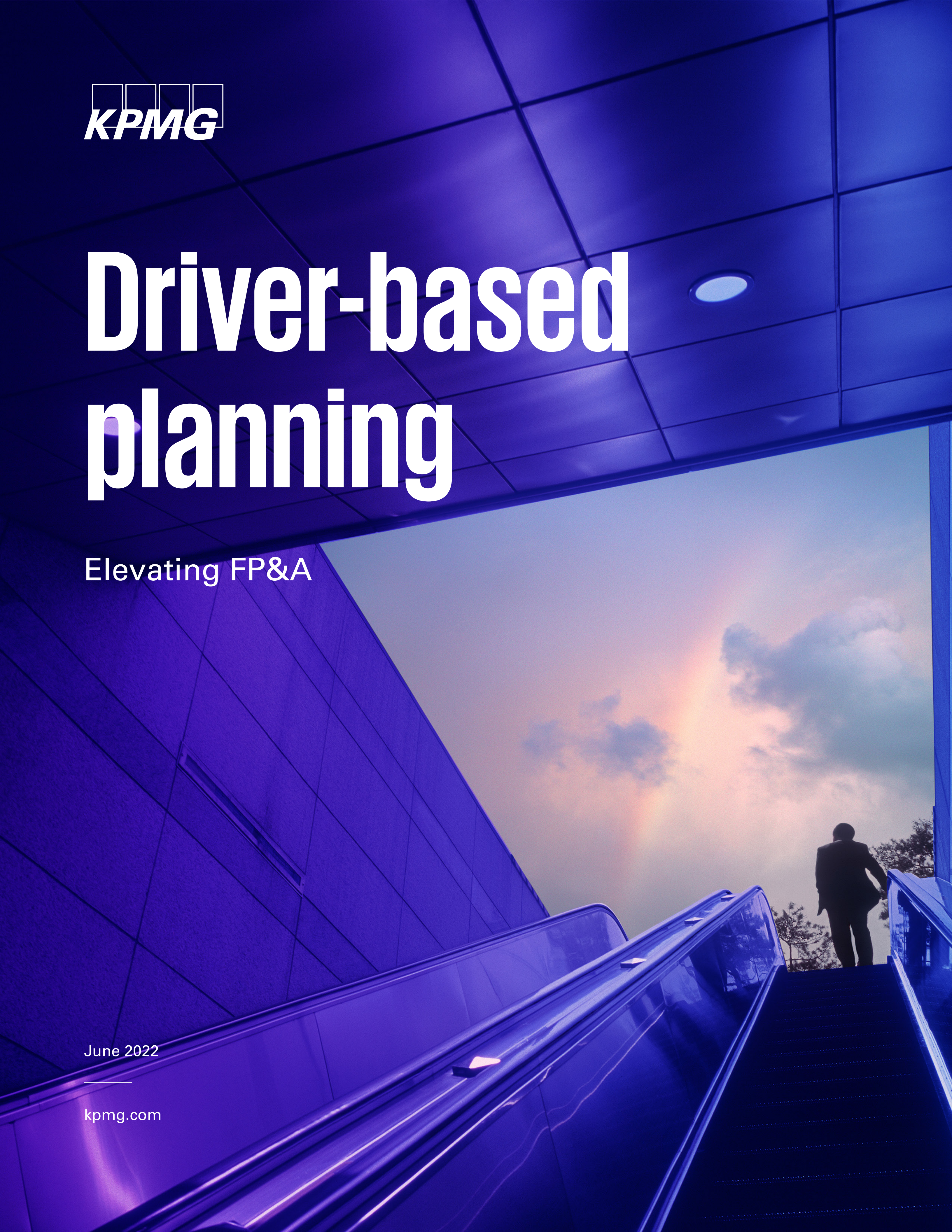


KPMG

Driver-based planning

Elevating FP&A

June 2022

kpmg.com

Read how a carefully designed hierarchy of tested business drivers can move the finance team from functional task master to value-generating business partner.

The driver-based imperative

Feel that? That's the competitive landscape shifting under your feet.

Company leadership is looking to you for ideas on how to respond, but your finance team is too busy building detailed, bottom-up budgets and then trying to reconcile them with top-down business goals. It's time to cut through the legacy finance operating bureaucracy and develop more dynamic budgets, forecasts, and strategies based on what really drives the business—and maybe even transform your company's task-based approach to financial planning and analysis (FP&A) along the way.

Make no mistake, those FP&A operational tasks still matter. It's just that last decade's "promising" technologies have steadily become this decade's commoditized table stakes to manage standard FP&A operations. Enhanced data, automation, predictive modeling, AI, and machine learning, increasingly, have a lot of those previously time-draining operating tasks covered.

The business imperative now is to transform the finance team from that task-based operating unit to a capability-enabled enterprise partner—elevating staff to focus on delivering larger, value-generating financial insights and companywide contributions.

And advanced driver-based planning, which embeds a multilevel framework of increasingly detailed and data-driven business indicators into the overall enterprise planning process, is the through-line to making that transformation.

Because—much like those now-established advances in data and analytics—dynamic, automated, driver-based business planning is no longer some idealized vision of the corporate future. Touchless forecasting and on-demand insights are here, today, enabling leading companies to transform their process-heavy, "FP&A-as-we've-always-done-it" approach to the finance function.

But this challenge to do a complete rethink of your company's traditional business and budget planning disciplines didn't just suddenly show up last week. It's been waiting to meet with you down in the conference room for a while now. Ready to take that challenge and turn it into some opportunity? Enhanced driver-based modeling can point the way. Here are the details.

A head start on driver-based planning

At a high level, driver-based planning is a framework to forecast business performance based on a multilevel, increasingly specific hierarchy of the key levers that deliver measurable impact for the organization. This driver-based approach determines the most actionable and material components of a business plan, and then uses those drivers to model the effects of future events on key financial metrics.

Driver-based planning replaces the traditional approach of reporting financial and operational management information in separate processes. It moves beyond using just historical financial results to predict future financials. And it paves the way for automated forecasting by reducing dependence on the detailed, manual process of bottom-up budgeting. As a result, it increases the speed, transparency, and efficiency of the budgeting and forecasting processes.

Once established, driver-based planning enables companies to transform FP&A's responsibilities into much broader business planning and partnering contributions: less time spent collecting and reconciling last quarter's data, for example, means more time for identifying strategic investment opportunities in the future. Ultimately, connecting finance to the meaningful business drivers across all areas of the business—and embedding those drivers in an increasingly automated planning process—is essential to true digital transformation and becoming a fully connected enterprise.

But getting started with advanced driver-based planning can seem daunting, because building a well-designed driver-based model takes time. Discovering which drivers best correlate with financial results requires a significant partnership with the business and plenty of fieldwork. Once the team identifies data that may correlate with financial results, it must test that against historical data to establish a potential driver's effectiveness. These analyses are complicated by the fact that some drivers have a cascading effect on others. And once the key drivers have been identified, the underlying data must be collated and governed on an ongoing basis.

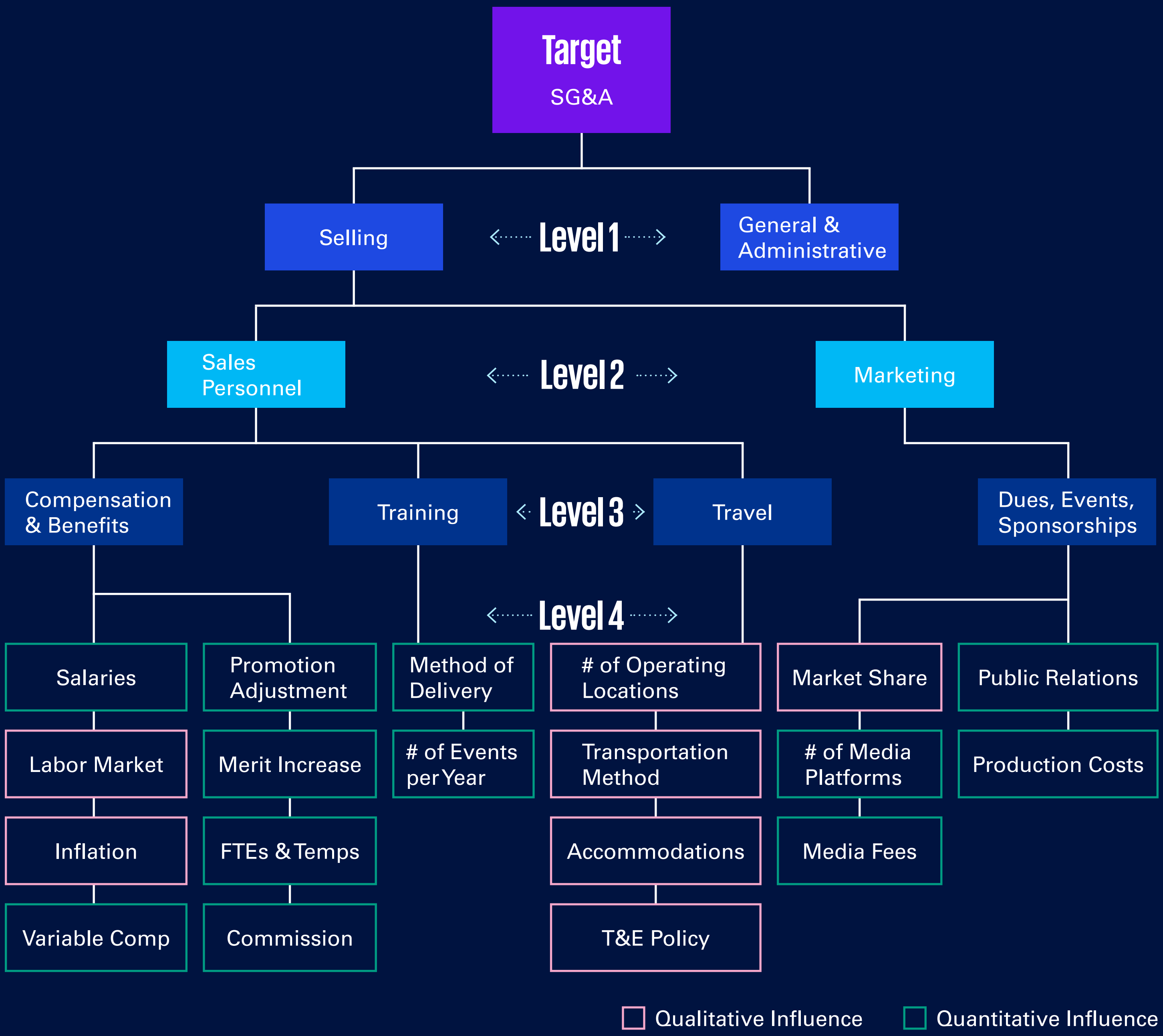
That's where driver frameworks come in. Rather than custom-building and testing increasingly complex driver structures on their own, leading companies are jump-starting their driver foundations with established, industry-specific frameworks that can give them a meaningful start on the journey to developing the right model for their business. These prebuilt frameworks allow companies to spend the bulk of their time on the customizations, tweaks, and additions of more detailed drivers—four or even five levels down the framework—that help them cover that last mile of accuracy and excellence specific to their business model.

Let's take a closer look.

Introducing the value driver tree

Advanced driver frameworks connect both operational levers and financial metrics at cascading levels that start to look like inverted trees as you move down the hierarchy. Understanding, deploying, and using these extended "value driver trees" is essential to delivering their ultimate promise of enhanced planning and forecasting. Here is an example of one part of a value driver tree related to SG&A.

SG&A – Industry-Agnostic



Here is an example of how driver inputs could be weighted and measured for a consumer products value driver tree that is measuring at level 4.

Level 3—Market Demand

L4 Drivers	Definition	Calculation	
Total Category	Size of the market products are sold (in units)	Market Demand = Total Category — Substitute Products	▲
Substitute Products	Amount of the market controlled by competing or substitute products (in units)		▼
Consumer Spending	Level of personal consumption expenditures as published by the Bureau of Economic Analysis		▲

Level 3—Market Share

L4 Drivers	Definition	Impact Indicator*
Marketing and Promotion Spend	Amount spent on marketing/advertising and promotions to boost product sales	Low High
Product Differentiation	Number of SKUs, categories, and brands and associated attributes	Low High
Innovation	The amount spent on R&D creating new product offerings	Low High
Sales Force	The number of resources dedicated to selling the product	Low High

How It's Calculated

These are drivers of the volume component for gross margin. When drivers are quantitative, the underlying calculation is provided. When drivers are qualitative, an Impact Indicator shows the value of the correlation and the degree of impact on the level above. These qualitative indicators will be unique for each client and could fluctuate more frequently than the core qualitative metrics.

Value driver trees are powerful, versatile tools. For example, for planning or forecasting purposes, you can cascade “up” the tree to see how changes in operational levers might affect financial results. And for strategic purposes, you can cascade “down” to see how desired changes in financial metrics should influence operational decisions.

Ultimately, these advanced driver frameworks streamline the process for leadership to set financial targets and cascade the resulting operational decisions down to the responsible teams.

Putting driver-based planning to work

In developing driver value trees across different industries, we've found that the key financial metrics vary by industry and that high-level financial targets such as gross margin typically cascade down into dozens of potential drivers. Explore any expanded driver tree framework, and you'll find multilayered industry-specific insights into the factors that drive costs and revenues and the relative importance of each factor.

These driver frameworks draw on our decades of experience and research in each industry and an understanding of the unique cost, revenue drivers, and leading practices for each. Our baseline templates can provide companies with a rapid foundation to get their driver-based planning up and running quickly.

Advanced driver frameworks typically rely on internal company data to start, and especially at the top three or four levels. But incorporating external data can play a vital role in fulfilling that last-mile potential by identifying a handful of new business drivers that further sharpen accuracy and confidence at deeper levels in the framework—fine-tuning the company's watch from seconds to milliseconds. For example, macro data signals such as interest rates might have a tightly correlated impact on predicting cost of goods, while more micro data such as foot traffic around local retail outlets can be a strong new cross-reference for store-level revenue. External data is increasingly easier to identify, test, and ingest through solutions like the KPMG Signals Repository, which provides more than 10,000 external data points.

Advanced driver-based frameworks provide the logic and calculation rules that enable automated budgeting and forecasting. But integrating that logic into the company's enterprise performance management (EPM) solution is critical to making driver-based planning operational. When drivers are configured in the EPM solution and connected to the right data sources, changes in assumptions and targets seamlessly cascade up to the key financial target metric. These models can facilitate budgeting and enable more dynamic and frequent rolling forecasts. For "what-if" or scenario modeling, they help you ascertain how business decisions can impact overall financial performance.

By design, driver-based frameworks are platform-agnostic. They are expanded business rules and requirements that, working with IT teams, can be embedded into any effective EPM system—whether through a prebuilt framework that a company can modify as it goes or a company's own design. Crucially, this EPM integration allows the driver-based planning frameworks to connect with a company's enhanced data and forecasting applications, establishing the business driver inputs that are essential to guiding the downstream forecasting outputs and insights—a hallmark of a fully connected enterprise.

Fulfilling the promise: The 100-day challenge

Quick quiz: If a fire started in one of your stores, would you need 100 days to determine that you should call the fire department? Of course not. So why wait that long to figure out how to respond to so many of your other business risks? The hard truth is, most companies today still are not able to assess the impact of a "what does this mean for us?" event until the finance team has a chance—too many months later—to roll up the latest quarterly numbers, reconcile variances, report the results, and allow leadership to identify corrective measures.

And the "what does this mean?" events are only growing. Cutting down business planning response times is an imperative for all leading companies. That's why driver-based planning is so essential, with its ability to streamline FP&A functions through enhanced data, technology, and automation.

While the tech and data details matter, successful driver-based planning is not an IT initiative. The underlying value trees really blossom when they are deployed as part of a larger, holistic, business-led effort. What does success look like?

- A fully connected enterprise, with finance embedded more deeply into the business and all of the operational levers that measurably drive success.
- Cross-functional alignment on the key business drivers, which begets companywide alignment on priorities and strategy.
- A "single source of truth" that brings consistency to planning and forecasting, regardless of the business unit, required data, or time horizon.
- Ongoing driver governance, with regular testing and recalibration to ensure that the driver framework retains its validity.

Yes, driver-based planning can streamline the time needed to complete the annual budget, align strategy across finance and operations, and generally increase a company's competitive advantage. But for many companies, the road to driver-based planning starts with more basic questions like: "Why do our actuals diverge from forecast? And why are we still spending so much time trying to figure that out?"

And then of course there's that nagging 100-day question: "What's the bottom-line impact of cutting our response time to two months? Or one?"

Advanced driver-based planning can answer those nagging questions, empowering finance to continue its essential evolution to becoming a capability-enabled, value-generating business partner.

Driver-based planning in action: Sample Use Cases

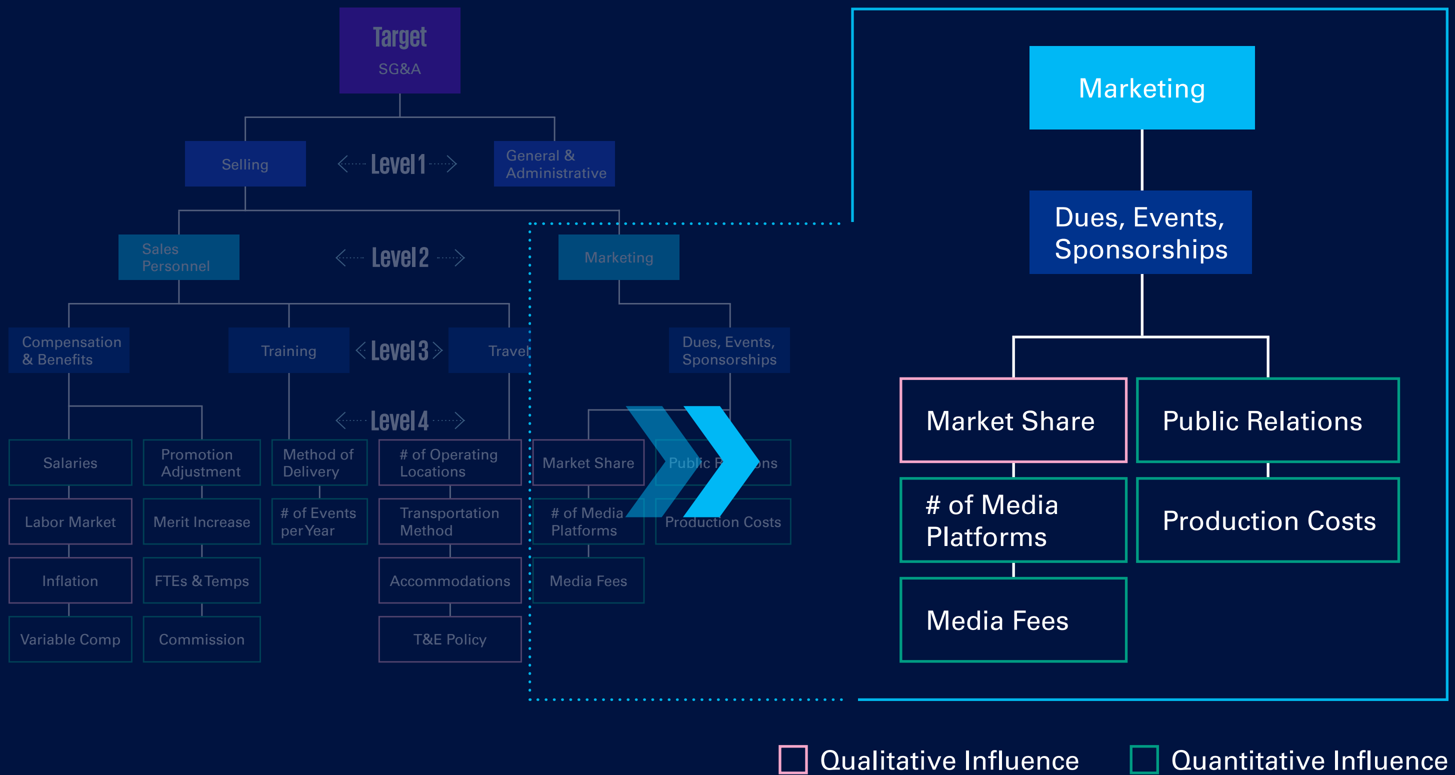
Example Use Case:

Guiding Marketing Spend

The marketing FP&A lead notices that a new nationwide marketing campaign is resulting in lower inquiries and conversions in the East Coast versus the West Coast. She reaches out to the East Coast product lead to better understand the impact.

She accesses the marketing driver model (see chart) to dig deeper on conversion metrics for each media platform and the financial impact of the latest campaigns. It becomes clear that planned media spend (Media Fees) is in line with strategy, but the Market Share metric is trending lower—a full 10 percent below historical performance. Not only is the new campaign not working, there are signs it may be dragging on the market segment. In fact, overall sales are down 12 percent, while production cost is in line with historical trends, which is reducing net margins. The FP&A lead reaches out to the regional lead to discuss options and strategies, including suspending or revamping the marketing campaign.

The driver tree is integrated into the FP&A lead's EPM solution, with financial performance and trends accessible via a dashboard. The EPM solution automatically detected the divergence from the historical trends, and the line graph showed the negative trend. These visuals enabled her to quickly understand the impact of the new marketing campaign and explore potential adjustments, making decisions in near real time—rather than months into the campaign.



Level 3 (Dues, Events, Sponsorships)—Selling

Driver	Definition	Calculation
Media Fees	Amount paid to media to run ads or promotions	Dues, Events, and Sponsorships Cost = Media Fees + Public Relations Fees + Production Costs
Public Relations	Cost to manage better public opinion or relationship with the public, inclusive of charity	
Production Costs	Cost to produce advertisements or promotions	
Market Share	Portion of the entire market segment controlled by a company or a company's product	
# of Media Platforms	The number of media platforms used to market and advertise a company or product	

Client case study:

Drive faster!

A leading technology company wanted to transform its task-driven and time-consuming business planning and forecasting processes by moving to a more automated driver-based planning framework. They turned to KPMG for help, and we are collaborating with them on a four-step process:

01 Strategy

We worked with the client to define their overall driver-based planning strategy and then helped them develop a baseline driver tree framework that mapped to their key business levers.

02 Testing

We validated some essential driver "branches" through use-case testing of a few existing lines of business, as well as potential new opportunities, based on both internal company data and external signals that tightly correlated to their new products.

03 Implementation

Once the use cases demonstrated results, we moved to broader implementation, helping the client integrate into their EPM and connect with the required data and systems, all tailored to the company's existing infrastructure.

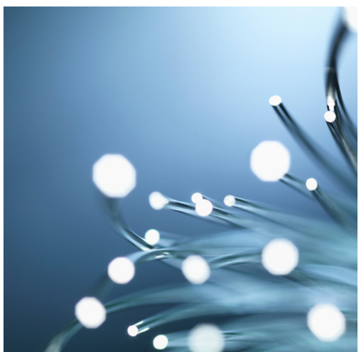
04 Change management

We know that the "people" part can often be the hardest, so we are working with the client to establish a Center of Excellence to help onboard business units, share out success, and foster innovation from within.

Outcome? The implementation has demonstrated so much value so quickly, the client is now outpacing the rollout and condensing its initial timeline to implement.

How can KPMG help?

KPMG is leading the way on advanced driver-based planning, helping our clients with the people, processes, and technologies needed to transform task-intensive approaches to FP&A. Here are some of the specific ways we have assisted our clients in the move to driver-based planning:



Driver-Based Frameworks

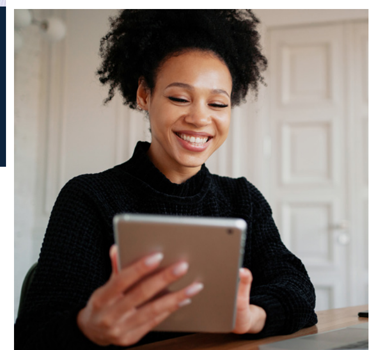
We have developed the foundational driver frameworks for more than 20 industries and continue to expand our models. These pre-built frameworks consistently establish the top few driver-levels quickly, allowing companies to focus on fine-tuning the more custom levers that influence their business, often four or five levels down.

Connected Enterprise & Intelligent Forecasting

Because driver-based frameworks are embedded in the EPM, they become a fully connected and essential complement to related finance digital transformation initiatives, including enhanced forecasting solutions that use advanced data, predictive models, AI, and machine learning.

KPMG Signals Repository

Our platform of 10,000+ external signals allows clients to easily ingest, test, and expand the types of external data that will sharpen and expand their business driver framework.



Scale and Maintain

We help clients with regular review and updates of their driver frameworks and support overall change management by helping clients design and launch Centers of Excellence to support business users across the company.

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