



## Focus on financial flexibility

*Adaptive financial planning increases the ability to react quickly to whatever the economy brings.* by **Darlene Bremer**

**Financial planning was easier** when all we had to think about was price. Traditionally, a company would prepare an annual budget that would be the plan for the year. It took weeks or even months to complete—with different departments working separately on their part of it—and it was relatively constrictive. Usually constructed on a simple spreadsheet program, the goal of this type of financial model is to project conditions into the future, which will hopefully allow the company to plan activities that will improve its financial results. This traditional annual budget, however, offers only a snapshot of conditions and limits flexibility in making financial decisions. A newer approach to financial planning is to be more adaptive to current conditions and continuously examine underlying assumptions and refresh the financial model to reflect changing conditions.

“Adaptive financial planning is the realization that a business environment is dynamic. To properly react, especially in a rocky economy, a distributor has to refresh its outlook more frequently and be more responsive to the marketplace,” said Bill Aiken, principal and CEO of the management consulting firm Abacist Group ([abacistgroup.com](http://abacistgroup.com)).

The concept of scenario analysis, not unlike the concept of building information modeling used in designing construction projects, takes adaptive plan-

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ning one step further. It goes beyond a single change in assumptions to examine a company's true financial standing through identifying key financial drivers.

According to Lantz Nefflen, solutions development executive for Demand Solutions Group (demandsolutionsgroup.com), a provider of Software as a Service (SaaS) business solutions, scenario analysis means examining a particular set of opportunities and their costs and determining the impact.

"For example, what if a distributor wanted to expand its territory, add a new product line, or hire more salespeople? What would happen to the company's profit statement, balance sheet, and cash flow?" Nefflen asked. "Scenario analysis software helps quantify what will happen if assumed conditions actually manifest and allow management to make real-time, effective decisions."

Financial modeling that uses scenario analysis allows various views to be taken under different circumstances, which enables users to more easily determine how to change activities and take different inputs into consideration.

"Scenario analysis software is more flexible than annual budgets and helps prepare a company for a variety of business conditions. It also helps mitigate risks by enabling quicker responses to changing conditions," added Aiken. In addition, the adaptive planning and scenario analysis concept enables constant reassessment of conditions, offers a consistent set of tools to use, is user friendly, and is less subjective than traditional financial models.

## MAKING ASSUMPTIONS

Most of the time it's best to avoid making assumptions. In financial planning, however, it's imperative. Today's adaptive planning software actually makes it easier for distributors to change conditions and variables and then automatically cascade the new data throughout the entire model almost immediately, according to Aiken. "Through the manipulation of underlying assumptions, financial planning software enables the company to perform 'what

if' scenario analyses quickly, easily, and often," he said.

And those assumptions can be about virtually anything, including territory, revenue, and sales. According to Brent Grover, managing partner in Evergreen Consulting (evergreenconsulting.com), which specializes in distribution consulting, and author of *More to the Bottom Line: Customer Profitability Analysis Tool for Distributors*, adaptive planning and scenario analysis programs enable distributors to create the three gross margin dollar scenarios: base case, best case, and worst case.

Grover believes that management should have at least a 50% confidence level in the base case coming true, with the best and worst case scenarios rated at about 20% each. "Having these scenarios to show lenders enables a distributor to demonstrate that its cash flow forecasts are accurate and that it remains a good risk," he said.

## ENHANCING COLLABORATION

Financial modeling programs provide a consistent and highly user-friendly methodology across the company, according to Nefflen. "All department heads or other contributors are using the same tool. Since the data is centralized, every change made to the underlying assumptions is seen by everyone involved in the process," he said.

According to Aiken, by implementing a financial planning model, a company can focus on a standard set of metrics that will define success and enable everyone to be on the same page.

"As a financial tool, adaptive planning or scenario analysis software pulls the various decision makers together and provides a platform that enhances discussions and increases collaboration between departments," he explained.

The software chosen is tied directly to the company's existing financial or enterprise resource planning system. "To get the maximum impact, the software should also be integrated with the company's supply chain management, human resources, and sales data and warehouse systems," Aiken advised.

Many of the programs available are web based and operate under the SaaS model. The main advantage is a lower total cost of ownership, especially for mid- and smaller-sized firms, because no investment is required in hardware,

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software, additional infrastructure, or IT staff. Other advantages include remote access of data, automatic software upgrades, and high levels of data security.

When examining the choices, choose a system that is easy to use and maintain; integrates with other business intelligence, financial, and operational software systems; quickly and easily consolidates various views and provides detailed data mining; and offers an enterprise-wide workflow capability.

"Also, keep in mind that in the future financial modeling and scenario analysis software will offer deeper levels of integration with existing financial systems and will offer increasingly sophisticated reporting capabilities," noted Nefflen. ■

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