Prophix

Your Guide to Scenario Planning

As history has shown us, the best laid plans often change. Whether it's rapidly changing market conditions, like we've experienced in 2020, internal restructuring, or a spike in sales, you need to be agile in your approach to planning.

For many organizations, it can be a challenge to accurately budget, plan, and forecast. And when faced with disruption, it becomes even more apparent how necessary these core financial processes are to the success of the organization.

Finance executives need to be able to react quickly, adjusting business plans to reflect current market conditions. For many C-suite executives, particularly CFOs, this means constantly reforecasting, running scenarios, and informing employees of all possible outcomes.

To do this effectively, finance professionals need access to up-to-date data to determine what impact market fluctuations have had on sales, staffing, capital requirements, and cash flow. The practice of taking stock of the business and its assets is at the foundation of scenario planning.

In this white paper, we will examine the applications of scenario planning, best practices, and how to apply the insights to your business.

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Defining Scenario Planning

Scenario planning sometimes referred to as “what-if” planning, can be defined as “a set of assumptions on what the future is going to be and how your business environment will change over time in light of that future.[1]”

The purpose of scenario planning is to consider multiple potential “realities” and determine how to best react to each to support the financial health of your business. Scenario planning encompasses several different variables including users, data, dimensions, security, timing, and workflow. It is best suited for cases where:

- Past performance is not an indicator of future performance – trend-based forecasting is not applicable
- It is unclear how market volatility will play out based on the information available at the time – companies need to be able to react quickly to changing market conditions

As a finance practice, scenario planning has applications in all sectors including private, public, not-for-profit, and government. Scenario plans are usually created in collaboration with C-suite executives, senior finance management, and analysts, who are invested in improving their organizations’ financial planning.

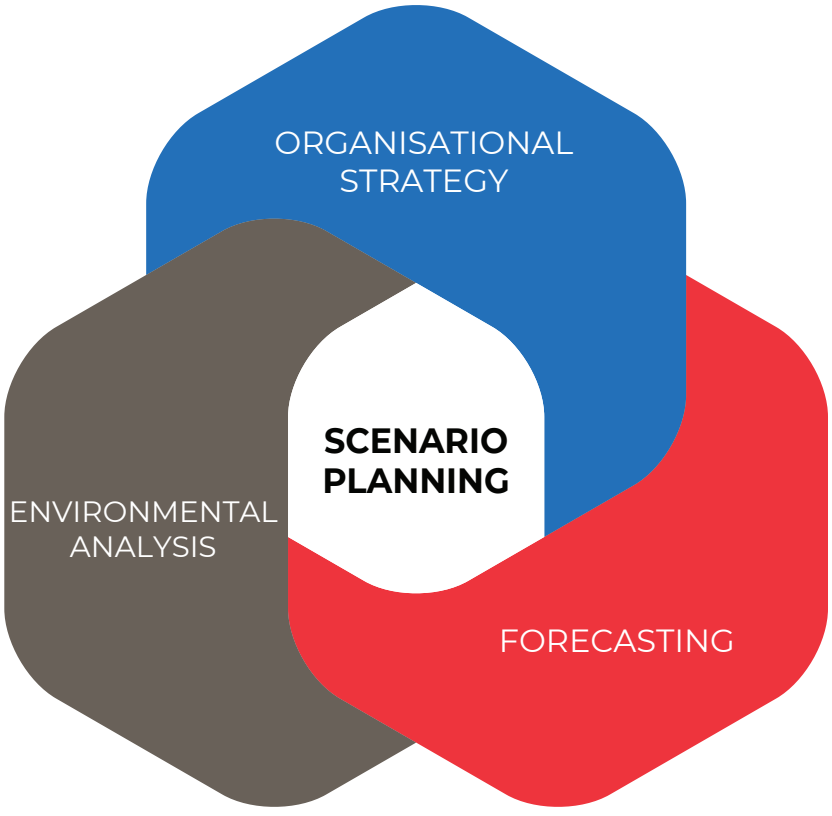
[1] https://www.smestrategy.net/blog/what-is-scenario-planning-and-how-to-use-it

Scenario planning is also an essential part of the risk management process. Having the ability to pivot corporate plans and make informed decisions on production, go-to-market strategy, credit terms, and more, is a critical part of being an agile organization.

Let's look at an example of scenario planning in manufacturing:

Example

The CFO of a manufacturing company wants to understand how limited staff will affect her product revenues. She can create two different scenarios (Scenario A and B) that consider how X number of products, produced at X selling price will affect her projected product revenues. With this insight, the CFO can evaluate different solutions for increasing revenues or decreasing costs.

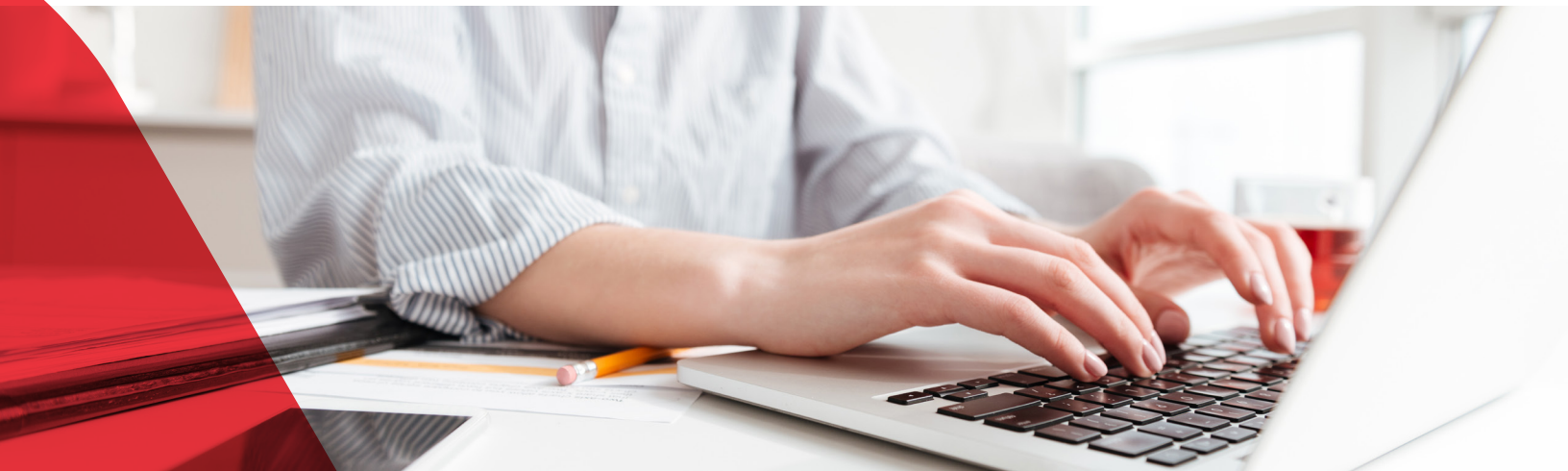


Tools for Scenario Planning

One of the primary challenges of scenario planning lies in organizational attitudes towards spreadsheets. For companies who still prepare scenario plans or forecasts in spreadsheets, it's difficult, if not impossible, to effectively incorporate real-time data. This is because spreadsheets cannot connect disparate systems (ERP, CRM, HR, payroll, etc.), which houses the business' most valuable data.

Companies interested in leveraging scenario planning should first challenge ingrained attitudes about the value of Excel.

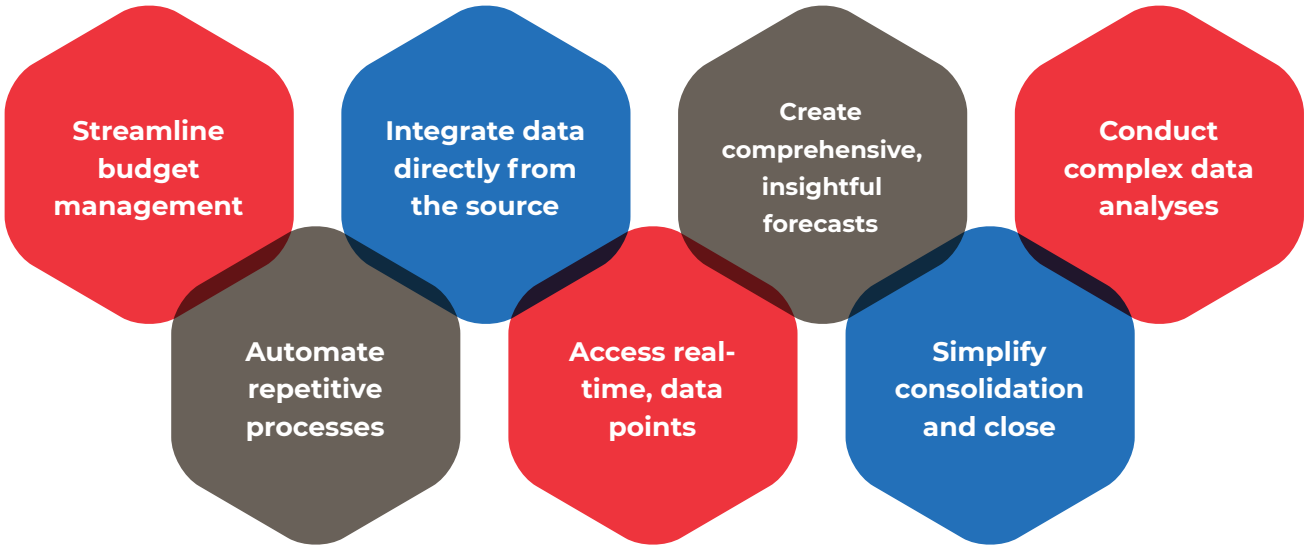
As an alternative to spreadsheet-based systems, cloud-based software has been designed with scenario planning in mind. Corporate Performance Management (CPM) software is one such alternative, allowing finance leaders to easily create scenario plans based on existing budgets and forecasts. With access to relevant data anywhere, finance professionals can easily manage resources and improve decision-making based on opportunities and risks.



What is CPM?

Corporate Performance Management software is a comprehensive solution that helps you manage all your budgeting and finance activities. With CPM software, you can automate repetitive or complex tasks, streamline your operations and boost productivity.

It empowers you to move beyond spreadsheets and into a new level of operational sophistication. With CPM software, you can:



Using a solution like Prophix, you can accomplish all the tasks you once relied on spreadsheets for, and so much more. Whether you choose a cloud deployment, you can focus your attention completely on managing your finances and your budget.

Creating a Scenario Plan

Before you create a scenario plan, there are several considerations to take into account. One of the first steps is to secure a commitment from senior management early in the process, as well as involving various departments within your organization. Before approaching your senior management team, you should have the following: [2]

- Support from a member of your executive team
- Approval on the objectives and scope from your executive team
- A plan to keep senior management engaged & informed

As part of the scenario planning process, you will also need to identify your objectives & scope, define key drivers, and collect data.

a. Objectives & Scope

First, you must understand the objective and scope of your scenario plan. In times of crisis, many organizations use scenario planning to evaluate the viability of specific plans or decisions over a short period of time. Some guiding questions to ask yourself when establishing the scope of your scenario plan are:[3]

- What issues or decisions are we trying to evaluate?
- Is there a high degree of uncertainty about the future environment in which we will face these issues or make decisions?
- What is the time horizon for making decisions and then executing them?

b. Define Key Drivers

Now that you've identified the scope and objectives of your scenario plan, you need to define what key drivers you'll model your plans around. CPA defines drivers as, "external factors that could influence the future environment and impact key internal variables.[4] " They go on to further explain that, "this means identifying those factors that could materially impact capital requirements profitability or risk over the time period being considered. [5]

External Drivers & Internal Variables

External Drivers

- Economic growth
- Government policy/ regulation
- Demographic change
- Market size and growth rate
- Commodity prices
- Consumer spending
- Rate of technological innovation
- Inflation
- Cost of borrowing
- Social attitudes

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Internal Variables

- Mission, vision, strategy
- Business model
- Customer satisfaction/ loyalty
- Productivity
- Cost structure
- Quality
- Talent
- Time to market
- Reputation/trust
- Access to capital

c. Collect & Analyze Data

By leveraging centralized financial data, automation, and collaborative workflow management, cloud-based solutions allow finance professionals to quickly collect the data they need to adjust and plan for a better future. This in stark contrast to spreadsheet-based systems that lack the agility necessary to build a forward-looking plan.

Scenario plans should incorporate a wide variety of data including, “historic trends, future projects and forecasts, insights to potential sources of disruption, alternative hypotheses of the future, and analyses of the relationships between key drivers. [6]

Given that CPM software integrates with your other business systems to provide a single, unified view into your financials, it’s easy to get a holistic view of your organization’s performance while satisfying the specific requirements for developing scenarios.

[2-6] https://www.cpacanada.ca/en/business-and-accounting-resources/management-accounting/planning-budgeting-and-forecasting/publications/scenario-planning-a-three-part-series/scenario-planning-guidance

d. Develop Scenarios

Once you have identified your objectives and scope, defined your key drivers, and collected the necessary data, you're ready to begin developing different scenarios. To ensure you're successful, consider the three key pillars of scenario planning:

People

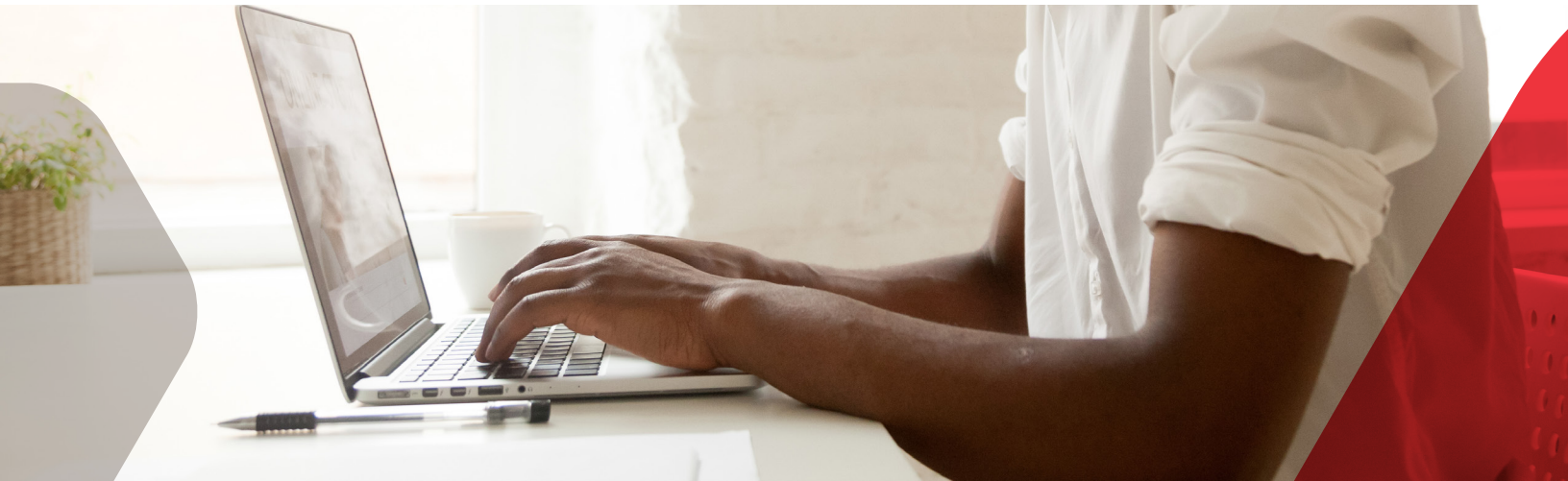
Foster an environment for collaboration by identifying, including, and empowering the right roles across your company. Given the length and complexity of the scenario planning process, some stakeholders may have conflicting priorities, which is why it's important to involve a variety of different roles and functions.

Process

Employ a tool that can help you drive your processes through workflows, map the planning cycle, and have regular and accountable touchpoints.

Technology

Utilize technology that allows you to connect your disparate business systems, giving you a single, cohesive view of your data. Purpose-built tools designed to streamline financial planning processes through automation will provide insights to stakeholders, enabling real-time data entry into budgets and forecasts. These solutions can also simplify high-value repeatable processes like scenario planning and rolling forecasts.



This is where the benefits of centralized finance data in scenario planning become apparent. CPM software brings together real-time, company-wide data from typically siloed systems, including:

Historical data and your most recent actuals from the GL in your ERP

Questions to ask - Are there correlations between your historical data and your recent actuals? What does analyzing the variances between your actuals and forecasts from your most recent reporting period tell you?

Sales volume data from your CRM

What were the booked sales from your last reporting period? What are the forecasted numbers for the upcoming period?

Pipeline health from your marketing automation system

What marketing campaigns or channels should you discontinue or double down on?

Personnel data from your HR System

Which roles lend themselves to remote working vs. onsite requirements? How long does it take to hire and onboard key roles?

With CPM software, you can readily access your company-wide data to get a holistic view of your business, as well as better inputs, drivers, and outputs for the scenarios you model, as outlined above.

Insights & Applying Scenario Planning

Proactive decision-making is one of the greatest benefits of scenario planning. Effective scenario plans give businesses a guiding framework with which to make informed decisions based on current events.

From company-wide data and the latest market intel, you can build and apply the insights from various scenarios to your business. As a starting point, you should consider no less than three scenarios:

High

Based on sales increasing, and demand spiking—due to sudden changes in the market or possibly new channels of revenue. It's a positive use case, but one that can add strain to a company in its own unique ways, perhaps requiring additional headcount or resources.

Medium

Assumes sales continue to trend based on your last period's actuals. This scenario shows how the last period's sales figures compare to forecasts, and what other decisions are needed to maintain your current trajectory.

Low

Where revenues or costs are challenging, and the only planning option involves revisiting your business model across fixed and variable expense structures, in addition to revenue streams.

If you're scenario planning because of disruption (i.e. financial crisis, pandemic, labor disruption, social unrest, or criminal activity), it's recommended to plan for more "low" scenarios to assess at which point you'll have to drastically cut costs. The insights you garner from scenario planning will benefit your organization by:

- Putting financial plans and budgets into context
- Creating a foundation for understanding and explaining variances by referencing scenario planning drivers
- Alerting you to potential opportunities and threats
- Identifying the inherent risks in using past performance as an indicator of future performance
- Increasing awareness of how external drivers affect performance

Conclusion

In the face of disruption, scenario planning is a powerful practice that can help put your business back on track. With the right systems and processes in place, finance departments can easily identify the scope, drivers, and data necessary to forecast a better future.

Prophix's CPM software minimizes the time, effort, and errors often found in scenario planning, helping you to better reorganize and quickly plan for all potential outcomes.

Prophix will centralize your data and give you the platform to:

- Assess, inspect, and plan for varying potential scenarios
- Improve forecasting accuracy with rolling forecasts that frequently update with actuals, depending on macro- or microeconomic shifts
- Accelerate the planning cycle with greater accuracy
- Create new scenarios as fast as possible
- Improve collaboration and alignment across departments
- Better manage costs against sales forecasts
- Reduce business risk

Image Credits

CPA Canada, *Scenario Planning Guidance* – https://www.cpacanada.ca/en/business-and-accounting-resources/management-accounting/planning-budgeting-and-forecasting/publications/scenario-planning-a-three-part-series/scenario-planning-guidance

KB Manage, *What is Scenario Planning* – https://www.kbmanage.com/concept/scenario-planning

Delta Academy, *Steps of Scenario Planning* – https://www.slideshare.net/henkmassink9/lecture-scenario-planning

About Prophix

Your business is evolving. And the way you plan and report on your business should evolve too. Prophix helps mid-market companies achieve their goals more successfully with innovative, cloud-based Corporate Performance Management (CPM) software. With Prophix, finance leaders improve profitability and minimize risk by automating budgeting, forecasting and reporting and puts the focus back on what matters most – uncovering business opportunities. Prophix supports your future with AI innovation that flexes to meet your strategic realities, today and tomorrow. Over 1,500 global companies rely on Prophix to transform the way they work.

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