FP&A: Making the Best of the Dog Days of Summer

The calm before the looming annual planning storm offers an opportunity to frame out high-impact projects to help strengthen the business.

By Marwaan Karame and Kal Vadasz

When the star Sirius rises at dawn, or so the tradition goes, the summer doldrums and worse set in. However, we see it as a time of hidden possibility. In our experience, FP&A departments are chronically understaffed and have little need for busy work, summer or not

Simplify the Capital Investment Model

Finance in 2022 should be, in part, about decentralizing some of the basic analysis involved in making investment decisions. This means operators should be able to take a preliminary swing at potential investments. The critical inputs usually come from the business itself and the quality of the information can only improve when the bigger picture is better understood by all.

We are not talking about a model that tracks a complex real estate transaction or tax play. Focus on decisions that are made on a repeated basis — for example, how much inventory to the warehouse, whether to open a new store or distribution center, or whether to retire an aging or underutilized asset.

If you make it easy to gauge a ballpark sense of net present value on the fly, then more ideas will naturally follow. If more ideas are offered, then better ideas should emerge.

Rather than issuing mandates such as “reduce costs or grow revenues by 10%” during the planning process without support, empower all employees to identify the best opportunities for performance improvement. Finance does this by raising their financial literacy and providing a clear framework for assessing the merits of operational decisions.

How many good ideas fail to see the light of day because “tinkerers” are discouraged from putting pen to paper, or keystroke to laptop, because they cannot easily assess if their idea translates to financial viability?

Commoditizing the most straightforward analyses and placing certain capital models in operators’ hands will eliminate tedious work, empower the field, and let finance experts make good use of their unique analytical skillsets to identify valuable opportunities.

Forecast the Balance Sheet

We have never met an executive that does not see the merit of balance sheet forecasting in conjunction with the P&L. Despite this, many companies forgo it and even develop their forecasts after the plan and budget are agreed upon. Imagine trying to forecast a bank account return without projecting how much is on deposit or a portfolio manager’s return without considering investor funds.

Balance sheet forecasting is a clear opportunity to improve the company. It can enhance the connection between finance and operations and help determine which division’s “plan” is more promising. The critical step to top-quartile performance is tying the profit to the investment in real-time.

If we do not bother to forecast the entire capital side of the plan — including not only capital expenditures but other aspects of the balance sheet like net working capital and strategic investments, what signal do we send to business managers? If the businesses see capital as something that we are planning for, might it stimulate ideas that drive better productivity of assets and overall performance?

The separation of capital planning and the budgeting process may have been a necessary reality in the past, but it’s 2022: businesses now have all the skills and resources on call to build out reliable balance sheet forecasts.

Further, compartmentalizing such critical aspects of the business may lead to actions we characterize as “bad behavior,” where managements are unaccountable for the opportunity costs of deploying investor capital. In truth, such managers are just acting rationally within the silos and incentive systems that company governance has created for them. To encourage better decisions, a more complete decision (and incentive) framework can be of use.

Sanity Check Performance and Forecasts

You don't need to be an analytics wizard to incorporate basic statistics into more of an organization's performance measurement processes. Building a history of how key performance indicators (KPIs) and other metrics have behaved over time can have a substantial impact on "managing" the business.

How? Do you have a good sense of what counts as outlier results? How about at more granular operating levels of the business? What part of month-over-month improvement or decline can be attributed to seasonality? Is the business set up to see trends emerging before they become either something to fix (in the case of bad) or a missed opportunity (in the case of good)? Can these reaction times be shortened?

Building even a modest archive of select KPIs and basic metrics and referencing them as month-to-month results come in will offer greater focus and clarity to performance analysis. It can provide a shortlist of issues to investigate before the boss asks about them and provide peace of mind when you are ready to move on. Finally, a KPI archive can be priceless in stress-testing incoming plans, from the feasibility of the baseline forecast to possible high-risk points therein.

The archive will not be the final word on anything, but it can better inform nearly all key investment decisions. After all, the KPIs have likely already been chosen; now is the time to follow through. Providing management teams with better information and context should produce the confidence to focus on high-value opportunities. Make sure to drill down deeply enough into the organization that you capture line-of-sight insights for each business and with enough history that a meaningful range of outcomes are included.

Make Intangible Decisions Tangible

This might be your most intriguing project because it can unearth hidden ways to pluck low-hanging fruit. Individuals in both the functional and operating areas of the business often face decisions that are difficult for them to assess quantitatively. We like to call these situations "intangible economics" problems; that is, a problem that includes variables that are a bit unwieldy but when properly solved can offer opportunities to save on costs or grow profit. For those inexperienced in grappling with these issues, sunk costs, erosion, synergy, and even just articulating the correct "base case" may prove difficult or discouraging.

Establishing and driving expertise in analytics-based solutions can help extract the requisite information to transform an idea into an analysis. Problems like these arise frequently but too often get put aside when they pull folks too far outside their comfort zone. Examples include decisions such as hiring full-time versus temporary staff, offloading unproductive but fully depreciated assets, analyzing the cost-effectiveness of a training or education program, or even prioritizing ESG initiatives.

These might be decisions that in appearance or actuality have a zero or negative net present value (NPV) impact. These are actions that can result in what Fortuna's CEO, Greg Milano, refers to as acts of ownership: behaviors that create shareholder value, despite conflicting with management's existing goals or incentives. They can emerge at all levels of the company. Articulating some logical frameworks can help employees get started.

The projects above only scratch the surface of good business habits that FP&A and other finance-related functions can help spread within the organization. Sadly, they may be too small or too ambiguous to merit the resources of an implementation or an initiative but too imposing to tackle on a quiet summer week. We are deep enough into the year that things that don't get planned now often won't happen. But don't let these opportunities get pushed for another year. Carve out some time and ask for resources if you need them. These initiatives can pay for themselves many times over.

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