The Issue

A Publication of CFOs2GO

Volume 10, Issue 1 **Jan 2020**

Driver Based Planning

No Trip to the DMV Required

By Joe Greenhalgh
Partner, CFOs2GO

WHAT IS IT?

Driver-based planning is an approach to planning and forecasting that ties business plans to the value drivers that have the most significant impact on the company’s success.

You may be thinking, “doesn’t every company do that?”. The reality in most small to medium-sized businesses is that budgeting and forecasting assumptions reflect a combination of past performance and the opinions of senior management. Unlike this traditional approach, driver-based planning emphasizes the role of a limited number of key variables in determining the company’s financial results.

A driver is simply an operational cause with a financial effect. Driver-based planning involves identifying the cause and effect relationships between independent inputs (“drivers”) and dependent outcomes.

Specialty Practice Groups

- International
- Non-Profit
- Small Business
- Family Office
- Healthcare & Life Sciences
- Financial Services
- Cleantech
- Equity Crowd Funding
- Mergers & Acquisitions
- Turnarounds & Crisis Management
- Valuation & 409A
- Financial Systems & Reporting
- Financial Modeling & Analysis
- Start-ups, Rapid Growth Companies, & Pre-IPO
- Balance Sheet Management
- Technical Accounting
- Enterprise Risk Management
- SEC Reporting
- Real Estate Development & Construction
- Food & Beverage

What is an example of a driver? The starting point for every company's P&L is total revenue, but the fact is that revenue is not a driver. Revenue is a dependent outcome. In a product-based business, revenue is typically driven by a combination of units delivered and the net selling price. Other related factors, however, may be equally important, including product mix, market growth, seasonality and the number of salespeople.

Identifying the most important drivers in each organization is the foundation of driver-based planning. That requires a deep dive into the P&L and balance sheet to identify items that are material and volatile and then create drivers for each of them.

Once the drivers are identified, models are created that enable managers to run scenarios based on these drivers to understand their impact on projected business results. Changes to the drivers ripple through all the connected projections to reveal the impact across the organization to the company's forecasted P&L, balance sheet, and cash flow.

WHY USE IT?

The many benefits of driver-based planning include the following:

Common language – Driver based plans get stakeholders on the same page by becoming the language in which you talk about the business. Discussions about financial performance and projections focus on the operational drivers, what's impacting them, and what actions can be taken to influence the drivers and improve financial results. It provides the leaders across all functions with a much clearer picture of the company's value drivers and helps non-finance people understand the key factors impacting financial performance.

Speed – The environment for most businesses is changing at a much faster pace, increasing the need for more frequent updates to key assumptions and projections. Driver based planning helps companies make faster decisions by providing visibility to the factors and the related levers that have the biggest impact on performance improvement.

Efficiency - Driver-based planning can significantly reduce the amount of time dedicated to budgeting and forecasting. Instead of getting caught up in the accounting-centric details of a G/L account level approach, the emphasis is placed on the most important business drivers. Finance and non-finance people can focus on what really matters, allowing for shorter planning processes and more frequent updates during the year.

Accuracy – Enabling the organization to ignore unnecessary items and focus on material drivers improves forecast accuracy. As accuracy improves, so does confidence in the integrity of the numbers and the process. Further increasing trust in the numbers, driver-based planning empowers finance to explain not just what's happening, but why it's happening.

Planning Flexibility – As the business environment changes, so too can the drivers. New drivers replace previous drivers, or the weighted mix of the drivers can be adjusted, with the impact of the changes rolling through the forecast for all to see. Driver-based models enable real-time scenario evaluation, what-if analysis, break-even analysis, and contingency planning. It's a straightforward exercise to simulate what may happen to the business under a variety of scenarios and assumptions, positioning the company to take decisive and timely action when needed.

Accountability – With a common language based on a limited set of key operational drivers, it is much easier to identify the primary factors, and the functional owners, behind variances from plan.

KEYS TO IMPLEMENTATION?

When you start down the path to a driver-based planning process, there are some important guidelines along the way:

Identify the drivers – At the risk of stating the obvious, start by identifying the most impactful drivers in your business. Take a deep dive into the income statement and the balance sheet to identify the items that are material, volatile, and likely to have the most significant impact on the company's financial performance. The drivers will vary from one company to the next, potentially even within the same industry. Additionally, as you review potential drivers, keep in mind that correlation isn't causation. Analyze the drivers you've identified

under a variety of scenarios to make sure the relationships are accurate, and that you can measure the results.

Start simple - Select a high visibility category, most typically revenue, and focus on the one or two most significant drivers. Depending on the size of the company, you could narrow the initial scope down further by focusing on a single business unit or product line. The key is to build credibility and momentum from the start and get as many early wins as possible. As the company becomes more comfortable with and confident in the drivers and the process, then consider introducing drivers in other categories, such as Cost of Goods Sold. Categories that vary in cost and fluctuate with volume are well suited to driver-based planning, but there are other categories that are more fixed in nature that don't warrant the same treatment.

Make it collaborative – It is essential to have organizational alignment. A successful implementation requires the active involvement of many functions, including operations, sales, and marketing. Everyone needs to understand their role in the process, who owns what, and the drivers and rates that will be used. Depending on the company's culture, you might want to invite a facilitator to help the team review and debate ideas in a balanced, objective discussion. If you let the finance team do this in isolation, you'll encounter resistance and minimal buy-in, dooming the process to failure.

Robust technology - While it's certainly possible to build models and run scenario analysis in Excel, there are newer technologies available that can increase the accuracy and sophistication of the models. These performance management applications, most of which include pre-built, driver-based modeling capabilities, make driver-based modeling much easier to implement and manage. Often, these applications are linked to the company's accounting and finance systems, improving data input, and providing a basis for comparison of actual results to forecasts. These applications further enable improved data analysis, cross-organization visibility and collaboration, and version control to preserve integrity and reliability.

Summary

If you're considering adopting a driver-based approach, or just have questions about it, the team here at CFOs2GO is here to help. We assist with facilitating driver-lead strategic thinking, offering advice and talent solutions for operational execution and providing expert ways to monitor your progress. Feel free to contact Joe Greenhalgh at (510) 857-6445 or via e-mail at jgreenhalgh@cfos2go.com.

Joe is a consulting CFO who applies his extensive experience in financial planning, analysis, and modeling in partnering with the leaders of small to mid-sized businesses to help them improve their companies' financial performance. Joe leads the firm's Financial Performance Management practice group and the Branded Consumer Products practice group.

CFOs 2GO Partners is a hand-picked team of leading practicing CFO consultants who customize and provide financial management solutions for client companies. The company was founded and is still managed by a former CFO. Each of the consultants have, in addition to themselves and the other consultants, access to specialty financial management executive search and placement services to assist in quickly fulfilling on client company requests both in the U.S. and abroad.

CFOs 2GO Partners is a member of the 2GO Group of Companies; CFOs 2GO Partners and "2GO" are registered marks of the 2GO Companies.

www.CFOs2GO.com
(925) 299-4450

2GO Group
CFOs2GO® CIOs2GO℠ IT 2GO® ACCOUNTANTS 2GO®