

# Forecasting: An FP&A playbook

---

A comprehensive guide to best-in-class processes

# Contents

Executive Summary	03
Traditional vs Rolling Forecasts	04
How forecasts are built	05
Methodologies used for forecasting	06
The impact of getting it right	08
Keys to success/best practices	10
How new technologies can help	12



# Executive Summary

Forecasting excellence is a leading prerequisite for effective enterprise performance management. Today's business conditions are rapidly changing at a pace not experienced at any other time in the history of modern business. Due to unstructured forecasting capabilities found in many enterprises, finance organizations are often stretched to adjust to these changes efficiently and effectively. They still rely on manual processes and legacy solutions to prepare financial forecasts which often take significant time and resources.

Many organizations struggle with rigid and difficult processes. They are unable to quickly enhance or customize their processes to adapt to new requirements driven by these business changes. On the other hand, some have adopted new technologies but have not done the requisite business reengineering to enable a more flexible/modifiable forecasting capability. Forecasting excellence is often hindered by approaches that are not flexible and rarely meet the forecasting needs of the enterprise.

Today, organizations use a variety of tools for financial forecasting, while many rely heavily on spreadsheets. First and second-generation enterprise performance management (EPM) solutions emphasize the development of budgets and business plans. As organizations adopt current third-generation tools, they can take advantage of forecasting capabilities that extend financial planning and analysis (FP&A) into a more agile planning and forecasting integrated toolset.

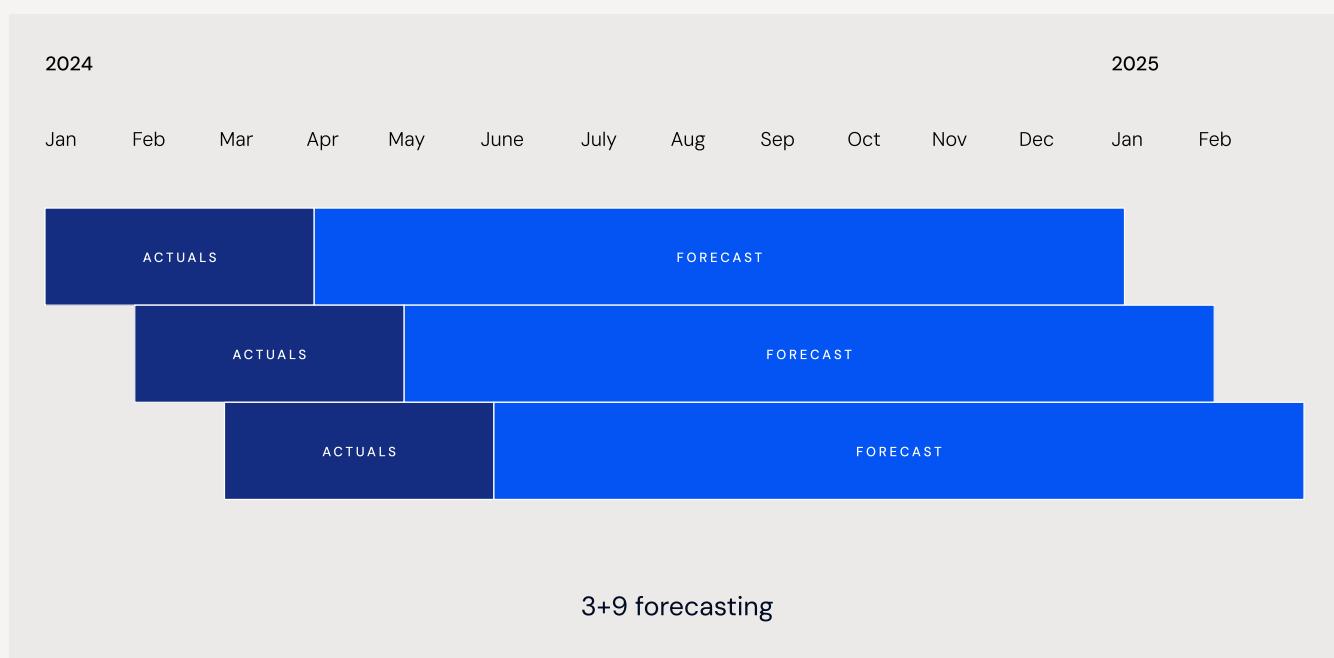
# Traditional vs Rolling Forecasts

The main purpose of financial forecasting is to predict future financial outcomes using a variety of inputs, including historical enterprise data, market trends, economic assumptions, and customer expectations to provide an estimate of what will happen in the future. To be effective, forecasts must support adaptive decision-making to consider changes in market conditions, global economic shifts, and unforeseen events.

Forecasting in the past generally happened at the same time as budgeting, and was set to cover the same time period. The issue with this, clearly, is that the forecast very quickly goes out of date and doesn't allow organizations to pivot in the face of change.

As a result, good practice is to now adopt a rolling forecast model – which entails completing a forecast for a fixed time period in the future, and then updating it on an ongoing basis (most commonly monthly or quarterly). That way, you always have a view into the future that reflects the business conditions of today.

Since forecasts are meant to be as accurate a prediction of the future, the past actuals can result in the changing of the future forecast. For instance if revenue is trending lower in the first half, then the second half may need to be adjusted downward as well if the trend is presumed to be a good indication of the future. The forecast is a living, breathing document that is meant to be changed based on market conditions. The comparison to actuals is a good barometer. A good example of a rolling forecast would be a 3+9: three months of actual followed by 9 months of forecasted data (all within the same board).



The frequency of updates and the amount of time a forecast stretches into the future will depend on three factors unique to the organization in question: namely, how fast market conditions are likely to change for your organization, the rate of growth you're experiencing, and the internal resources you have available.

# How forecasts are built

Financial forecasts typically focus on predicting short-term revenues, costs, and returns on investment. The approaches to building a financial forecast involve quantitative analytical approaches such as financial modeling and statistics, as well as qualitative based upon observations and judgments that have been built up in the finance department.

Financial forecasts are often done on a standard set of components, which can include:

- » Expense/cost of goods sold forecasting
- » Margin/Profit and loss forecasting
- » Revenue forecasting
- » Cash flow forecasting
- » Balance sheet forecasting
- » Capital investment/expenditure forecasting

# Methodologies used for forecasting

Many organizations' initial approaches to financial forecasting include using pro forma statements modeled after income statements, balance sheets, and cash flow statements. Pro forma forecasting of these statements can provide a picture of the organization's financial health and future performance, as impacted by changes in economic and market conditions. Most organizations run multiple scenarios based on different market and economic assumptions to provide alternative views of future performance.

Quantitative methods are used extensively in producing financial forecasts. They form the basis of scenario planning, where models are prepared that model the impact of market, economic, and internal factors.

While they are used extensively in forecasting, it must be understood that additional factors that influence performance can't be quantified and many organizations adjust their forecasts to use qualitative approaches, relying on expert knowledge and experience to predict performance rather than historical numerical data.

The Harvard Business School has identified seven quantitative approaches that are used in financial forecasting that must be considered:

## Percent of Sales

Calculate future forecasts using a percentage of sales approach. This would include modeling forecasts using the cost of goods sold, which is typically based on a percentage of sales revenue.

## Straight Line

Forecast using assumptions about historical growth rates that will remain constant. A good place to start with a forecast, however, does not take into consideration market, economic and supply chain issues.

## Moving Average

Forecast using a weighted average of prior periods, such as building a forecast by averaging the previous quarter performance. This is an underlying approach in rolling forecasts.

## Simple Linear Regression

Forecast metrics based upon the relationship between dependent and independent variables.

## Multiple Linear Regression

Forecast metrics based upon two or more variables impacting a company's performance. The ability to account for several variables that affect performance should lead to a more accurate forecast.

---

## Delphi Method

Forecast involving consulting internal and external experts who analyze market conditions. Results are compiled and circulated until a consensus is reached.

---

## Market Research

Obtain a holistic market view based on economic, market, competition, and consumer expectations. Important for new businesses when historical information is not available to understand these trends.

# The impact of getting it right

Financial forecasting is a key driver of business performance excellence and is an important capability the organizations must invest in, influencing and driving performance in many areas of the business.

It provides a perspective on what will happen in the future and can enable an organization to be agile in addressing changing market and economic challenges. Forecasting is critical to financial planning and can help identify where to “shift course” to ensure that an organization can perform to its strategic goals and objectives based upon an ever-changing marketplace.

Consider the following business impacts when determining the level of investment in financial forecasting:

## » Strategic Decision-Making

Effective financial forecasting helps an organization to make informed strategic decisions concerning financial and operational areas, including bringing new products and services to market in specific geographies.

## » Investor Confidence

Investors rely on accurate forecasts of financial performance to make investment decisions concerning an enterprise's financial health and well-being. This also extends to lenders, partners, and other stakeholders.

## » Stakeholder Expectations

Investors also rely on communications that contain realistic pro forma projections of future business performance. Critical communications with stakeholders must be grounded in effective financial forecasting.

## » Enterprise Strategy

Excellence in forecasting can help determine and align enterprise strategic goals and objectives that are realistic. This also enables alignment of enterprise planning to key performance indicators, and goals.

## » Setting and Adjusting Resources

Forecasting will enable an organization to better allocate resources across the enterprise and make changes as required. This is critical for both operational and capital requirements concerning inventory levels, staffing requirements, and supply chain plans.

## » Operational Budgets

Financial forecasting is key to the underpinning budget development process. This is vital for cost control to ensure that future spending and revenues align with the enterprise financial plan.

## » Capital Plans

Financial forecasting helps organizations to make critical decisions on where capital investment is needed by forecasting from the drivers that determine where future injections (as well as liquidations) are needed.

## » Tax Planning

Financial forecasting can also be used to determine the tax impact of certain operational decisions as well as determine what markets to pursue and what investments to make while optimizing the tax implication.

## » Cash Flow Planning

Financial forecasting is essential for managing financial liquidity. It helps organizations to anticipate future cash surpluses or shortfalls as part of a working capital management program.

## » Risk Mitigation

Developing accurate financial forecasts is crucial to manage business plans that are reflective of future reality. The numerous risks that are outside of an organization's control require an agile approach to forecasting that is essential when anticipating and planning for unexpected economic downturns and events.

# Keys to success/best practices

There are several areas you must address when you are building or improving your financial forecasting process to ensure that you are successful. These can help you to enhance the accuracy and reliability of financial forecasts while providing a solid foundation for strategic decision-making.

## 01 Take inventory of the current technologies and processes used for financial forecasting and prioritize tools that natively include AI models

Determine the solutions currently in use and where data is sourced and transformed in the process. Understand forecasting tools available in your current technology solutions and where you can potentially automate more of the process, while reducing the reliance upon offline spreadsheet-based processes.

## 02 Consider your enterprise business model

A prerequisite to any financial forecasting process is to ensure that your approach accommodates all required aspects of your enterprise business model. Understand what key performance indicators (KPIs) drive your business and how they should be forecasted. In addition, ensure that you have considered revenue drivers and cost structures that are vital to the forecasting process.

## 03 Understand historical data

Most forecasting processes rely on a thorough understanding of your historical financial data. You must analyze your historical financial data to identify seasonality, cost and revenue behavior that will impact future performance. AI can analyze vast amounts of historical and real-time data to identify patterns and trends that might not be apparent with traditional methods.

## 04 Ensure you have the right skills

Firms often struggle with financial forecasting by not making the right talent investments, both talent acquisition and training. Financial forecasting can be a more advanced skill when compared to other capabilities in finance (e.g., transaction processing, reporting), especially as you move to more complicated planning models. It is also an area that will evolve so those involved would need to stay updated on the latest tools and techniques.

## 05 Link forecasts to benchmarks

Organizations must be able to bring in third party benchmark data to compare forecasts to industry benchmarks. Incorporate peer performance and data on competitors if available.

---

## 06 Achieve consistency in assumptions

Ensure that assumptions are well documented and communicated to those who participate in the forecasting process. Ensure that the assumptions for each forecasting model are attached and understood to avoid confusion.

---

## 07 Learn and improve the process

Each forecast you produce builds from the learnings from prior forecasts. Seek to continuously improve forecasting by evaluating prior forecast accuracy and gather feedback on opportunities for improvement. Develop a list of enhancements that can be used to improve future forecasts.

---

## 08 Understand key risk indicators (KRI) that can impact your key performance indicators (KPI)

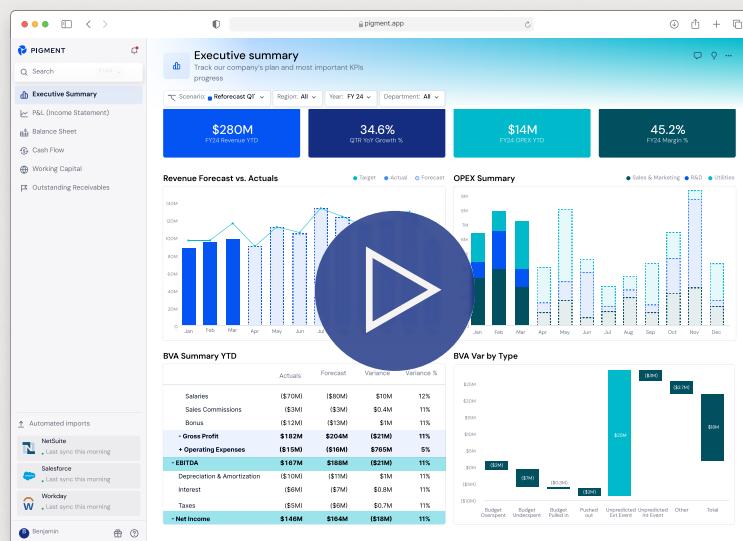
Ensure that you document the risks that could impact your forecasted KPIs and communicate these KRIs to key stakeholders. Typical financial KPIs include return on investment (ROI), profit margin, and revenue growth rate. A balanced and integrated set of KPIs can help provide a more comprehensive financial view across the organization.

# How new technologies can help

Organizations can gain significant financial forecasting efficiency by leveraging new technologies. These solutions bring together budgeting, planning, and forecasting capabilities into an integrated toolset that can be used to consolidate these processes.

Prior generations of these tool sets focused primarily on gathering and consolidating budgets and plans, including a rationalization of high-level plans with detailed budgets – the flexibility and agility to properly leverage and integrate forecasting into the process were lacking and not agile.

The current generation of these tools has made forecasting much easier and reduced the heavy dependence on offline Excel processes. They have incorporated many of the leading planning methodologies in the products, providing a single approach for financial forecasting and planning.



[Watch: Budget planning and forecasting in Pigment](#)

Scenario planning, in particular, is far faster in a tool like Pigment than in a spreadsheet: it lets you create and test as many scenarios as you like at the application level. Then, you can run these scenarios to compare your model data simultaneously across several future paths or leverage the AI to rapidly visualize and drill down into business data.

In addition to improving financial forecasting, these tools have also made strides in incorporating improved reporting and operational planning beyond finance – there are significant advantages to be gleaned by conducting sales forecasting and headcount planning within the same platform where you build your financial forecasts, plans, and budgets.

## » Sales forecasting in Pigment

Pigment empowers sales leadership to create reliable forecasts and make informed decisions with up-to-date business data, by bringing in the relevant cross-functional teams at the right time.

[Learn more >](#)

## » Headcount planning in Pigment

Turn data to insight, and then act on it fast. Pigment helps you identify gaps between budgeted headcount and actuals, quickly understand the impact on revenue and bottom line targets, and adjust your plans accordingly.

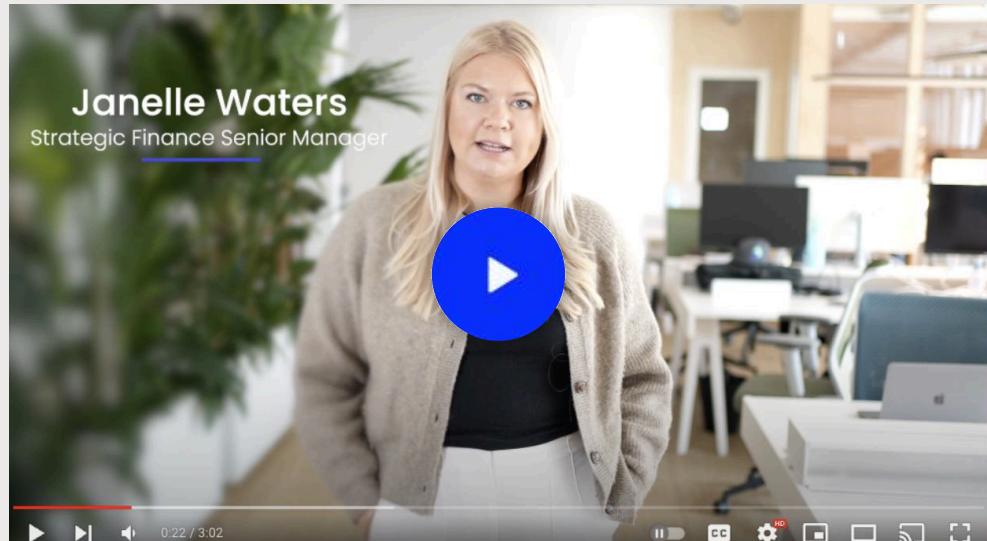
[Learn more >](#)

## » Case study - Carta

Carta's existing EPM solution didn't give the fast-growing ownership and equity management platform the agile insights they needed.

*“By having all data updated in real-time from Workday, the company is able to run continuous planning with a 12-month rolling forecast.”*

Janelle Waters, Strategic Finance Senior Manager, Carta



[Read or watch case study >](#)

## » A view to the future

Financial forecasting is an art and a science. It's a "science" in that it requires quantitative tools to ensure the proper handling and consideration of the variables found in the financial model forecasted. It's an "art" in that it also requires a good sense of expert intuition into what has happened in the past, and what is therefore likely to happen in the future. This is where financial forecasting both relies on quantitative and qualitative approaches.

Excellence in financial forecasting is still an emerging discipline for many organizations. Many have immature financial forecasting capabilities that could be greatly improved through new technologies as well as the investment in resources that are well versed in new forecasting methodologies.

As you plan your journey to forecasting improvement, you must plan for the unexpected. Your approach must address the agility required for today's economy which is certain to change rapidly. Forecasting excellence must be at the foundation of your approach.

[Learn more >](#)

---

*"By integrating AI into our workflows, we aim to democratize financial analysis and optimize decision-making."*

Eda Karael, FP&A Director, Uberall

[Read or watch case study>](#)