The philosophy of forecasting

Going beyond the numbers

In the Xero 2018 Australian Accounting Industry Performance Report, 98% of all firms rated 'advisory services, eg budgeting, cash flow forecasting and business planning' as one the top 5 most attractive areas for growing advisory services revenue this year. 65% rated it as their #1 opportunity...

Castaway has been around a while. We've watched, and helped, lots of accountants grow thriving advisory businesses with budgeting, forecasting and planning as their centrepiece. We've learnt a few things along the way too.

But we've never seen numbers like these. There's no doubt the surge in interest has been helped along by the rise of future-focused apps in the Xero ecosystem. And as a long-term advocate for the power of forecasting, this is music to my ears.

The reality is that there has always been a need for budgeting, forecasting and planning services. A well-designed forecast is at the heart of any business improvement program. Have you ever met a business owner who doesn't want to improve their business?

In my view, if a business doesn't forecast, it doesn't have a future. We can learn from the past, but we can't make it different. Every single thing we can do to improve a business will happen in the future. So, it makes sense to be clear on where we're headed.

There's forecasting and there's forecasting

Before we go too deep, let's clear up a key point. The term 'forecasting' is used to describe 2 very different services. The first is short-term cash management and forecasting daily and weekly cash flows, often at invoice level. The focus is on survival and giving leadership the confidence that comes from knowing there are no cash traps ahead.

The second is longer term 3-way modelling, with a focus on forecasting overall business performance (including cash flow) across a range of scenarios. Castaway is designed for the second version.

When Castaway launched in 2010, we started out as a replacement for WinForecast, which for a long time was the benchmark in 3-way forecasting software. Back then, we were completely focused on being the most powerful and flexible 3-way forecasting tool on the market. Looks and usability were important, but not our main focus.

The Xero influence

Xero, and the community of apps and add-ons that followed, changed all that. They raised the bar for look, feel and user experience. We listened. The game changer came in 2015, when we launched our first Xero-Castaway integration. Suddenly, we could build a fully customised forecast in minutes and import 'actuals' data for monthly or quarterly reporting in seconds. Then, users started to listen. We now work with plenty of the most successful and celebrated Xero partners.

Xero have been great to work with even though we don't quite fit the mould, being an on-premise product. We've been a quiet achiever on the Xero scene, not promoting hard, but growing through word of mouth referrals. 8 years on, we're well past the level of WinForecast™. Someone recently called us 'WinForecast for the 21st century'. I take that as a real compliment.

Why I don't like budgets

I don't like budgets. At least not budgets done the traditional way – decided once a year, for 12 months at a time and never reviewed. Budgets like these might look good on paper, but they offer little value to the business. In fact, they can be dangerous.

You start the year looking 12 months ahead. As the months pass, that focus shortens, so the business gets more short-sighted as the year goes on. How can that be a good idea?

Even worse, I've sat in too many month-end performance review meetings where variances against a budget (that hasn't been updated) are explained away 'because the budget is out of date'. And the conversation stops there, a wasted opportunity.

Done well, these meetings are a great forum for aligning focus and driving improvement ideas. Traditional budgeting works against these outcomes.

Budget v Forecast – what's the difference?

Surprisingly, there's never been an agreed definition for these terms. There are lots of opinions, and they're all different. It doesn't matter, because arguing about it produces no value. Here's what we work with.

A budget is an idealised picture of what the business wants to achieve for the coming 12 months. A forecast is a realistic picture of what the business expects to achieve over the coming 1-3 years.

A budget is set annually in advance and fixed. A forecast is updated regularly and dynamic.

A budget often includes stretch targets, contingencies and is used for reward-based motivation. A forecast is the 'best view of the truth' and is used for decision-making.

Why I do like forecasts

A forecast is one of the most important documents in a business. It lays out well-considered answers to 3 questions that are critical for every business:

What we think will change in the market (the assumptions underpinning our planning)

What deliberate moves we intend to make (our proactive strategy and direction)

How we plan to react to changes in the market (our reactive risk/opportunity response)

The forecast is essentially the business plan written in numbers, a roadmap that sets out the game plan for the future. It is fully aligned upwards to business strategy and downwards into KPIs. As a communications tool it helps drive focus on not just the financial outcomes, but on the business engine that produces those outcomes.

Forecasting v fun with maths

Clearly, I'm assuming here that the forecast is the result of a decent planning process. If we don't apply the right rigour and thought, the forecast is a waste of time.

On this note, I'm disturbed by the focus among some advisors on 'speed-forecasting'. Take last year's numbers, add X% and call that a forecast. That's not forecasting. That's fun with maths.

Garbage produced quickly is still garbage...

Can every business forecast?

We talk to people all the time who are certain they can't forecast, often because their revenue is unpredictable. They say 'mate ...' (we are from Australia after all!), 'how can I forecast? I can't predict when a customer will come through the door' or 'I don't know if we're going to win that contract'.

I disagree totally. Uncertainty like this is exactly why we must forecast! The revenue might be uncertain, but the costs don't stop. So, decisions will need to be made at some point. The most important thing my 'mate' could do is to use the forecast to decide ahead of time what needs to happen if he does win the contract ... or if he doesn't.

Building a forecast is not about predicting the future. Nobody can do that. It's about working out your game plan months or years ahead. It means you get to make clear-headed decisions in advance, which is always better than doing it real time and under pressure.

Remember, there is no rule that a forecast has to assume only 1 scenario. The best forecasts allow for a range of scenarios and lead to a range of game plans. The aim is to be ready for anything.

What we risk by not forecasting

Running a business is hard. It's unrelenting and often deeply lonely. The sheer number of decisions to be made every day means our focus is constantly pulled shorter. Our thinking is reactive. If we look ahead, it's to the end of the week or the end of the month.

So, you miss stuff. You don't see the storm clouds gathering on the horizon that tell you of trouble ahead. You don't see the bright lights down the road that signal approaching opportunity. And if you don't see it, you can't act on it.

Looking further ahead creates more time to make the strategic moves that drives business value. That's exactly why adopting a rolling forecasting cycle makes such a difference.

The rolling forecasting cycle

Forecasts are important. But if they are a one-off outcome of a one-off exercise, their value is limited. To be truly useful, the forecast should be a living document, continually reviewed, validated and updated. We're big advocates of rolling forecasting, the art of constantly looking ahead.

The rolling forecasting cycle is an ongoing process of: reviewing the future, deciding assumptions, making action plans, building the forecast, taking action, analysing results, identifying causes and back to reviewing the future.

The speed of the cycle depends on the pace of business growth or the rate of change in the market. Fast-growing businesses might reforecast every month, more stable businesses less often.

The culture of forecasting

So, forecasting is good. A rolling forecasting cycle is better. And then there's something that's even better! Another level that creates ongoing strategic value, something the best companies do but don't talk about much.

The pinnacle achievement is creating a culture of forecasting, where forecasting is not a thing we do, but a way of being.

In a sense, building the forecast is just a trojan horse. If we approach it the right way, the forecasting process trains people to look ahead, to question what they see and to think actively about ideas for improvement. And the more people who are thinking about the future of the business, the more we build a culture of insight and ideas.

Who should be involved in forecasting?

We talk to lots of external advisors who prepare the forecast in their office with minimal input from the client. In my experience, this is not the best way to go. A good, reliable forecast can only be produced with significant input people who know and understand the business deeply.

Taking planning out of the hands of our clients stunts their growth. It's a much richer experience for both advisors and clients to be sitting in a room together talking about where we want to go, what might happen and how we would respond. The advisor becomes the future-coach.

Are accountants and bookkeepers well placed to transition to business advisory?

Of course we are! In fact, most are us already doing advisory, we just might not call it that. If it's just off-the-cuff advice, we might not even be charging for it. Every time we help a client solve a business problem, to me that's advisory.

The shift we see is more advisors are becoming proactive in packaging, pricing and promoting their advisory work. That can only be a good thing for the SME sector.

What skills do we need to become great at forecasting?

Accountants and bookkeepers are trained to know the right answer. Business advisory, and forecasting in particular, is about knowing the right question. It's about embracing uncertainty and holding multiple scenarios, true all at the same time.

But it's also about listening differently and shifting our focus entirely to the client.

Occasionally I'll step in and present our training courses to Castaway users. I remember one session in Brisbane, Australia. One by one the attendees were describing what they wanted from the day. A senior accountant from a mid-sized firm said he was 100% focused on learning how to build budgets quickly. He reasoned that faster building was the key to delivering advisory services more profitably.

The next attendee was CFO for a mid-sized not for profit organisation. His organisation was facing a major threat to their future ... a 10 year government contract worth millions was up for renewal and the forecast was a big part of their costing submission. From a strategic perspective, he also wanted to get clear on what the organisation looked like if it won the contract and what the options were if they did not.

The difference in focus was stark and the opportunity for an advisor to add value was enormous. But he risked missing it with his internal focus. It was a great lesson in the importance of focusing on the right problem.

So what's the message?

Real forecasting takes time. But it's worth it. And it's the perfect way for advisors to build a deep understanding of the businesses they work with. Along the way, plenty of opportunities to improve the business reveal themselves. That's the path to creating value.

Michael Ford, Founder & CEO, **Castaway Forecasting**

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