About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA Members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

About the Technical Information Service

CIMA supports its members and students with its Technical Information Service (TIS) for their work and CPD needs.

Our information specialists and accounting specialists work closely together to identify or create authoritative resources to help members resolve their work related information needs. Additionally, our accounting specialists can help CIMA members and students with the interpretation of guidance on financial reporting, financial management and performance management, as defined in the CIMA Official Terminology 2005 edition.

CIMA members and students should sign into My CIMA to access these services and resources.

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Planning and Forecasting

Definition and concept

Planning is defined as:

‘The establishment of objectives, and the formulation, evaluation and selection of the policies, strategies, tactics and action required to achieve them. Planning comprises long term/strategic planning and short term/operational planning. The latter is usually for a period of up to one year.’

*CIMA Official Terminology, 2005*

A forecast is defined as:

‘A prediction of future events and their quantification for planning purposes.’

*CIMA Official Terminology, 2005*

Plans often incorporate forecast data.

Context

Planning is covered in Managerial level paper 2, Decision Management (cost planning) and paper 5, Integrated Management (scenario planning). Students also study planning in the Strategic level paper 6, Business Strategy.

Forecasting is covered in managerial level paper 1, Management Accounting Performance Evaluation, paper 2, Decision Management and paper 4, Organisational Management and Information Systems (market forecasting). Students also study forecasting in strategic level paper 6, Management Accounting Business Strategy.

This topic gateway only mentions Strategic Planning, Budgeting and Cash Forecasting briefly as these topics will be covered by other topic gateways.

Related concepts

- **Budgeting:** Like planning, budgeting looks into the future beyond the immediate timeframe. Planning is an attempt to shape the organisation’s future, while budgeting aims to predict what resources the organisation can use and might expend. Budgets are an essential, more detailed element of planning. They are not effective when divorced from the planning context.

- **JIT (Just in Time):** This relies on detailed forward planning to schedule when parts will be needed to reduce inventory and speed up response times to customers.
Overview - Planning

Planning is a universal management activity, inherent in every business proposition. A plan exists when an objective is framed and a sequence of events identified to reach that objective. Planning is an analytical activity, and is:

‘…breaking down a goal or set of intentions into steps, formalising those steps so that they can be implemented almost automatically and articulating the anticipated consequences or results of each step.’

Henry Mintzberg, 1994

Plans are usually prepared in a cascade, that is, in the context of plans at other levels in the hierarchy. Strategic plans usually take a long term view, five or more years into the future. Tactical plans (also known as functional plans) look two to four years ahead. Operational plans, which include budgets, have an annual scope.

Specific types of plan in the business context include:

- contingency planning
- scenario planning
- the business plan.

Contingency planning

‘A plan, formulated in advance, to be implemented upon the occurrence of certain specific future events.’

CIMA Official Terminology, 2005

The contingency planning process includes identifying possible problems as far as is practicable. It considers what actions could prevent or ameliorate the impact of those problems. Contingency planning involves monitoring if the trigger points for those problems occur.

Scenario planning

This is similar to contingency planning in that it also scopes out a limited number of possible futures in the context of high uncertainty. However, scenario planning is used to generate a population of possible futures to help long term plans remain flexible, rather than to prepare for the worst.
Business plan

A business plan outlines the company’s expected course of action for the medium term. This should be in the context of the industry, market, products, policies, capacity and resources. It should not be a one-off exercise, but a document which is regularly used and revised. Its purpose is to help the business:

‘…meet the expected and unexpected opportunities and obstacles the future holds… a guide to navigate successfully through its unique competitive environment.’

Harvard ManageMentor, 2006

Forecasting

Forecasting is an attempt to estimate the future. It is based on available past data, the extrapolation of trends and the application of judgement. There are three basic forecasting methods.

• Time series analysis and projection

The analysis of past data is used to identify patterns, such as trends, seasonality or cycles. A trend is an upward or downward pattern which is not caused by seasonality. Projection is about extending this trend into the future using those observations.

• Qualitative techniques

Where non-numerical information is used to improve the accuracy or relevance of forecasts. Mintzberg refers to such information as soft information. These techniques include the Delphi method where predictions and analysis from experts are collected, moderated and summarised.

• Causal methods

In which:

‘Theory, prior research and expert domain knowledge are used to specify relationships between a variable to be forecast and explanatory variables.’

Forecasting Principles, Methodology Tree

Available from: www.forecastingprinciples.com/methodologytree.html
[Accessed 4 July 2008]
Application

Planning helps organisations articulate, share and implement their strategies. It assists in the allocation of resources and in monitoring their use.

Forecasts are used by many functions within the organisation. One specific application, the cash forecast, is prepared by the Finance department. This forecast predicts the size and timing of inflows and outflows of cash over a defined period. Typically, the Finance department prepares a monthly forecast for the first two years. This is usually followed by a less detailed annual forecast for the next three years.

The Finance department also uses forecasts to anticipate whether budgets will be met. If not, Finance can analyse where the problem areas are. Similarly, profit and loss forecasts predict the trading performance of the organisation, given projected sales and costs.

Operational departments use forecasts to schedule production, and for purchasing and logistics. If there is insufficient capacity, forecasts can be used to determine the timing and amount of capital expenditure to increase capacity.

The Sales department uses forecasts to set targets and quotas for salespeople.

Forecasts are mainly generated from the Finance and Marketing departments, the latter frequently including external data in its forecasts. For example, Marketing might estimate how the market for its products will develop. This would involve looking at market potential, based on economic and perhaps social trends. Marketing will also consider how the organisation’s share of that market might develop. This would be based on customer trends and intentions, as well as market testing and competitive data results.

It is helpful (some argue essential) to have a dedicated specialist forecasting resource in the organisation. This helps ensure that different departments base their forecasts on common data. It also facilitates the sharing of results and good practice.

Reported benefits of planning and forecasting

Although there are many types of plan with different purposes and planning horizons, in general planning may:

- help management to think about the business logically and strategically
- identify milestones towards the achievement of objectives (clarity and focus)
Planning and Forecasting

• enable management to chart progress against the plan (performance monitoring)

• ensure that strategies specify what resources are needed and when (resource allocation and scheduling)

• help management inform employees of the direction and intentions of the business (co-ordination, communication and involvement).

A business plan may also:

• provide an overview of essential information to inform the decision making of lenders or potential investors.

Forecasts may:

• help manage financial market expectations by enabling management to better communicate with analysts. For example, this might regard profit and loss forecasts

• reduce costs by enabling more efficient production scheduling and minimisation of stock holding (production and logistics forecasts)

• reduce the cost of borrowing by enabling the organisation to predict when it needs finance (cash flow forecasts)

• helps focus marketing effort to those areas where it will have most impact (forecasts of market potential).

Reported drawbacks of planning and forecasting

Critics of planning report many of the same drawbacks for planning as for budgeting. It is time-consuming and plans need to be updated to maintain any usefulness. A large proportion of users report a lack of satisfaction with the process. Cranfield Management School’s Centre for Business Performance advises that there is widespread dissatisfaction from practitioners, who conclude that the effort spent on planning and budgeting is simply not justified by the results.

In June 2006, CIMA Insight published a survey on business performance management techniques. Over half of respondents criticised their own planning for not relating to strategy, echoing the views of management theorist Henry Mintzberg.
Mintzberg felt that planning and strategy were mutually exclusive activities. He characterised planning as the mere codification and operationalisation of existing strategies. Mintzberg acknowledged planning had a vital role, but felt it was a process which stifled innovation and commitment. He believed planning was based on a faulty assumption that the future will resemble the past. It also under appreciated the role of soft data, hard to gather and analyse, but providing the essential insight and wisdom. [Henry Mintzberg, 1994]

Some dissatisfaction may stem from deficiencies in the planning process. Organisations have on average six planning systems compared to the typical three of best practice organisations. This is according to consultants The Hackett Group, quoted in an article in BusinessFinancemag.com. Those best practice companies generate 48% fewer reports. So there seems to be potential to streamline the planning process.

http://www.businessfinancemag.com/magazine/archives/article.html?articleID=14682andhighlight=planning

Forecasts come in for criticism if they are routinely inaccurate. The inaccuracy can be caused by poor quality data, faulty assumptions or weaknesses in methodology. Analysing the cause of the problem can help improve future forecasts.

**Planning process**

Planning is a cycle (with a feedback loop) rather than a process. It shouldn’t be a periodic intellectual exercise but something against which performance is regularly monitored and analysed.
The analysis of opportunities can be made using several well-known approaches (discussed in more detail in the Strategic Planning topic gateway) such as Porters Five Forces, SWOT analysis or PEST and its derivatives.

A useful mindmap of the issues in relation to strategic analysis and strategic planning can be found at the Bized website. Available from: http://www.bized.co.uk/educators/16-19/business/strategy/presentation/strategic1_map.htm

The suggested best practice for the forecasting process is to start with a sales forecast. This should be expressed in quantities rather than values. All other forecasts such as production, income, net profit and so on are based on activity levels assumed in the sales forecast. For not-for-profit organisations or cost centres, the proxy for sales will be an indicator of demand for services. For example, visitor numbers, number of visa application numbers or volume of calls to the IT helpdesk.

The advantage of this approach is that it highlights the sales volume element which needs to be forecast. Strictly speaking, the other forecasts are only estimation – the application of logic and arithmetic. By linking all the forecasts, it is possible to flex the assumptions in the sales forecast. This enables forecasters to see how the forecast filters through and affects all the subsequent estimations. [Richard Stutley, 2003]
Case studies

Harvard ManageMentor PLUS The Preparing a Business Plan module includes a case study.

BPlans™ - This site is a marketing channel for software publisher Palo Alto’s planning software. It describes itself as the largest collection of free business plans on the web, with 60 specimen business plans. Available from: www.bplans.co.uk/cu/about.cfm
[Accessed 4 July 2008]

References


Further information

CIMA articles

BPlans™ - This site is a marketing channel for software publisher Palo Alto’s planning software. It describes itself as the largest collection of free business plans on the web, with 60 specimen business plans. Available from: www.bplans.org.uk/sample_plans/businessplans.cfm
[Accessed 4 July 2008]

Barret, R. WH Smith aims to avoid profit warnings with better forecasting. CIMA Insight, July 2006. Available from: www.cimaglobal.com/insight
[Accessed 6 November 2007].

[Accessed 6 November 2007].

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**Other articles**

Abstract from Business Source Corporate through My CIMA [www.cimaglobal.com/mycima](http://www.cimaglobal.com/mycima)


**CIMA online sources**


A survey of practices in 41 UK companies showed that most made regular forecasts. However, the authors characterised the methods adopted as typically, relatively unsophisticated.

‘For example, most companies made forecasts only to the end of the financial year. One company was felt to be exceptional in developing its forecasts to include the remainder of the current financial year and the whole of the
following year’.

Contemporary management accounting practices in UK manufacturing

Business Source Corporate (BSC) has the full text of several planning and forecasting journals, including.

- Decision Sciences.
- Journal of Business.
- Journal of Business Forecasting Methods and Systems.
- Business Strategy Review.
- Business Change and Re-engineering.
- Journal of Forecasting.

BSC also contains thousands of company, country and industry profiles. These include forward-looking information which would be valuable for forecasting. On a more general note, BSC also includes downloadable articles from ‘futurologists’ on trends and developments likely to affect the way we live, in the journal Futurist.

Driving value through strategic planning and budgeting. (PDF 468 KB). This is a joint research report from Cranfield School of Management and Accenture. (2001). Accenture reviewed more than 100 publications on planning and budgeting, interviewed senior executives from 15 companies and many analysts. Available from: [Accessed 4 July 2008]

Websites

Bized
Website for educators and students of accounting, business and related commercial fields. Contains useful material for CPD such as topic overviews, resource lists and cases. Available from: [Accessed 4 July 2008]

Cranfield School of Management Centre for Business Performance Specialises in the development of predictive performance measures, among other areas. The site includes articles, research papers and events. Available from:
www.som.cranfield.ac.uk/som/research/centres/cbp/research.asp
[Accessed 4 July 2008]

Forecasting principles
Portal provided by the International Institute of Forecasters. Provides terminology, methodology, and solutions. Includes a diagnostic to help users identify weak areas in their forecasting systems. Also gives reviews of commercial software and some freeeware. Definitely worth exploring for the serious forecaster. Available from: www.forecastingprinciples.com/welcome.html
[Accessed 4 July 2008]

Mind tools
Useful site with many tips, tools and techniques for the business manager, including those for decision making and project planning. Available from: www.mindtools.com
[Accessed 4 July 2008]

Prepare a Business Plan
Business Link’s step by step guide to preparing a business plan for small entities. Available from: www.businesslink.gov.uk
[Accessed 4 July 2008]

Strategic Planning Society
Membership organisation which publishes research and other material intended to bridge the gap between academics and practitioners. Available from: www.sps.org.uk
[Accessed 4 July 2008]

Value-based Management
Site includes useful material on scenario planning. Available from: www.valuebasedmanagement.net
[Accessed 4 July 2008]