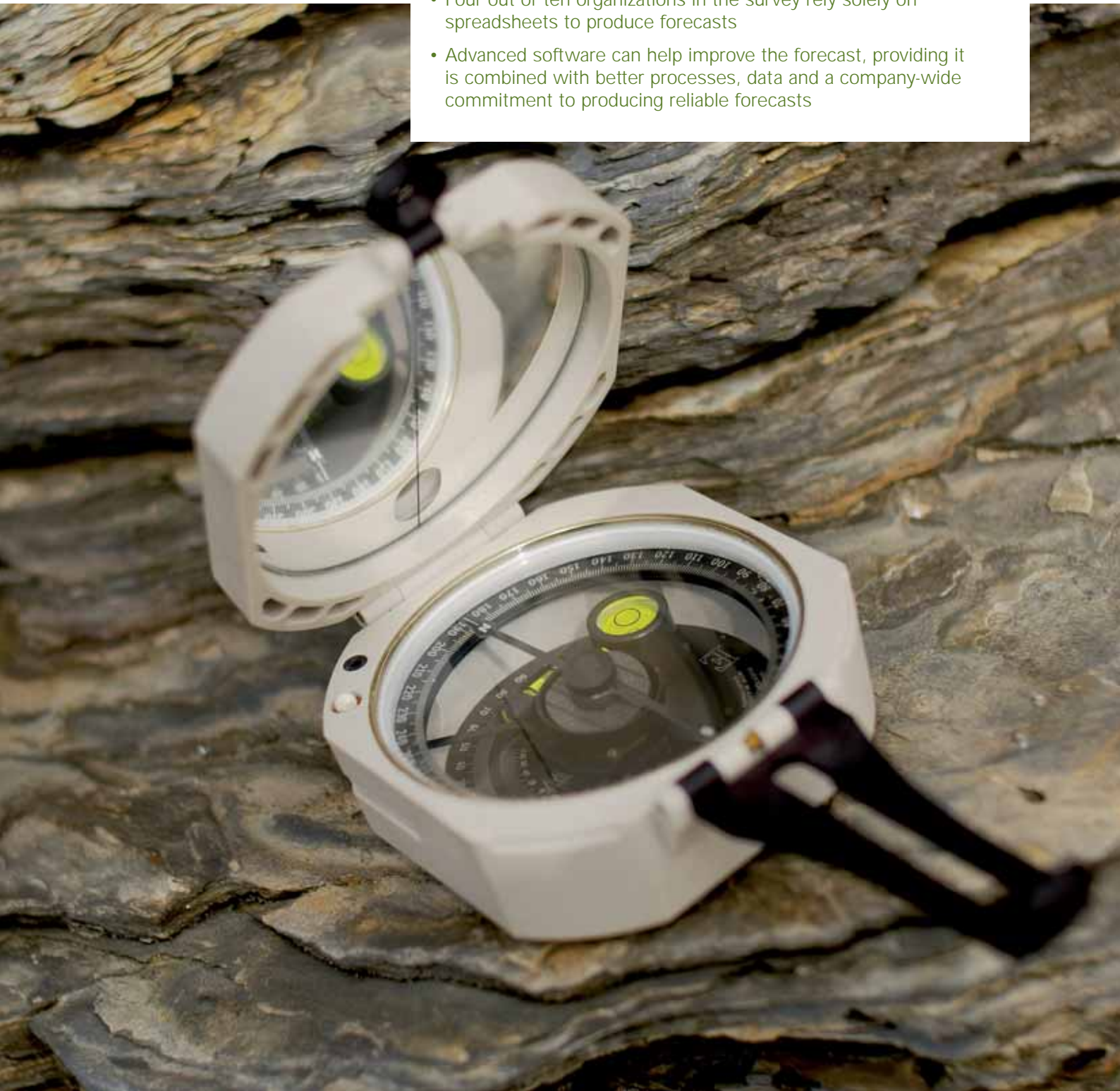
The lack of a single, satisfactory technology platform for forecasting is emphasized by the fact that some 96 percent of organizations still rely on spreadsheets for at least part of their forecasting process.

Percentage of companies using only spreadsheets to produce forecasts

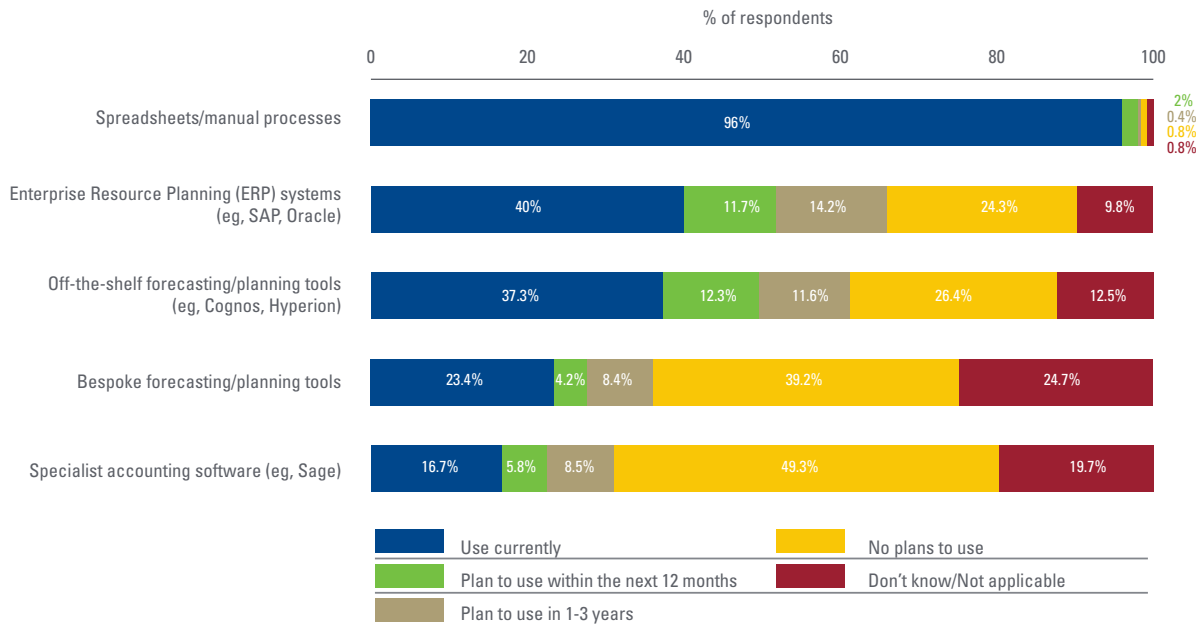


Key findings:

- Technology is currently one of the major impediments to forecasting, but is also seen as one of the key tools that could help improve forecasts
- Four out of ten organizations in the survey rely solely on spreadsheets to produce forecasts
- Advanced software can help improve the forecast, providing it is combined with better processes, data and a company-wide commitment to producing reliable forecasts



Which technology does your organization use to produce its forecasts?



Respondents: 365 – 506

What is more surprising is that spreadsheets are the only software tool that 40 percent of organizations use for forecasting. Among the more accurate forecasters, the proportion of organizations using just spreadsheets drops to 28 percent, reinforcing the point that the top performers are more likely to use more sophisticated software, such as ERP systems, off-the-shelf planning software, or bespoke tools in their forecasting.

Inefficiency is not the only resultant issue. Van Rossum notes that spreadsheets simply do not work as well. “They are too easy to tinker with. The sophistication that goes into planning models is very considerable. By the time you have all your assets

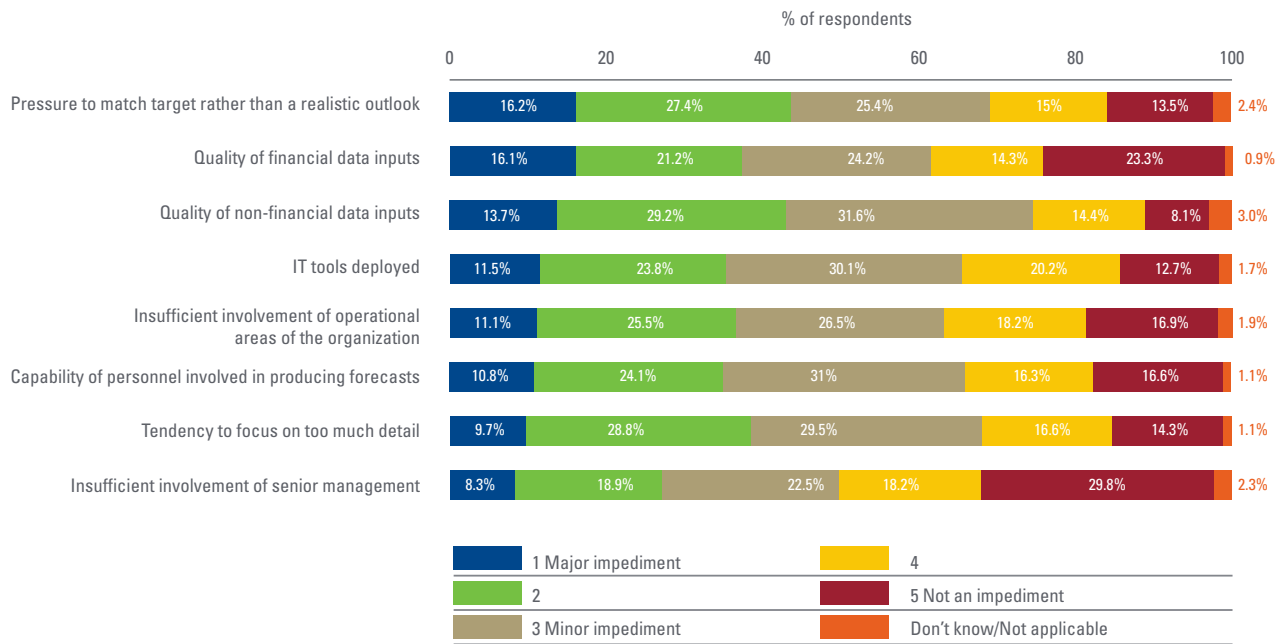
on spreadsheets you are likely to have spreadsheet errors.”

The fact that 28 percent of the most accurate forecasters are still just using spreadsheets shows that it is possible to produce reliable forecasts using basic tools. But the adoption of more advanced tools certainly appears to yield benefits. The most accurate forecasting organizations definitely exploit more technology – 48 percent use ERP in the process (against 37 percent of less accurate peers); 47 percent use off-the-shelf forecasting software (against 34 percent); and 34 percent have bespoke technology tools (against 20 percent).

“The most important thing is to have good quality data and a robust, reliable process.”

One reason for the slowness of more firms to integrate technology into forecasting may be problems delivering what organizations want in a straightforward way. The lack of a single preferred type of forecasting software, and the reluctance to move beyond spreadsheets suggest that businesses are still experimenting to find the most effective tools for their circumstances. So too does the survey’s finding that nearly one-quarter of firms rely on bespoke software for at least part of their forecasting process. Even the use of one or more advanced programs does not ensure smooth sailing. According to Gibbins, SAP and Hyperion, two common software packages used by Shire, integrate in some areas, but not in others.

How great an impediment is each of the following in producing accurate forecasts at your organization?



Respondents: 525 – 535

The technology itself, however, may not be the biggest problem. As is noted earlier, many survey respondents are still producing reliable forecasts using nothing more sophisticated than spreadsheets. More advanced solutions can help streamline forecasting, but the most important thing is to have good quality data and a robust, reliable process.

Far more important than the tools are how people use them. Kothari notes that accuracy is more a cultural issue – where corporate cultures are defined by incentives – than a technical one. The reluctance to adopt better technology may simply be because most people contribute to the forecasting process by going through the motions as opposed to

really seeing value to it. “ Many feel they have to do this paperwork and it isn’t that crucial,” Kothari adds. The correlation between accuracy and more advanced IT use may conceivably arise as much from organizations with a serious attitude to the process adopting the latter as from the undoubted technical benefits IT solutions provide.





KPMG comment

Technology alone is not the answer

While many respondents cited technology as a key enabler to improving their forecasting capabilities, getting the processes and data right is a critical first step. Technology can be a significant investment; to obtain its benefits, organizations must concentrate on aligning both their processes and data with technology to avoid the risks of automating a broken process that uses unreliable data.

The first priority in leveraging the technology investment is to establish an overall framework for how forecasting fits within the management of the business. Organizations need to understand strategically how forecasting can benefit them. They need to determine what they want from it and then ensure the supporting processes are designed and built in the context of those expectations.

Spreadsheets are still ubiquitous despite the availability and sophistication of modern planning tools.

The process requirements need to be properly framed and designed in the context of specific business objectives

and the manner in which forecasting will be integrated into the business performance management framework and processes.

The second priority is the data – specifically, the architecture, integrity, control, and security of the data feeding into the forecasting process. Leaders ensure that they create executive ownership for data and governance, maintain clear and robust management and control processes, and ensure common data structures and standard definitions. Sourcing data across multiple systems, defining standard data structures and definitions, and establishing centralized governance processes to manage and control data on an organization-wide basis are all critical to ensuring that the maximum returns are gained from the investment in forecasting technology.

As for the technology itself, spreadsheets are still ubiquitous despite the availability and sophistication of modern planning tools. The power of spreadsheets means that they will always have some role for individual planners. To be effective, they need to be integrated into an effective

forecasting process – one that is collaborative and organization-wide, controlled, and standardized.

Exploiting the capabilities of purpose-built planning tools is therefore critical to enabling an effective and reliable forecasting process.

Furthermore, it is inherently difficult to effectively integrate spreadsheet models with transactional systems, external data sources such as supplier and customer systems, management information, and reporting and analysis tools. Exploiting the capabilities of purpose-built planning tools is therefore critical to enabling an effective and reliable forecasting process that is at the heart of the organization's performance improvement cycle.

Faced with a wide array of choices when investing in technology, organizations must understand how to leverage their current technology and augment its capabilities to create a forecasting system that is scaleable, flexible, and integrated with other systems.



Section IV

The practice of forecasting: moving beyond process

The practice of forecasting in organizations has both cultural and practical elements. Before turning to the former, more important area, it is worth noting where our survey points to process areas in which organizations can make adjustments to improve the reliability and utility of their forecasting. In essence, the more you put in, the more you get out.

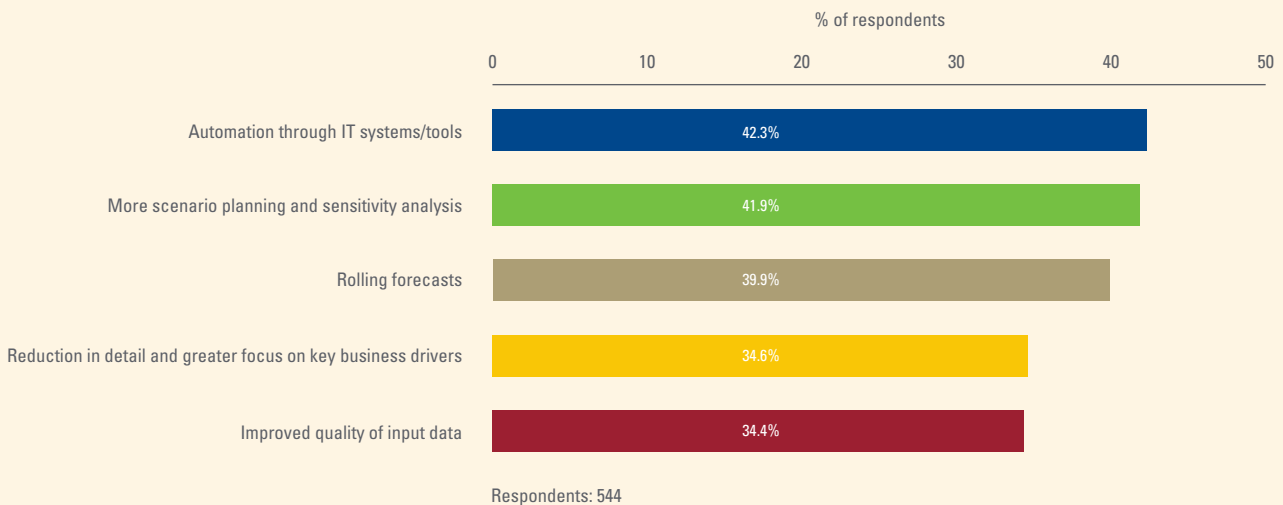
As can be seen from the accompanying graph, the three initiatives that executives in the survey thought would do most to improve confidence in the forecast were IT automation, more scenario planning and sensitivity analysis, and the use of rolling forecasts. The first two areas have already been discussed, but what of the pros and cons of the rolling forecast?

Frequent forecasting helps alert people to differences from expectations early.

Certainly the organizations with better forecasts in the survey do them more frequently: 58 percent of this group review theirs at least monthly compared with 44 percent of other firms.

Couillard explains that frequent forecasting helps alert people to differences from expectations early and Rudolph notes that through the practice “variances are drummed out. People have to understand and explain why their forecasts didn’t match with actuals.”

Which of the following has/would give your organization most benefit in improving the confidence of forecasts? (Top five are shown.)



Key findings:

- Rolling forecasts are becoming increasingly popular as a way to ensure that organizations keep pace with a rapidly changing business environment
- Leading organizations are more likely to involve their operational managers in the forecasting process
- Senior executives need to demand reliable forecasts that drive decision-making and performance management



Over two-thirds of respondents use rolling forecasts in some form.

In addition to improving accuracy, Van Rossum notes that regular bottom up forecasts have a broader benefit for those that apply these numbers to strategy and performance management. “It gives you the opportunity to proactively take corrective action for what isn’t going in the way you want. It helps management focus on the things that are really important.”

Over two-thirds of respondents in the survey use rolling forecasts in some form. Forty percent using rolling forecasts believe that they either already have or will increase forecasting confidence.

Kothari credits their popularity to the rapidly changing business environment. “In general, static forecasts are too little. Rolling forecasts adapt to new information. If you are rigid and not willing to make adjustments, you are at a competitive disadvantage.” Shire Pharmaceutical has just started this practice, but already Gibbins sees improvements in accuracy.

It is therefore important that the forecasting process has buy-in from executives across the organization.

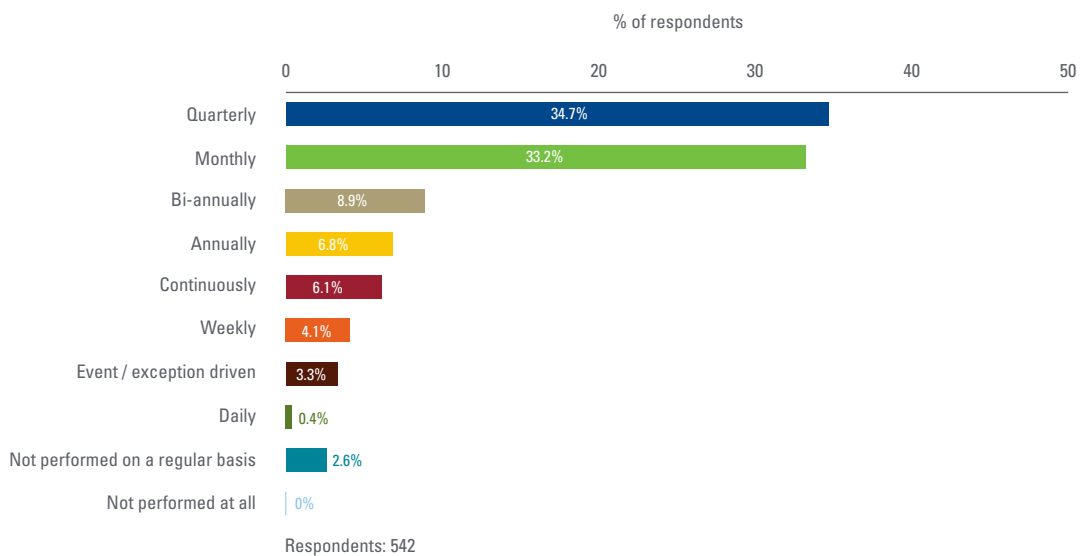
He considers rolling forecasts one of the best ways to keep expectations reasonably in line with those of the market and, more important, to have good data to feed into planning. “The budget becomes out-of-date pretty

quickly. The forecast is the process we really use for the senior management committee,” he comments.

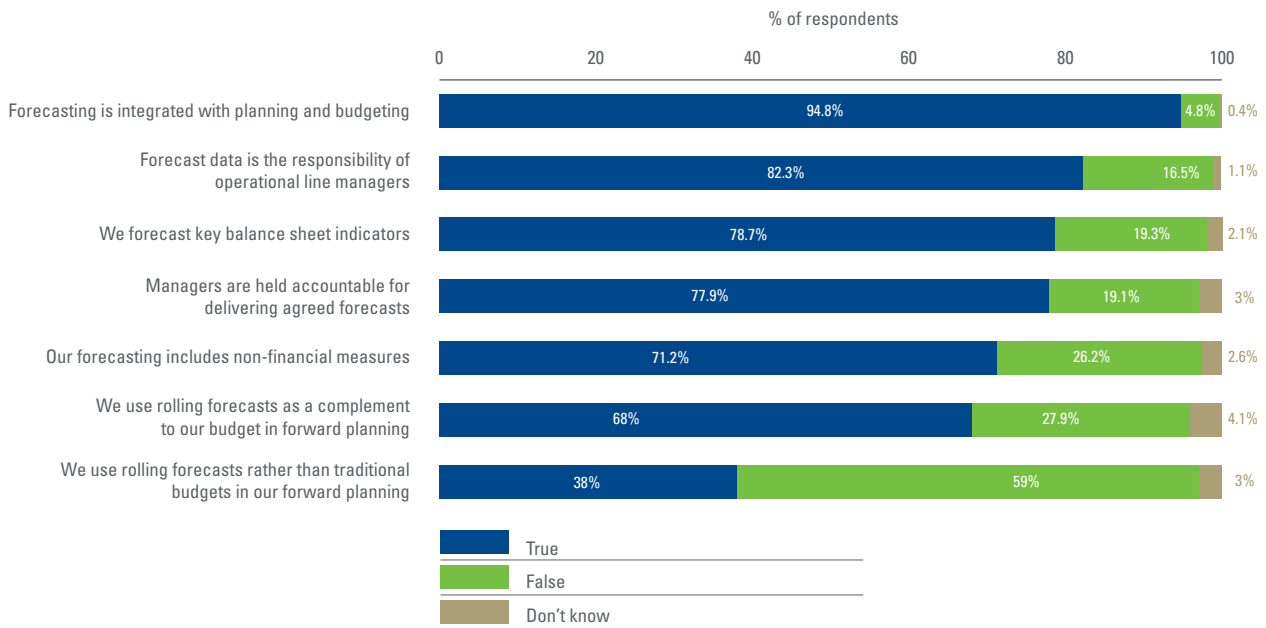
Another practical issue relates to who generates the forecast. The more accurate organizations are more likely to have operational and line managers do the work (40 percent to 34 percent). These managers are much closer to where business decisions are being made and therefore the data is much more reliable. It is therefore important that the forecasting process has buy-in from executives across the organization.

“This is not a finance-driven game at all,” says Roder of forecasting at AIG. “Country managers help with the process. You can’t underestimate the importance of that side of it in a life

How frequently are your organization’s forecasts updated?



Which of the following statements are true within your organization?



Respondents: 532 – 540

insurer.” Van Rossum adds that, beyond accuracy, working together gives a great amount of ownership and helps internal communication.

Although there are some general best practices that can be adopted for forecasting, interviews suggest that a variety of different approaches work well for different organizations. Mielsch explains that Metro Cash and Carry, which has been working very hard on improving accuracy recently gave up on rolling forecasts “because nobody looked at them”. The correct level of resource allocation is in particular a matter of circumstance.

“Forecasting always has a tendency to be rather conservative, costs a bit overstated, revenues a bit understated.”

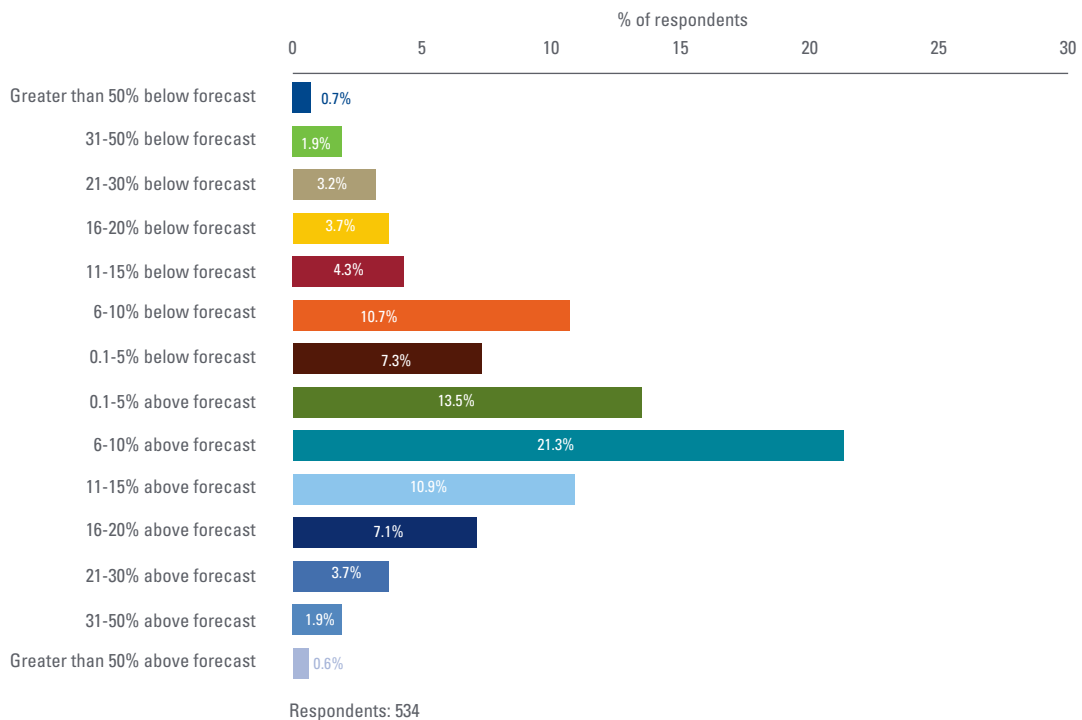
As Kothari points out, regularly updated rolling forecasts are a good thing, but you can have too much of a good thing: “You don’t want to spend too much time on forecasting and none on execution.” Van Rossum agrees. Although Unibail Rodamco uses a rolling approach for some specific information where it is essential, such as cash flow, for other areas “going through a bottom-up process is a huge amount of work, so we do it once a year”.

Better technology, scenarios and rolling forecasts may have a role to play in improving confidence in the forecast. But there remains a bigger, cultural question of how committed organizations are to reliable forecasting in the first place.

The survey results on forecasts against actual results over the previous three years were interesting not only for their mean absolute deviation – 13 percent discussed earlier – but because the answers had a surprisingly normal distribution centred not around zero percent, or matching forecast, which might reasonably have been expected, but around exceeding it by six-ten percent. This suggests not that organizations are bad at the practice so much as that they are on average good at bringing in forecasts which understate performance by roughly eight percent, even though share price data, as noted earlier, indicates that accurate forecasters grow faster in value.

Underplaying the forecast

Question asked respondents how their actual results varied from the forecast over the past three years. Taking the total sample average, companies are consistently forecasting around six-ten percent below actual performance.



What could account for this tendency to underplay the forecast? Sutcliffe has noticed that some national units of Old Mutual “like to impress you with a macho forecast... others always want to beat their forecast” so the initial suggested one “is usually low.” Under-forecasting, however, is clearly much more common, to a degree because caution is part of the nature of the exercise. Gibbins notes that “forecasting always has a tendency to be rather conservative, with costs a bit overstated and revenues a bit understated.”

The problem with “sandbagging” and “gaming” is that it interferes with good decision-making.

According to Kothari, company structures also reward this practice. He points out that employees are most concerned with their own performance evaluation, so to avoid failing to meet forecasts “they lowball it.” Moreover, senior executives can be just as guilty as bonus-protecting employees. Some 44 percent of respondents thought that pressure

to make forecasts match targets was a notable impediment to accuracy.

In certain specific circumstances, this practice can truly be beneficial to the organization itself, especially with an eye to investor opinion. A company that had suffered a severe reaction to a profit warning, for example, might decide that it was better to accept an achievable budget and pay high bonuses than to stretch it and risk another profit warning. The bonuses would cost less than hubris.

The problem with “sandbagging” and “gaming”, as various interviewees call it, is that it interferes with good decision-making. But overcoming this instinct needs a concerted effort from senior management.

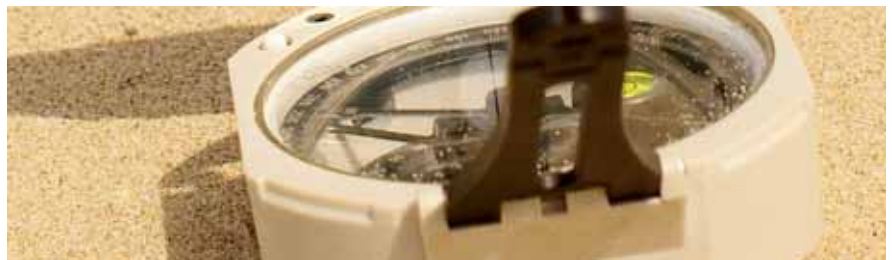
The problem is not just about rewarding those who exceed forecasts.

Van Rossum notes that “human behavior is not that easy to fight.” He says that if

you start rewarding people for such activities, you will never get the truth. Competing agendas over the purpose, and therefore desired accuracy, of forecasts may account for why so many more organizations hope for strategic insight from better forecasts than actually have them play an important role in strategy formation.

The focus on forecast accuracy, while effective in achieving better predictions, also raises what van Rossum calls “the

biggest challenge of the process”: how to encourage accuracy without penalizing those striving to beat expectations. Kothari points out that the problem is not just about rewarding those who exceed forecasts. If an organization wants to encourage risk taking, it must understand that some experiments will inevitably fail and not necessarily pay people less for taking chances.



Challenger financial services group and rolling forecasts

Our survey shows that rolling forecasts are increasingly common as a complement to, or even replacement for, the budget process in forward planning. In the Asia-Pacific region, a striking 57 percent have done so, against slightly over a quarter of firms in North America and Europe. In fact, only 13 percent of Asia-Pacific respondents did not use these forecasts in some form. Paul Rogan, Group CFO at Challenger Financial Services in Australia, notes that “most ASX 100 companies have something of this nature in place”, although with varying degrees of sophistication.

“People often underplay their forecast numbers because they want to over-achieve.”

Challenger, a mid-cap Australian firm, provides a range of products – including fund and asset management, mortgage lending and annuities – and has over

US\$40 billion under management or administration, a number that has more than doubled in the last three years.

Amid this growth, the organization has been, in Rogan’s words, “playing catch-up” to introduce rolling forecasts to supplement its existing long-range planning. At the moment, the rolling forecasts look to the end of the current financial year, but Challenger is in the process of moving to true rolling 18-month forecasts in 2007–2008.

Although a relatively recent addition at Challenger, rolling forecasts are already helping to increase discipline in the forecasting process. Rogan says people often underplay their forecast numbers because they want to over-achieve. A rolling approach, which involves regularly looking at the forecast, and at upside possibilities and downside risks, encourages those involved to “put the information on the table.”

The new process is saving a lot of time. Last year’s budget took three months from start to finish, and this year’s only about five to six weeks, a number Rogan hopes to reduce further.

“Think through what actually drives value. A lot of the time this has nothing to do with standard budgeting items.”

Individual functions are also finding the resultant forecasts a much improved tool. Those involved in investor relations, for example, can now see what communication issues will be facing them in the near future, and accordingly be more proactive and professional.

Most important, the switch to rolling forecasts is helping the organization to run better overall, to such a degree as to alter what divisional CEOs think of the group’s finance function.

“We have moved from an environment where we would report backward only.”

Positive changes in this area began right away. In order to set up these forecasts, Rogan says people needed “to think through what actually drives value. A lot of the time this has nothing to do with standard budgeting items.” This process also led managers focused on different sections of the organization to develop a group-wide view. To outsiders, eighteen months ago the company looked like

four separate businesses, but now investors and even those inside the company can see it as a whole.

Discussions in the reporting, forecasting and budgeting process are now about strategy and execution rather than history. “We have moved from an environment where we would report backward only,” says Rogan. Now within ten days – with a target of five days with the aid of new analytical tools – the organization can produce an entire pack of data that gives a picture of the current health of the business and where it will

be in six to nine months. This aspect is the crux of the matter for Rogan.

Forecasting remains the “best guess of a probable outcome”, he says. “The key thing is not so much the accuracy of the original forecast. It is how we react when the forecast needs to change. It is about taking actions, getting executives and management thinking about both upsides and downsides and responding appropriately.”

Written by the Economist Intelligence Unit



A new mindset at Metro Cash and Carry

Metro Cash and Carry (MCC), Germany-based and operating in 28 countries, is one of the world's leading food self-service wholesalers with a turnover in 2006 of over US\$40 billion. The company has made a major effort in recent years to improve its forecasting. The key to this, according to Dr Christian Mielsch, MCC's chief administrative officer, has been to introduce "a new mindset" as well as merely improving forecasting processes.

Disentangling forecasts from other corporate measures has also increased their reliability and usefulness.

Mielsch explains that the business introduced new principles on forecasting. The company has always set high standards for the reporting of financial data, but "now manipulating in forecasting is as bad as manipulating actual figures". Because of its predictive nature, it is admittedly "harder to track where you are manipulating and where

you are making errors in predicting the future, but there is now a clear statement" which has altered attitudes.

Disentangling forecasts from other corporate measures has also increased their reliability and usefulness. MCC now separates targets and forecasts. Previously these were one and the same thing, which meant that operating units were reluctant to adjust the forecast. The split has allowed forecasts to become "much more oriented toward action plans," says Mielsch.

The tie between rewards and forecasts has been completely abolished.

The company sets top down targets for units based entirely on country benchmarks in clusters of country development phases and business life cycles. The forecasts, which are adjusted monthly, highlight possible deviations between targets and likely outcomes, leading to discussions on how the company can achieve its aims.

The tie between rewards and forecasts has been completely abolished. Managers have schemes entirely independent of their budgets. In this system, the "underpromise and overperform" attitude and political games with regard to setting up budgets are gone.

Other changes in the approach have helped bring improvement. The company now has a greater emphasis on getting the numbers right, with a forecasting accuracy scorecard that measures deviations on a monthly basis and ranks reporting units. Balance sheet items also receive attention, rather than just P&L items, as previously.

Overall Mielsch says, "We have become much better, are more sure of achieving our goals, and are informed earlier about deviations." Improved forecasting accuracy has also helped with strategy and performance planning: "We know what we are doing, so we are taking action much earlier than in the past."

Written by the Economist Intelligence Unit



KPMG comment

Reliable forecasting is a management discipline

Reliable forecasting is a discipline. Those that excel at it may achieve measurable value and are rewarded in the marketplace. Leaders differ in their forecasting practices in several unique ways:

- 1 They treat it as a key management process, involving the right people
- 2 They instill a culture that facilitates quality forecasting
- 3 They align incentives to relative performance rather than targets

Involve the right people

Leaders embrace forecasting as a core business process, one that engages operational decision-makers across the business. They tap into their managers' knowledge in real-time so their forecasts mirror actual front-line events, and managers remain engaged in the debate about potential courses of action. In this way, operational managers own and are accountable for their forecasts, and they value the process as a crucial management responsibility.

Involving the right people in the process also breaks down organizational silos and

enables managers to understand how their decisions affect other parts of the organization. As a result, enhanced dialogue, openness, and a level of integration between various parts of the business emerge that enables business managers to use the discipline of forecasting to improve performance.

Instill forecasting into the culture

Leading organizations place a strong emphasis on the importance and reliability of the forecast. Within these organizations, senior managers sponsor and value the exercise, are visible and active in the review, provide clear direction and coaching, and follow up on the actions arising from the process. Only a shift in focus at the highest levels will enable forecasting to evolve from a rather arbitrary process to an effort that actually helps leaders make better decisions and build trust with external stakeholders.

The first step to changing the culture is to champion a realistic outlook of future performance. Senior management should uphold forecasting as a means of

enabling the business to manage the gap between targets and anticipated performance, rather than of resetting targets. With this perspective, behavior throughout the organization can begin to change.

Align incentives to relative performance

Incentives are often not appropriately aligned and therefore can become a real hindrance to sustainable improvement in forecasting. Traditionally, "making the budget" has been the key measure of performance and driver of behavior. Eliminating this link can eliminate the "gaming" that may result when rewards and incentives are tied to budget performance and managers are focused on hitting the budget at all costs.

Linking incentives to relative performance (e.g., market performance, external and internal peers, or key economic conditions) rather than meeting a budget that was set months ago is a significant enabler to changing behavior.



Section V

Conclusion

Organizations are not forecasting well, and it does matter. Poor forecasting not only shakes investor confidence, it prevents use of an extremely useful tool in strategy setting and performance management. With forecasts diverging from actual by an average of 13 percent, there is a huge window of opportunity for organizations that work on excelling in this area.

Fortunately, application and resources, not rocket science, will take organizations much of the way. Improving data generated internally, seeking out good external information, taking into account the implications of uncertainty, leveraging appropriate information technology, and getting operational managers involved in regular forecasting will all improve reliability.

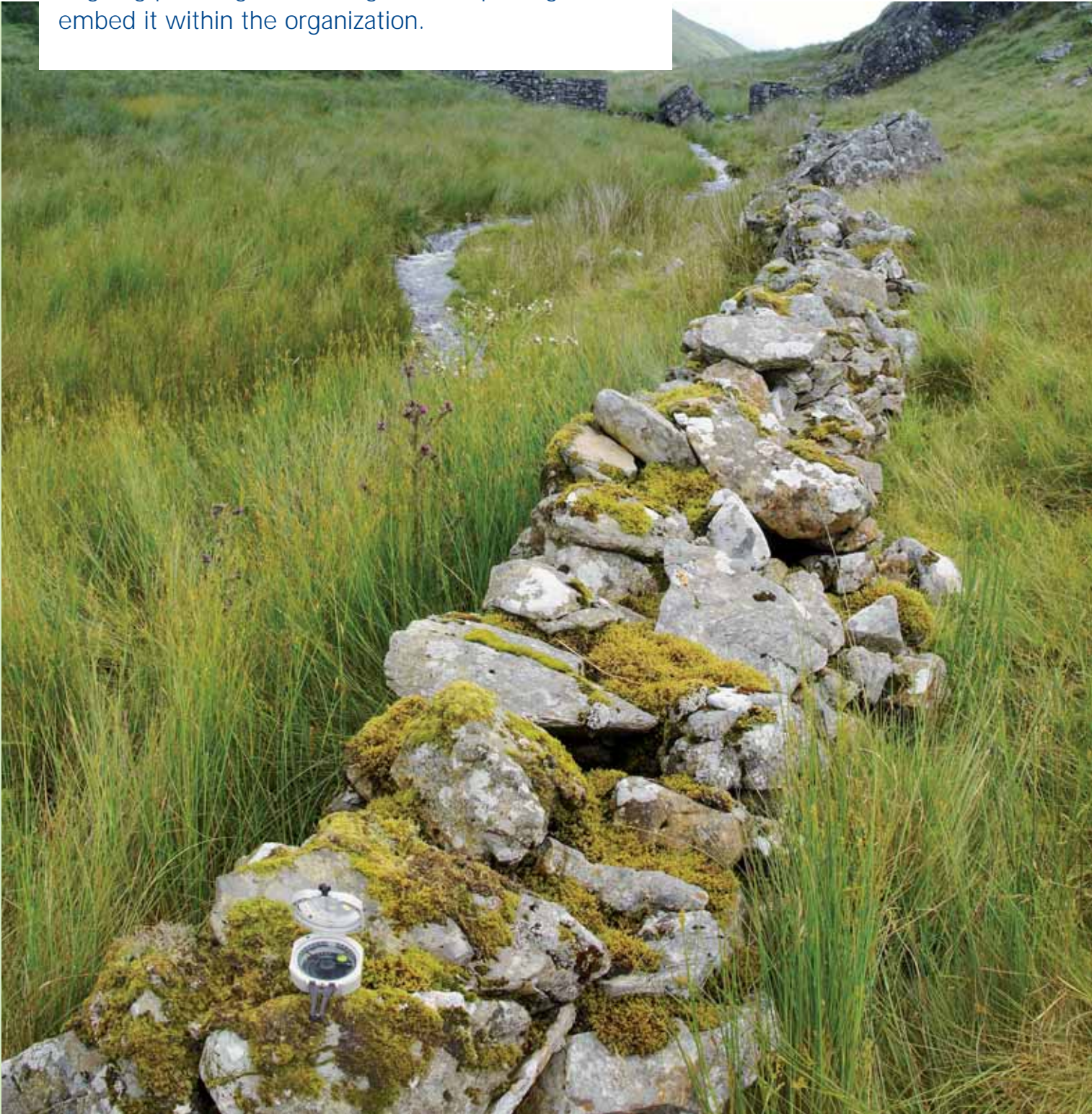
These measures, however, rather than isolated process improvements, need to be part of a broader cultural shift within organizations. The forecasting process needs to change from being

seen as an inconvenient waste of time which at best requires manipulation to improve pay packages, to a means of generating data that is important for the successful management of the organization. If businesses make sure that they are giving this message, then questions of employee buy-in, the correct level of resources to commit to the process, and balancing forecast accuracy with encouraging excellence all become much more straightforward. As a result, rather than providing feared drudgery, the forecast actually can help organizations increase their value.

The forecasting process needs to change from being seen as an inconvenient waste of time to a means of generating data that is important for the successful management of the organization.



The next step is to link the forecasting process to ongoing planning and management reporting and embed it within the organization.





KPMG comment

Forecasting, the next step in the business transformation journey

KPMG member firms believe that the key to reliable forecasting is the ability to draw together culture, process and internal and external data into a balanced and cohesive framework enabled by technology. While getting it right is difficult, it is critical: reliable forecasting is at the heart of the business performance management process and creates measurable business value over the long term.

For us, there are three key areas that need to be addressed and balanced appropriately if the finance function is to lead this change. Leaders need to:

- 1 Apply rigor to the forecasting process
- 2 Use it as a core management tool
- 3 Embed forecasting discipline into the culture and day-to-day activity of the organization.

Leading CFOs are able to find the right balance for their organization. As finance functions continue to innovate and transform their capabilities, reliable

forecasting presents an opportunity to drive business value well beyond the “walls of finance.” Forecasting is a key next step in the business transformation journey as finance organizations focus their attention on performance management, business intelligence, decision support and enterprise risk management.

An approach

The finance function needs to build consensus and commitment around a common vision of forecasting as a core, organization-wide management process and then translate that vision into a viable process couched in “the language of the business” and a pragmatic improvement plan. The next step is to link the forecasting process to ongoing planning and management reporting, and embed it within the organization.

The challenge is then to determine how to close identified gaps. The focus should be on processes, information, people, governance and systems.

The results

Transforming forecasting can result in:

- Reliable financial and business projections
- Greater agility – the ability to quickly sense and respond to changes in the increasingly dynamic business environment
- Increased transparency into future business opportunities
- Improved ability to manage uncertainty and risk
- Improved basis for dialog with external stakeholders, enhancing trust and increasing confidence
- Increased shareholder value

Across KPMG firms, we wish you well as you create a leading forecasting discipline.

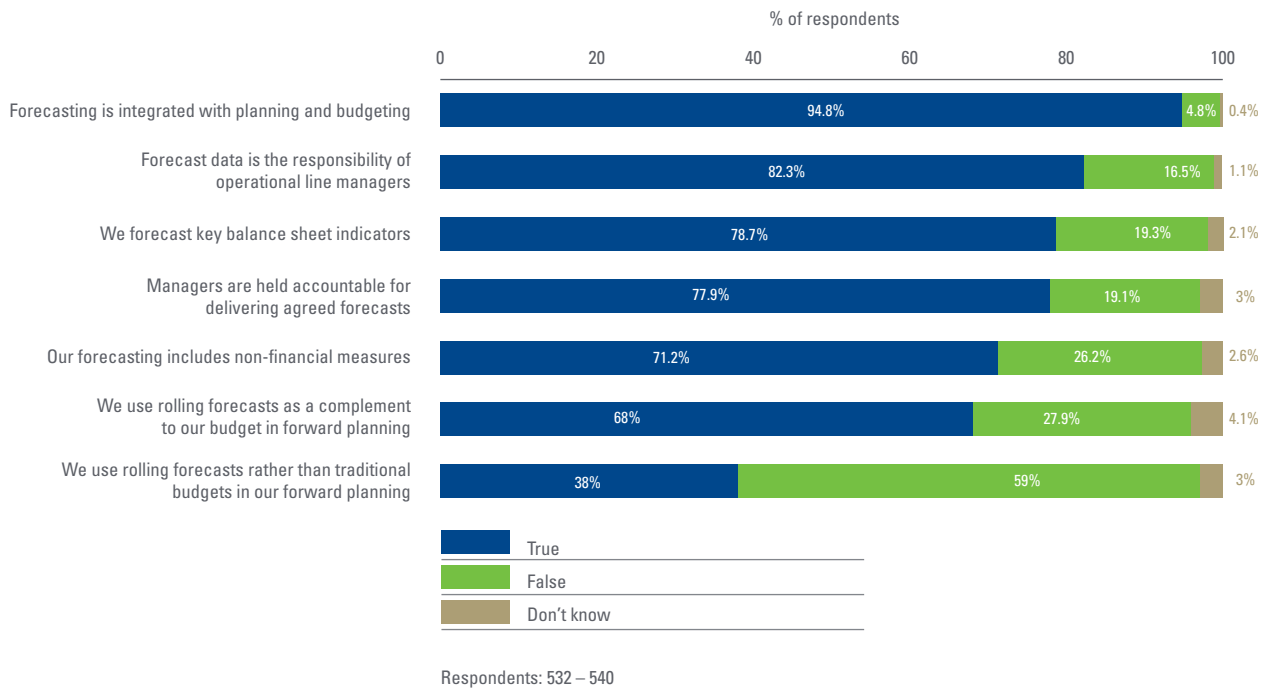


Appendix Survey results

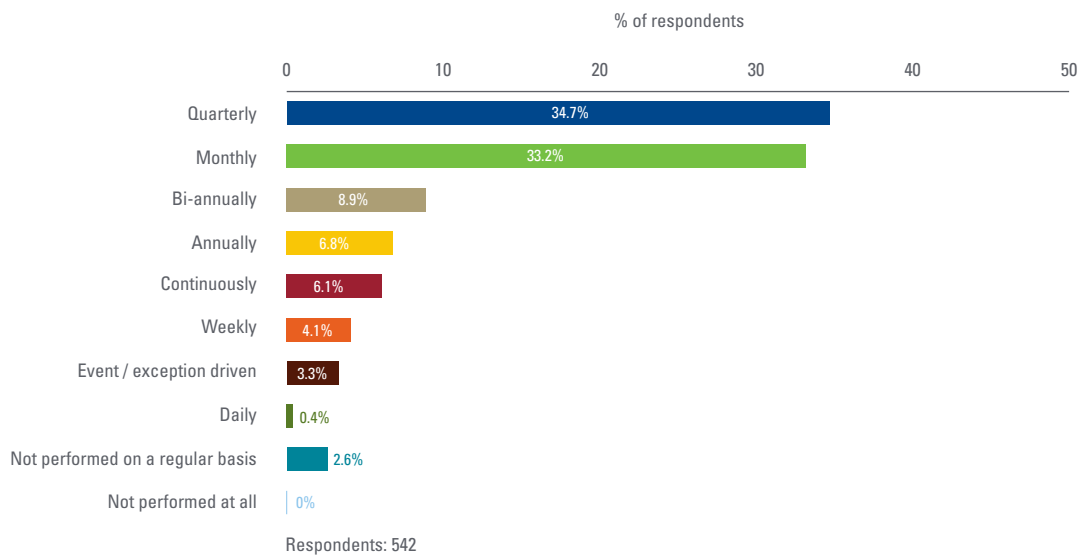
This research was conducted by the Economist Intelligence Unit in 2007. The 544 senior executives who responded to the survey were drawn from a cross-section of industries and included 168 CFOs. Each respondent was confirmed to have involvement in the financial forecasting process in their organization. What follows is a compilation of the survey results as well as detail about the respondents and their organizations.



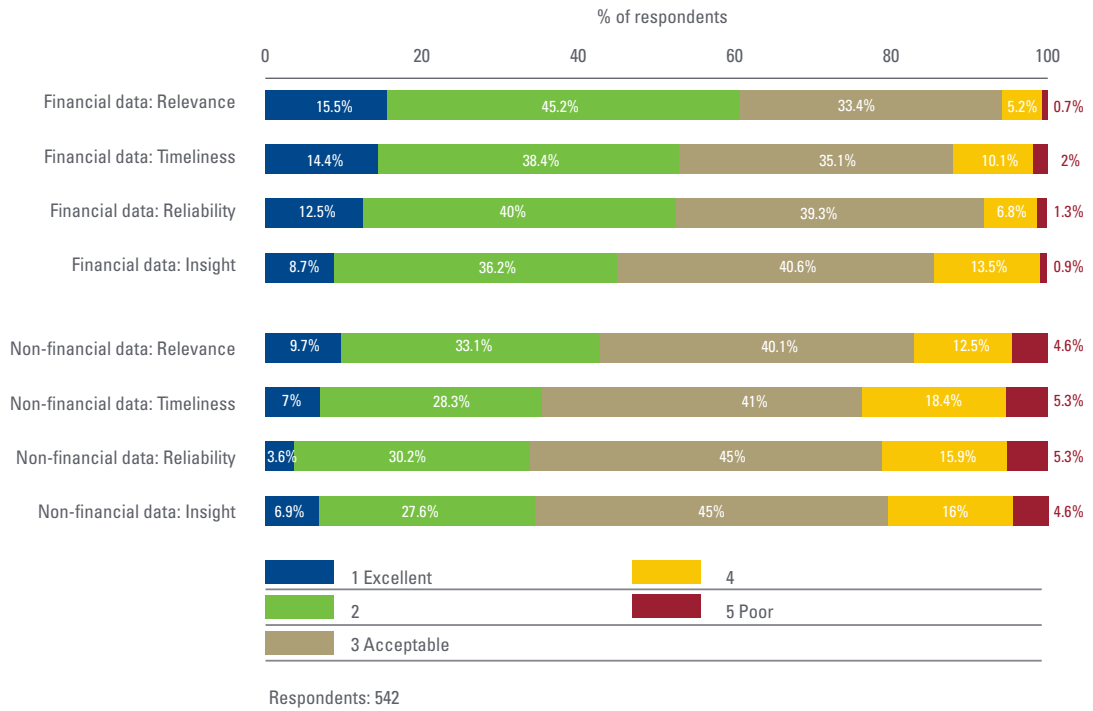
1. Which of the following statements are true within your organization?



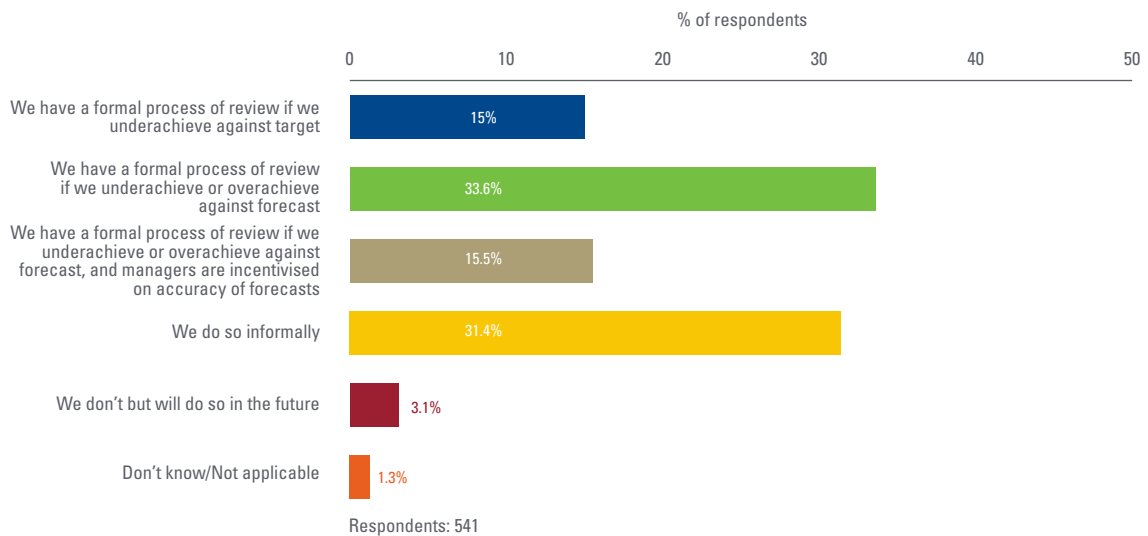
2. How frequently are your organization's forecasts updated?



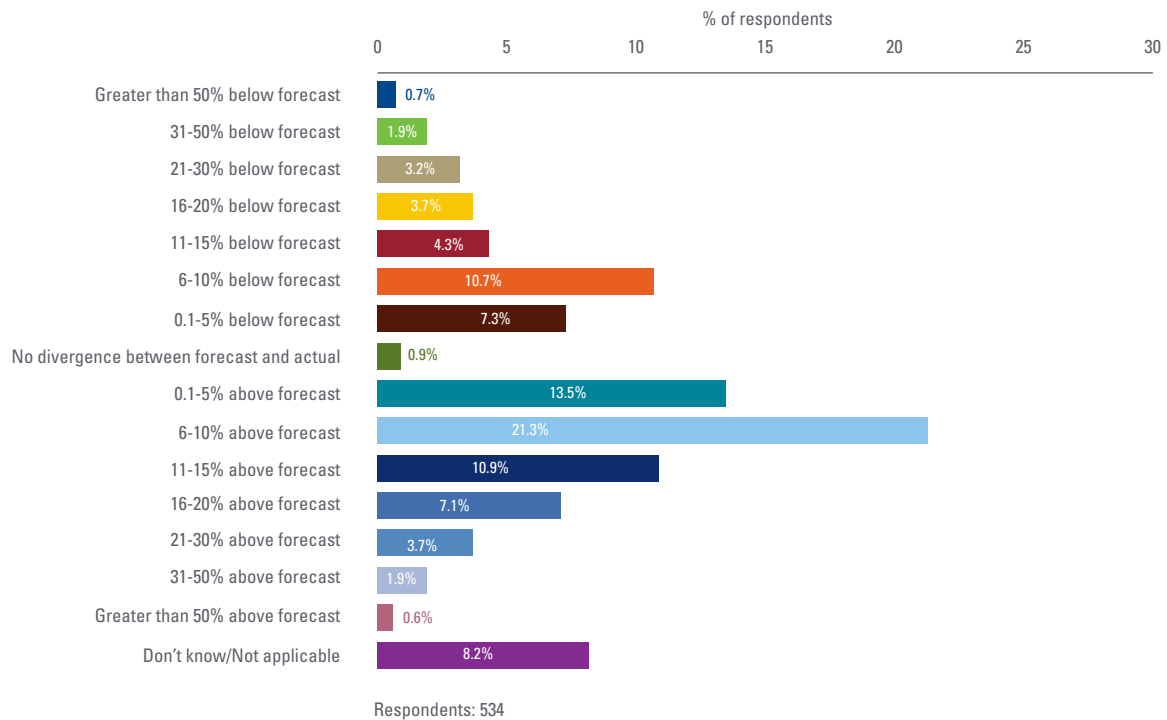
3. How would you rate the following attributes of your organization's forecast data?



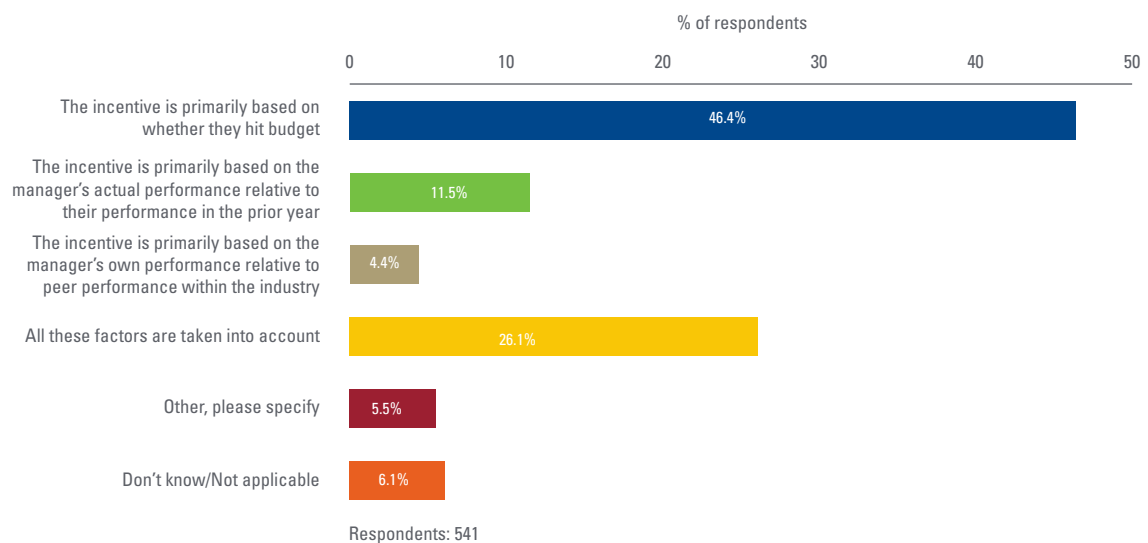
4. How does your organization measure the accuracy of forecasts?



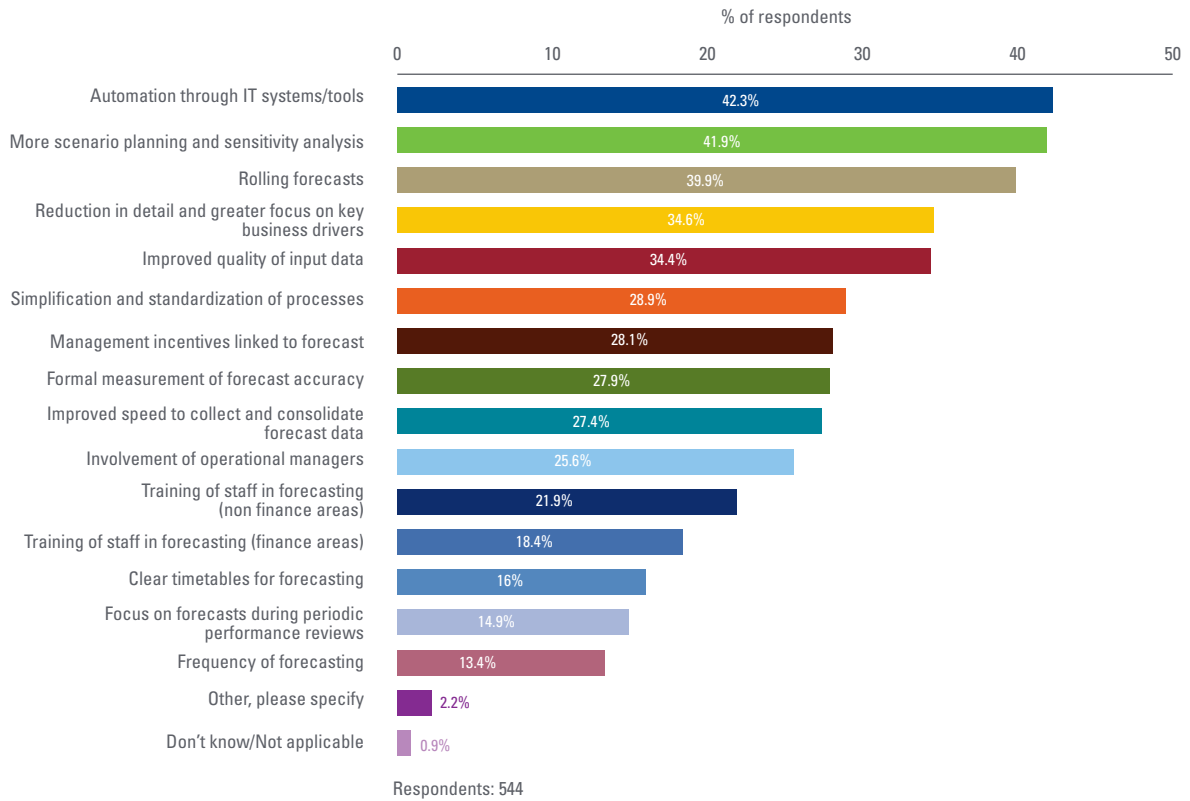
5. Has there been a variance between your forecast performance and your actual performance over the last three years, and if so, what was the approximate variance?



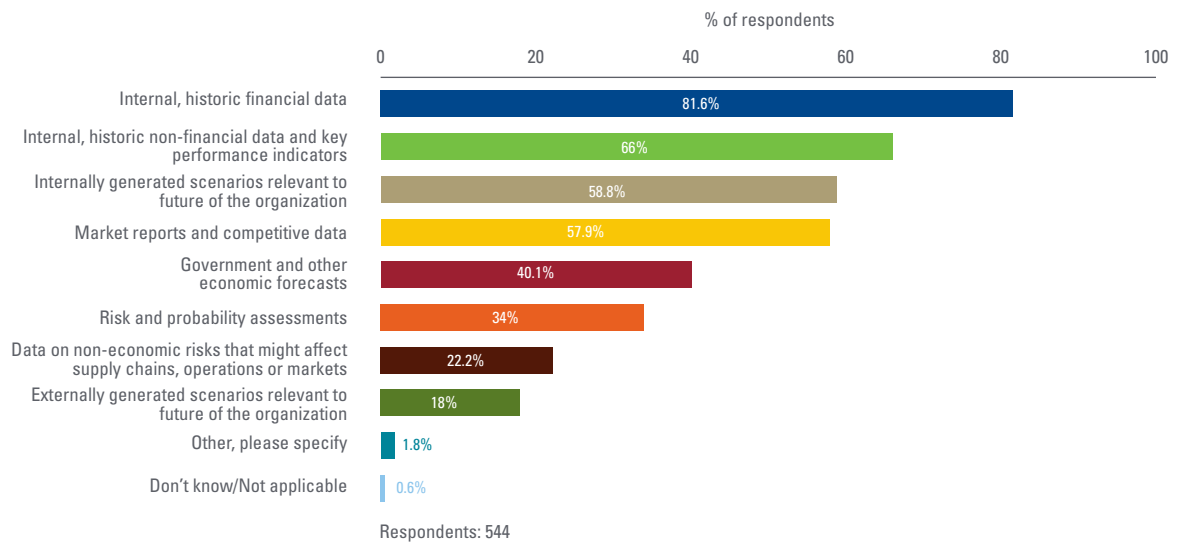
6. How are incentives used in your organization to drive managers' performance?



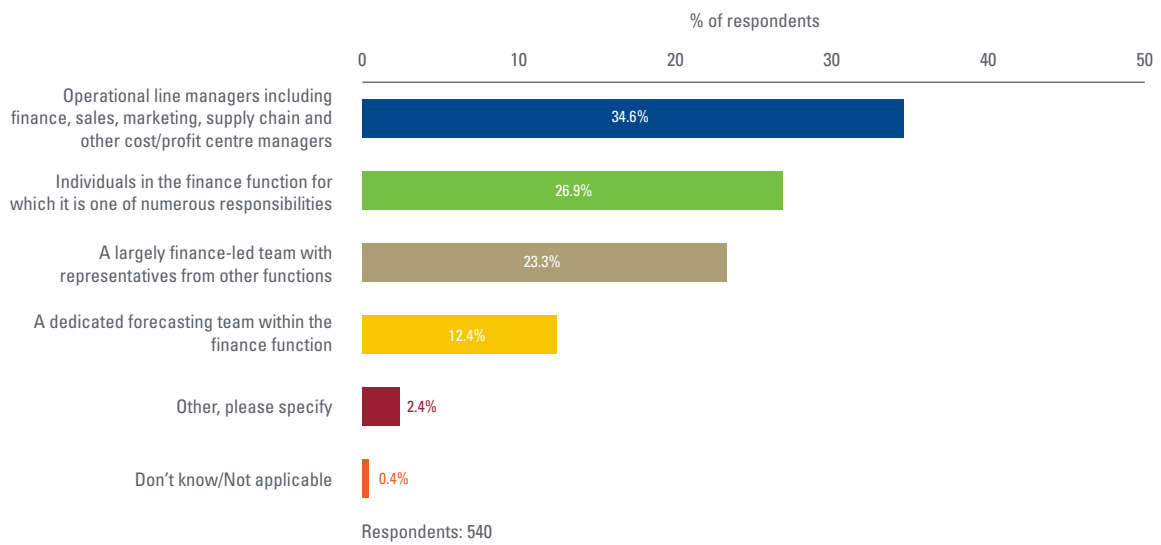
7. Which of the following has/would give your organization most benefit in improving the confidence of forecasts?



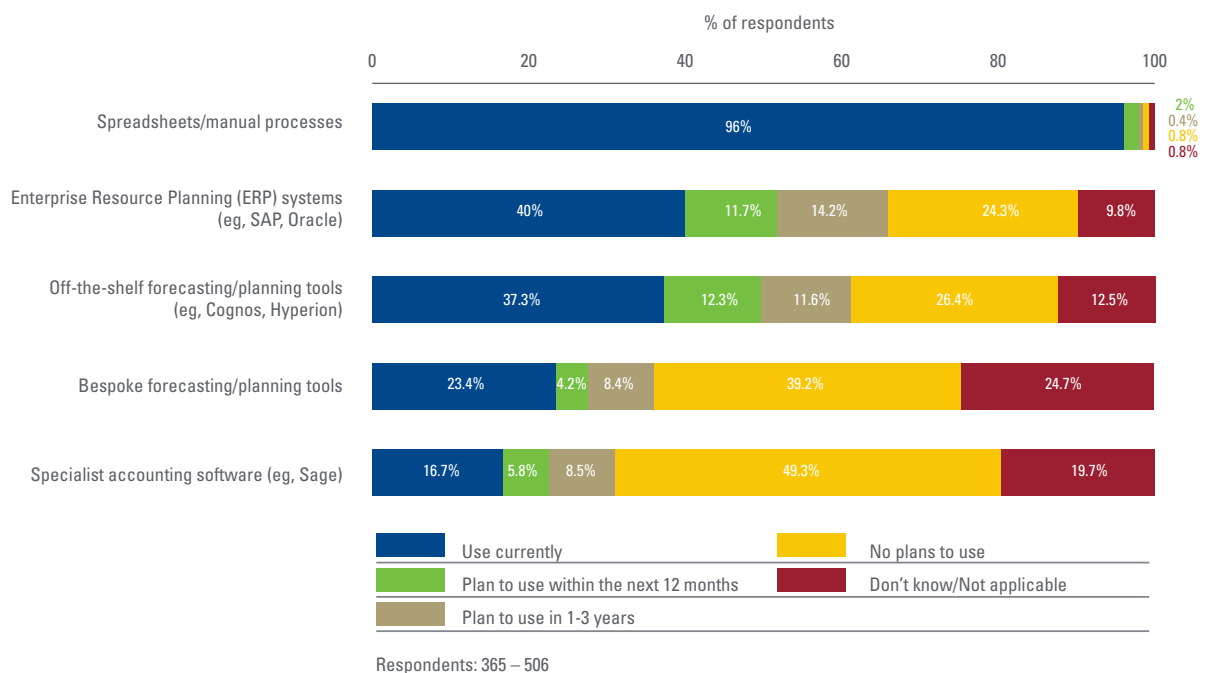
8. Which of the following does your organization use in formulating forecasts?



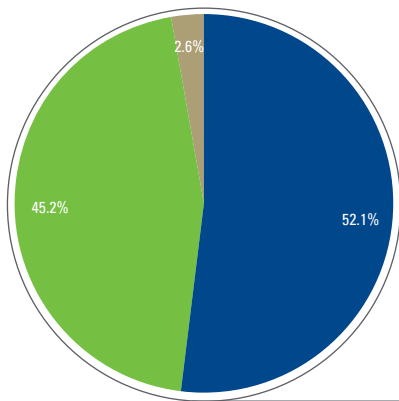
9. Which of the following best describes who is responsible for preparing forecasts for your organization?



10. Which technology does your organization use to produce its forecasts?



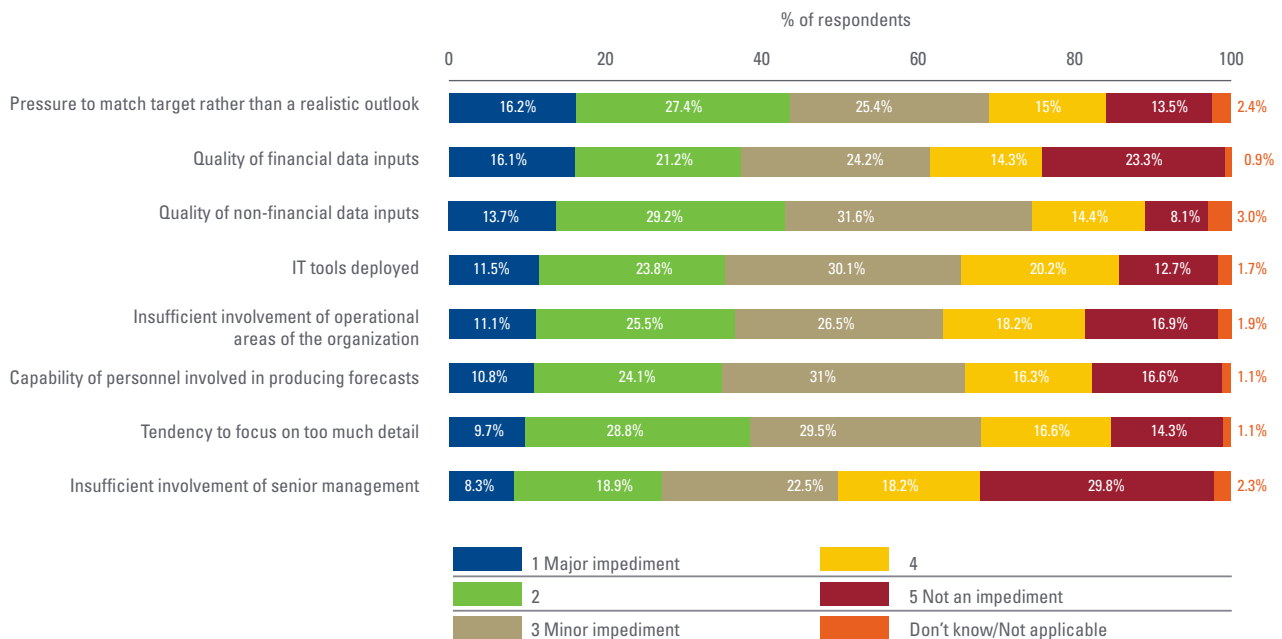
11. Which of the following best describes your organization?



- We collect forecast data on a different tool than the one we use for actuals reporting
- We use one tool to integrate actuals, budgets and forecasts and reporting
- † Not applicable – we do not track forecasts

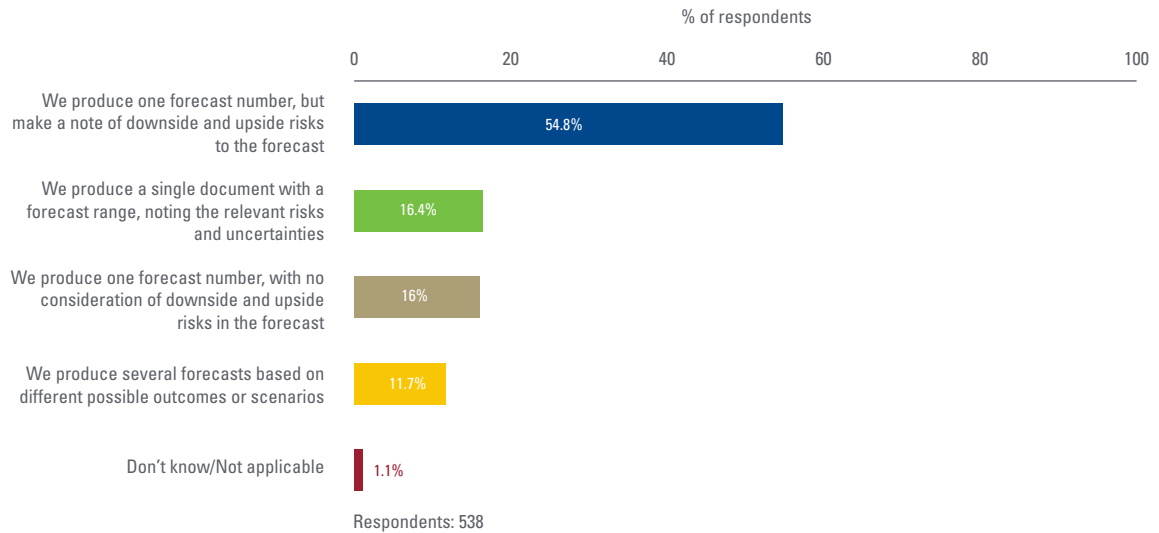
Respondents: 535

12. How great an impediment is each of the following in producing accurate forecasts at your organization?

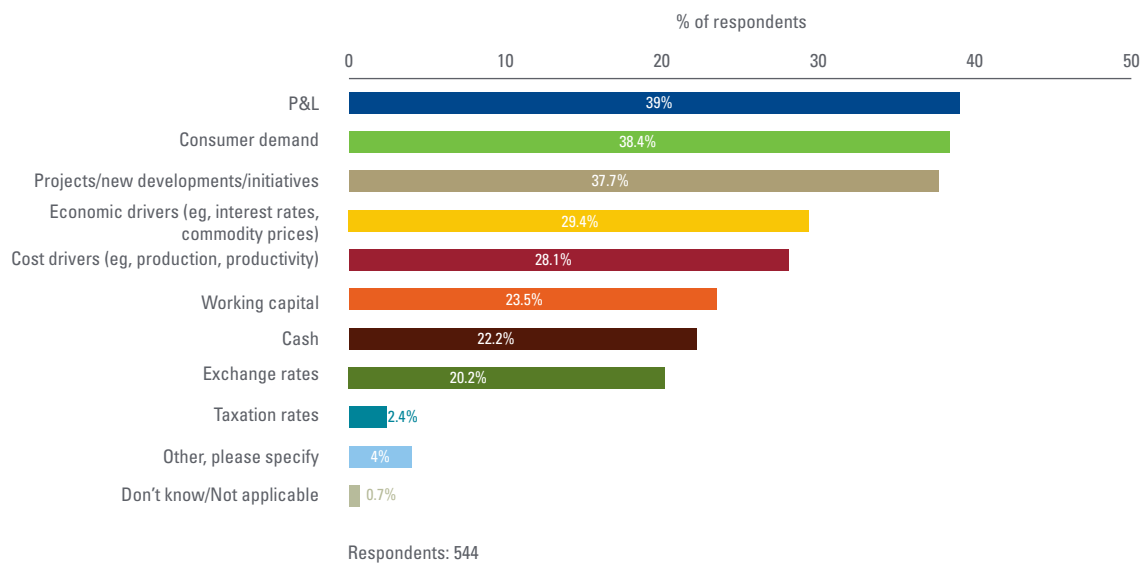


Respondents: 525 – 535

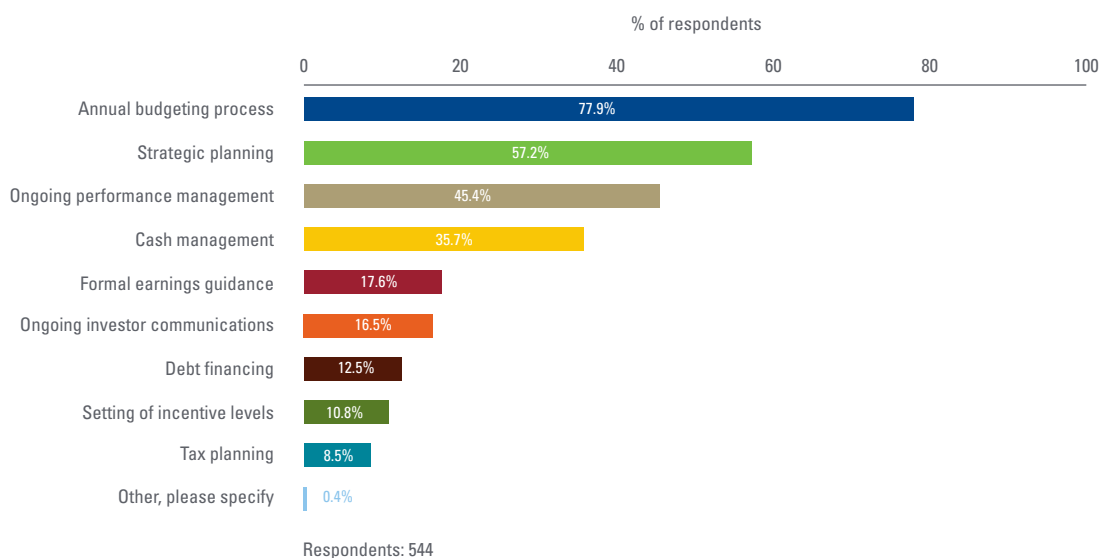
13. Which of the following best describes how your organization deals with uncertainty in the forecasting process?



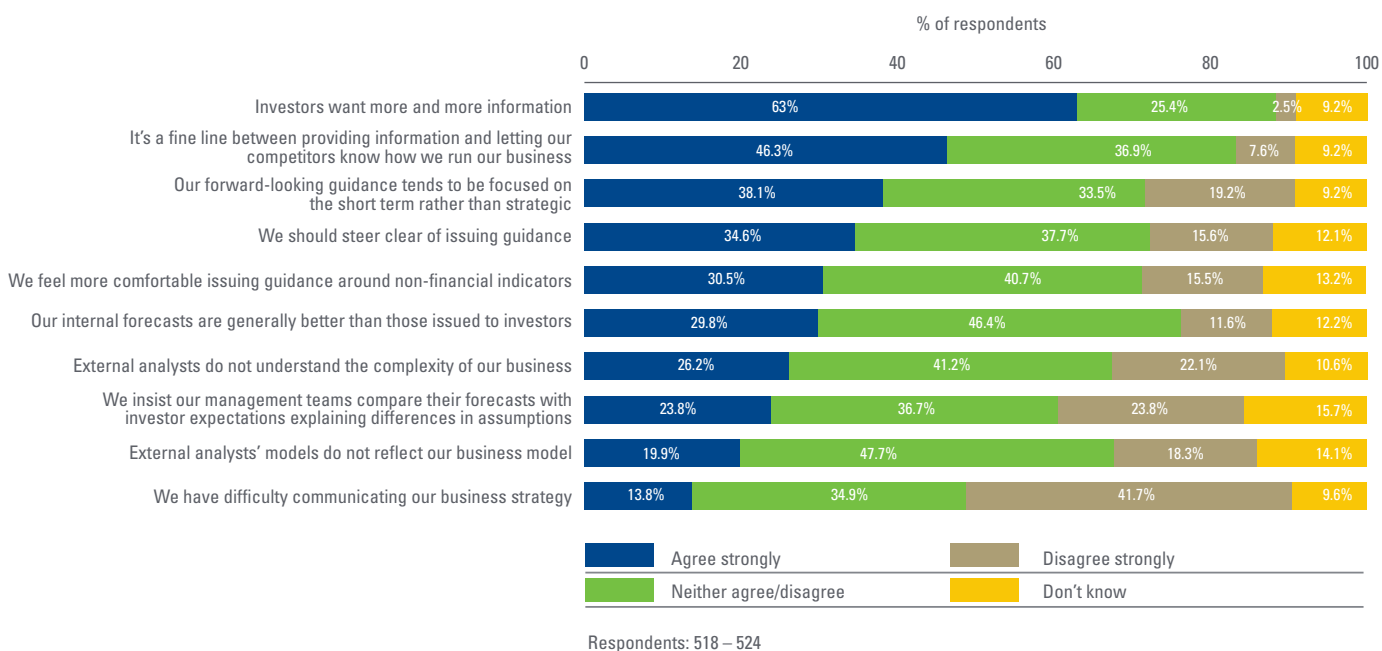
14. Predictions in which of the following areas tend to lead to the greatest errors in your organization's overall forecasts?



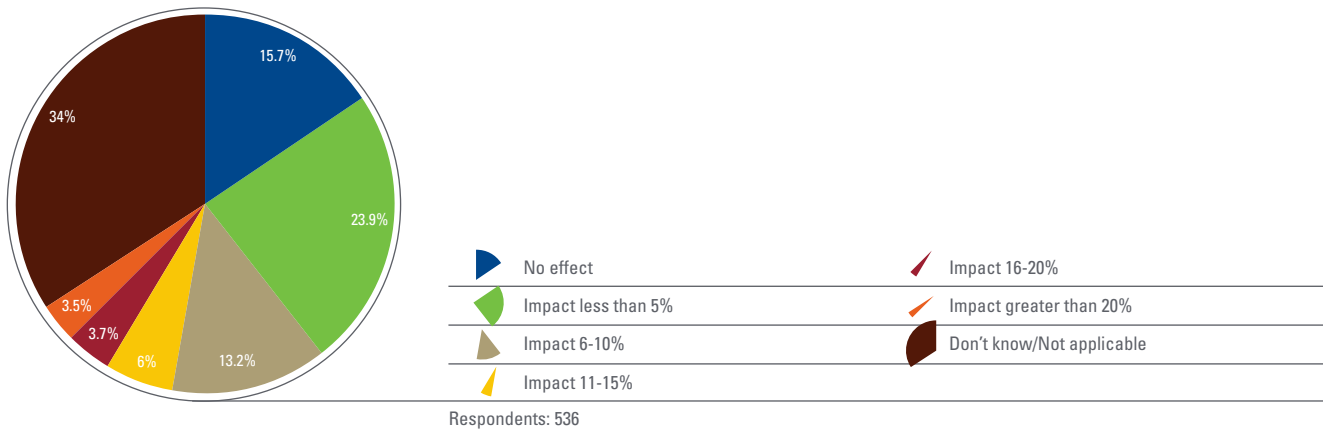
15. In which of the following does your organization's forecast play an important role?



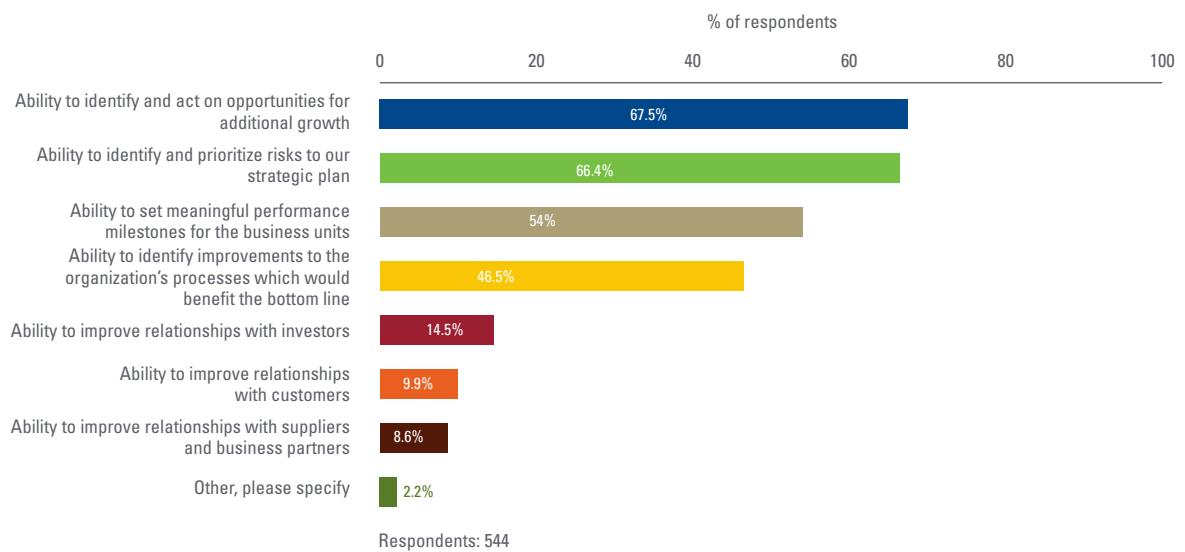
16. When considering earnings guidance to investors, which of the following statements do you agree with?



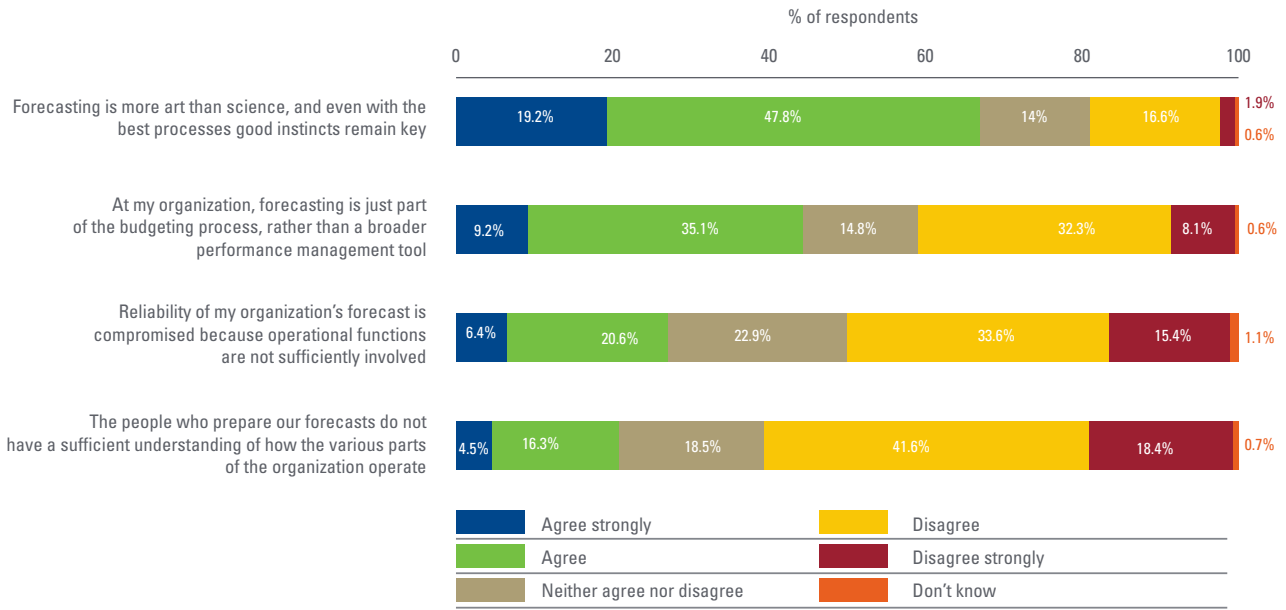
17. When considering the impact of forecasting errors, approximately how much do you estimate that these have cost your organization over the last three years in terms of share price?



18. What do you anticipate would be the main benefits of better forecasting within your organization?

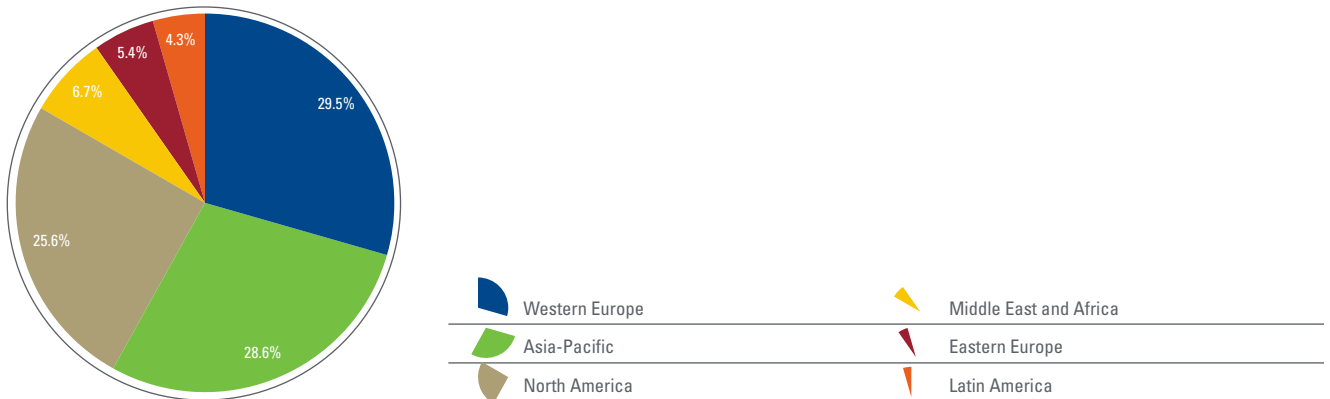


19. To what extent do you agree or disagree with the following statements?



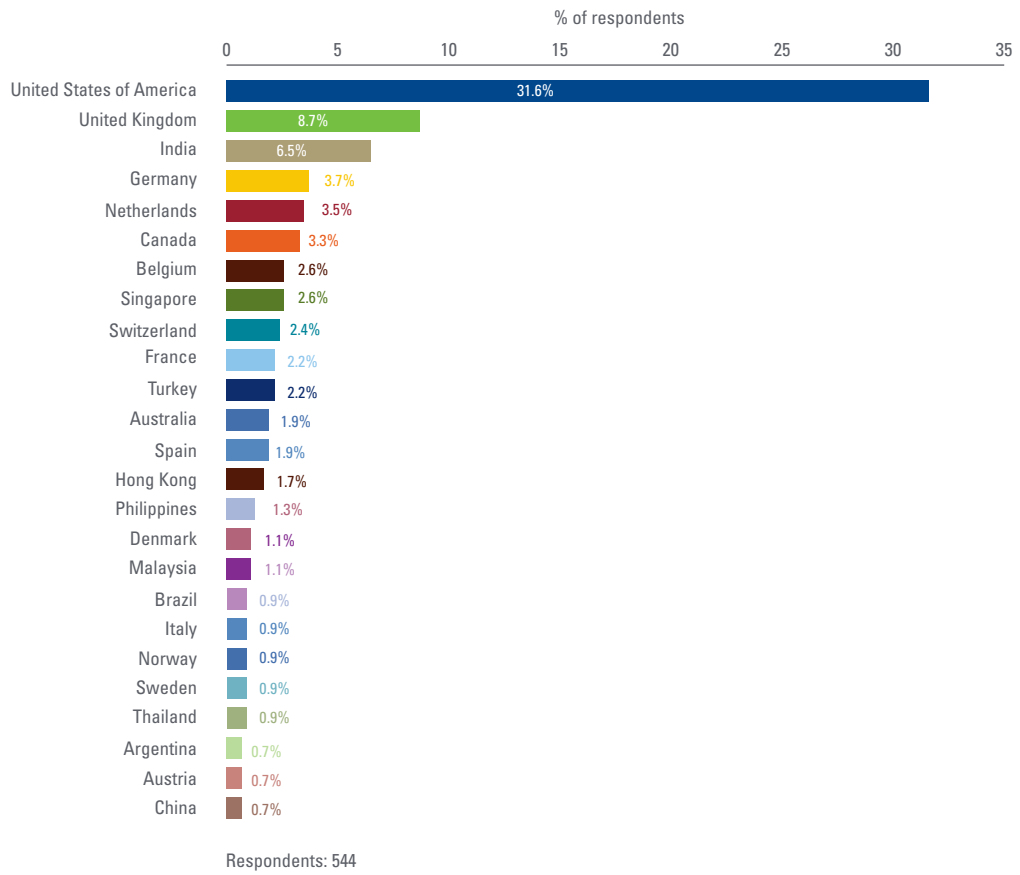
Respondents: 533 – 536

20. In which region are you personally based?

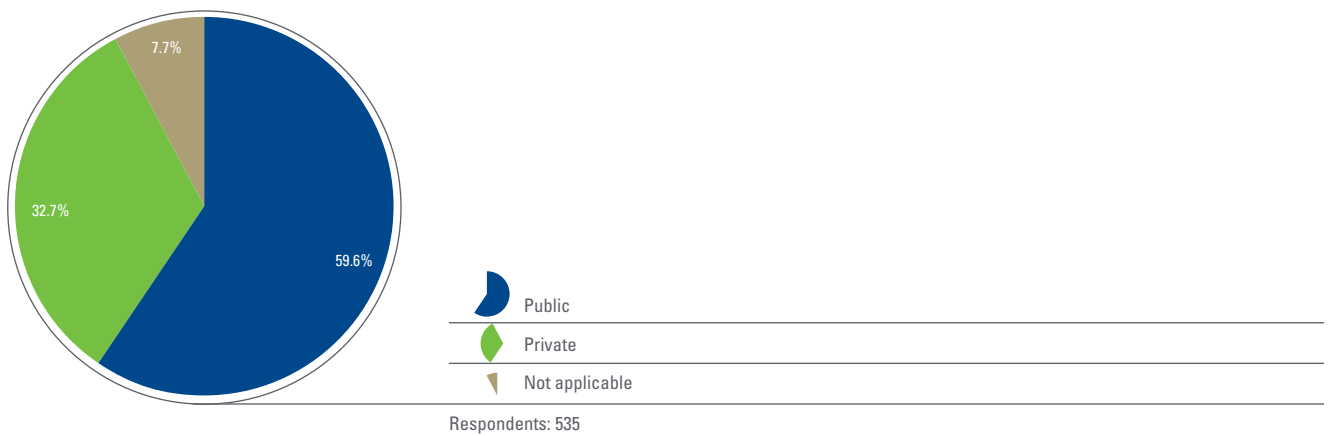


Respondents: 539

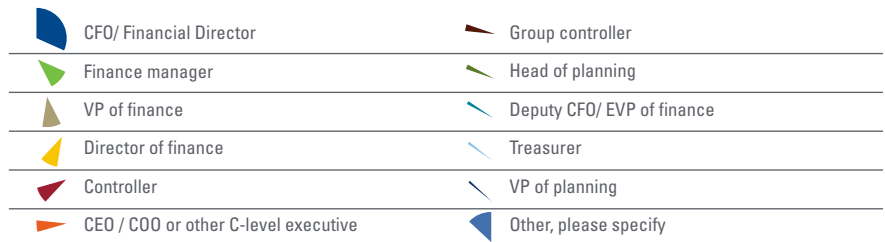
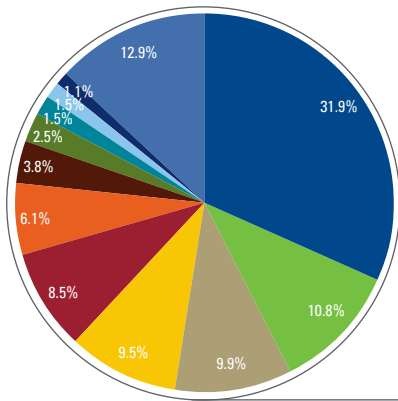
21. In which country is your organization headquartered? (Top 25 countries are shown.)



22. Is your company publicly listed or privately owned?

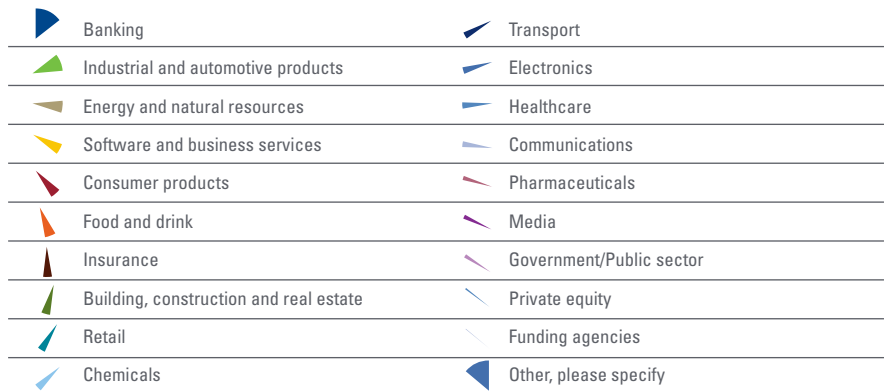
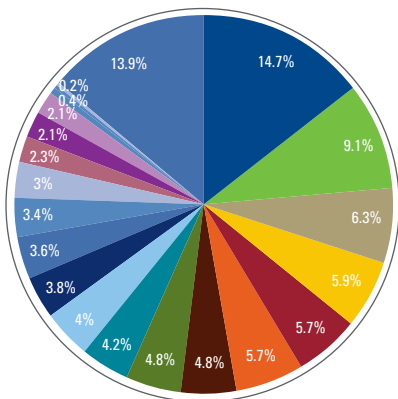


23. What is your title?



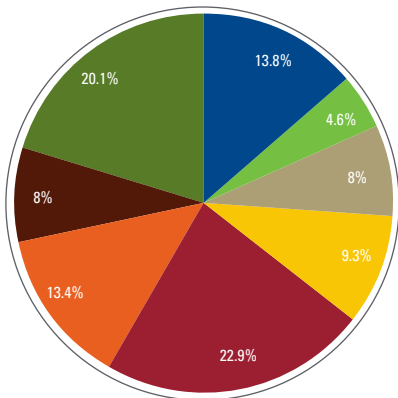
Respondents: 527

24. What is your organization's primary industry?



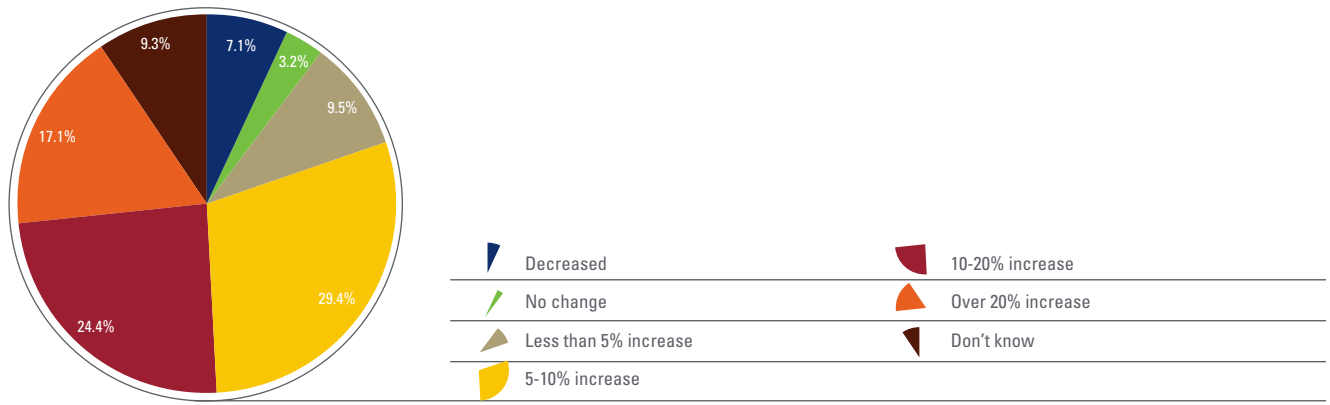
Respondents: 525

25. What are your organization's annual global revenues in US dollars?



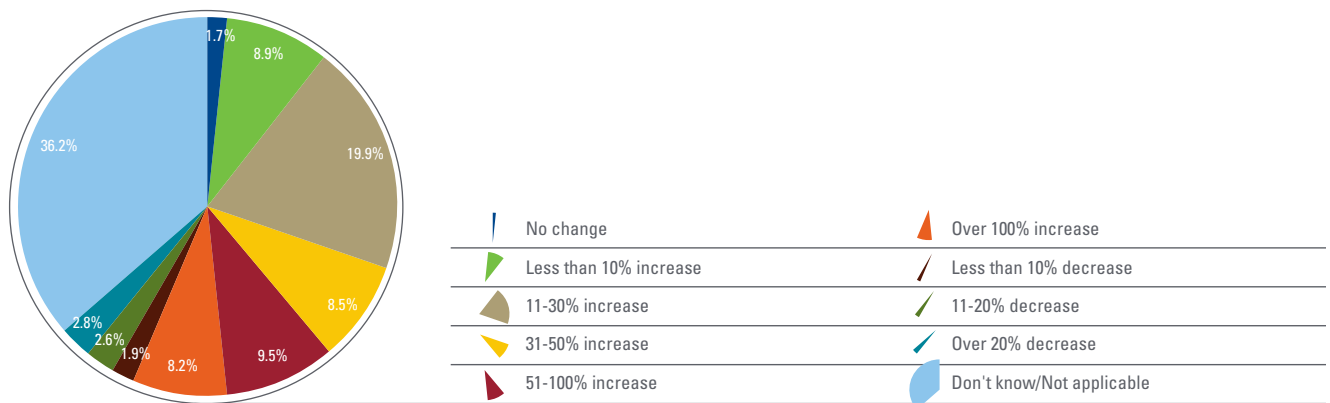
Respondents: 538

26. How has your organization's EBITDA changed each year, on average, over the past three years?



Respondents: 537

27. How has your organization's share price changed over the past three years?



Respondents: 539

Special thanks go to the key contributors of this publication whose insight, experience, perspectives and passion for this research effort made it possible.

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We chose the imagery in this research report to describe the dual concepts of a journey and the trust humans place in a compass as a powerful and dependable guide.

Leaders use a compass to find the right path, and they trust it as a tool to facilitate a successful outcome. It enables those who understand its power to make important decisions with confidence. For all these reasons, the compass serves us well in illustrating the potential power of forecasting.

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