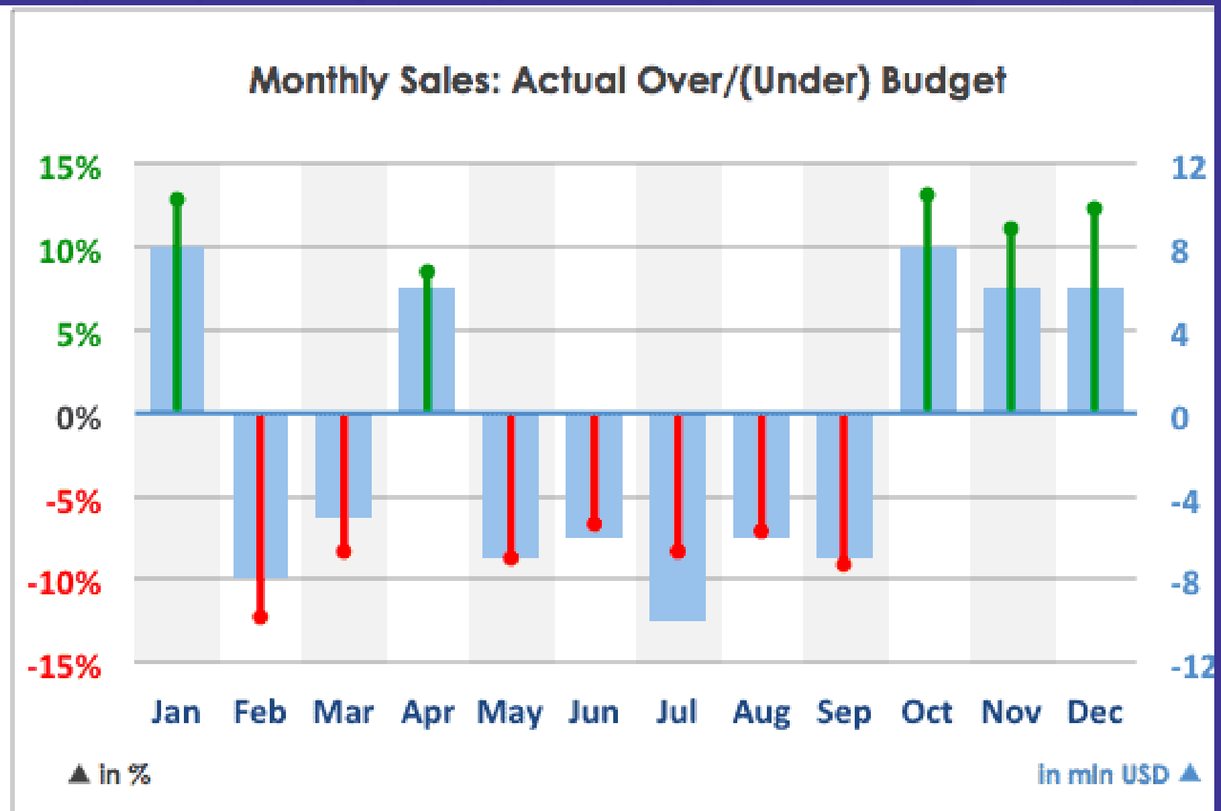
FP&A Variance Analysis

Bridging Numbers with Business Decisions

What is Variance Analysis ?

Variance analysis is the process of identifying and explaining why actual business results differ from expectations (budget, forecast, or prior year). It goes beyond reporting deviations—it uncovers root causes, highlights risks and opportunities, and recommends actions to improve performance.



🎯 Why Variance Analysis Matters for FP&A

1. Bridges Numbers with Decisions

- Variance analysis takes raw numbers (actuals vs. budget/forecast) and turns them into insights.
- It helps leadership understand **what happened, why it happened, and what to do about it.**
- Without it, finance becomes a reporting function instead of a **strategic business partner.**

2. Identifies Controllable vs. Uncontrollable Factors

- Some variances are within management's control (e.g., pricing decisions, supplier contracts).
- Others are driven by external shifts (e.g., market demand, economic conditions).
- FP&A uses variance analysis to distinguish between the two — which guides **where to act** and **where to adapt**.

3. Supports Forecasting and Resource Allocation

- Variance analysis feeds directly into **reforecasting** by showing trends early.
- It ensures resources are allocated to the **highest-value activities.**
- Example: If customer retention costs are rising, FP&A can advise whether to invest more in retention or shift strategy.

4. Drives Accountability Across the Business

- When teams see variance explanations, they know **where performance is slipping.**
- It enforces ownership by linking performance to drivers.
- Builds a culture of **financial discipline and transparency.**

5. Protects Profitability and Cash flow

- Small variances can **snowball into large profit leaks.**
- Variance analysis allows FP&A to catch issues early (e.g., rising overtime, supplier cost inflation).
- This helps protect margins and liquidity.

📊 How Variance Analysis is Different from Just Reporting

“Reporting tells you what happened. Variance analysis explains why it happened and what to do about it — turning finance into a strategic partner.”

Reporting = What Happened

- Reports show the raw numbers: sales, costs, expenses, profit vs. budget/forecast.
- They answer “What are the results?”
- Example: “Revenue came in at $5M vs. $5.5M budget.”

Variance Analysis = Why & What Next

- Goes deeper to explain the drivers behind the numbers.
- Answers **“Why did this happen?”** and **“What should we do about it?”**
- Example:
- Why: Revenue fell short due to lower volumes in Product A (-$300K) and delayed shipments (-$200K).

🎯 The Big-Picture Goal of Variance Analysis

“The big-picture role is to shift finance from scorekeeper → strategic partner

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Not Just Explaining Deviations

- Variance analysis is not about dwelling on misses or writing commentary for its own sake.
- It’s about turning financial deviations into actionable business insights.

Driving Business Decisions

- The ultimate purpose is to help leaders decide what to do next.
- Example:
- If sales are below forecast → should we adjust pricing, change marketing strategy, or cut costs?

Improving Future Performance

- Variance analysis helps FP&A improve forecast accuracy and sharpen resource allocation.
- Each variance explained today = better planning and fewer surprises tomorrow.

Steps in Variance Analysis

(The What → The Why → The So What)

Variance analysis is only effective when it goes beyond reporting numbers. A structured framework ensures every variance is explained with clarity, insight, and a recommended course of action. The process can be broken down into three essential steps:

The What

Identify and Quantify the Variance

The Why

Diagnose the Root Cause

The So What

Interpret & Recommend Actions

Understanding the **key impacts** of variance analysis on business strategies is crucial for effective decision-making.

The what

This step answers the basic question: **What changed?**

- Compare **actual results** against the **budget, forecast,** or **prior year.**Highlight whether the variance is **favorable** or **unfavorable** and quantify the size of the gap.

💡 **Example:**
"Sales revenue came in at $4.8M, compared to a forecast of $5.2M. This represents a $400K unfavorable variance, or –7.7%."

The why

This step is to explain **"Why it happened"**

- This requires digging into the underlying business drivers.Common root causes include **volume variance, price variance,Mix Variance ,Timing Variance,Efficiency Variance**

💡 **Example:**
"Sales revenue came in $12M below forecast. Of this, $7M was due to delayed shipments of Product A (timing variance), and $5M was due to a shift in sales mix toward lower-priced products."

The So What

So What and advise leadership on the next move.

- Assess the **business impact:** Does this variance affect margins, liquidity, or strategic targets?Recommend **corrective actions:** Adjust pricing, renegotiate supplier terms, reallocate marketing spend

💡 **Example:**
"The $400K sales variance could impact Q2 cash flow. To address this, sales incentives should be shifted toward higher-margin products, and operations should expedite the delayed shipments to recover lost revenue."

🔍 Root Cause Analysis Tools

Drill down step by step until the underlying issue emerges.

5 Why’s

Map how operational drivers (volume, pricing, headcount, utilization) roll into financial results.

Driver Trees

Categorize potential causes across People, Process, Technology, or Market.

Fishbone Analysis

💡 Example:
An **unfavorable variance of $10M** in sales was initially attributed to delayed shipments. A 5 Whys review showed the true root cause was **misalignment between sales forecasts and procurement planning**, leading to raw material shortages and missed deliveries.

📌 Rules for Effective Commentary

💡 **Example: Payroll Variance Commentary**

"Salaries favorable by $1.2M, primarily due to slower hiring in R&D ($1.6M). This was partially offset by higher retention bonuses ($0.4M). While favorable in the short term, the delayed hiring could slow product launch timelines, requiring a forecast adjustment for Q4."

- Use consistent signs → Clearly state Favorable (positive) or Unfavorable (negative).
- Focus on materiality → For a $3B company, variances under $0.2M may not be meaningful, but a $5M swing is significant.
- Stay concise but insightful → A 2-3 sentence commentary is enough if it quantifies the driver, explains the cause, and highlights the impact.
- Link to action → Every variance explanation should hint at what needs to be done – adjust forecasts, reallocate resources, or escalate risks.

🔎 Key Variance Categories to Track

- Revenue & Margin → Shifts in sales volume, pricing, product mix, or discounts.
- Operating Expenses → Salaries, marketing spend, IT investments, and overhead.
- Capital Expenditure → Project delays, overruns, or underutilized budgets.
- Working Capital → Changes in receivables, payables, or inventory positions.
- Customer & Market → Trends in retention, acquisition, or demand shifts.
- People → Headcount gaps, overtime, training investments, or turnover costs.

🔎 Types of Variances (By Driver)

- Volume Variance → Higher or lower units sold/produced.
- Price Variance → Differences in selling prices or input costs.
- Mix Variance → Shifts toward lower- or higher-margin products/customers.
- Timing Variance → Revenues or expenses occurring earlier/later than expected.
- Efficiency/Utilization Variance → Productivity changes, e.g., labor hours or machine usage.

Key Takeaways

Email

ripalt23@gmail.com

Social Media

LinkedIn

Phone

650-727-2585