Introduction

Traditional budgeting and planning is a straight jacketed and hierarchical exercise. Goals and budgets are set at the top of the organization and cascaded down, yet plans on how to reach the goals are created per department and are then rolled up. Often, this tension creates a game of ‘ping pong’ that takes many months to resolve and the outcome rarely reflects the dynamic reality of business. No wonder there are so many budget games!

Although this approach may help organizational control and accountability, it highlights the gap between how the business is traditionally managed, and the actual business model. Work doesn’t flow top-down; it flows from outside the organization into the organization, and out again, passing multiple nodes in a network of activities. Moreover, most current business models are networked as well. They are based on product componentization and mass customization, involve sourcing across multiple organizations, and are driven by customer self-service. Consider the pharmaceutical industry’s move towards personalized medicine and the configuration options car makers offer buyers. Examples are to be found in almost every industry. Insurers, telecoms providers and consumer electronics manufacturers routinely outsource customer service. Across all industries, production, logistics and even R&D are often outsourced, alongside support functions such as HR, finance and IT.

The networked economy challenges the fundamentals of business organization, for example, where does the front-office stop and does the back-office start? Can companies still define product-market combinations themselves and launch go-to market plans? Is it still meaningful to plan for customer, channel, or product profitability, or is transaction profitability the only measure that counts? With businesses effectively organized as networks rather than hierarchies, product-oriented and functionally oriented planning mechanisms fall short. An effective plan connects the demand chain and the supply chain in an integrated manner.

On top of that, economic circumstances ask for a different approach. Much has been written about the difficulty of forecasting business performance even when times were good, but now the emphasis is different. There is a palpable shift in emphasis from strategy and long term planning to short term performance, cash preservation, working capital management and even business survival as some of the world’s largest businesses struggle to stay afloat.

With prices constrained, dramatically shortened product life cycles, increasing market volatility, excess capacity in almost every market and costs cut to the bone, the room for manoeuvre is slim. Maintaining slender margins in these conditions needs deft management and complete mastery of business performance. The twin challenges of constant volatility and erratic consumer behaviour means that there has never been a greater need for nimble business planning. The classical planning and control cycles with a financial focus and aimed at internal control are not up to this speed of change. More modern management processes are needed.

But how many businesses have planning and reporting processes that are smart, agile and aligned? For many decades businesses have been organized along functional lines, which has proven to be a convenient vehicle for grouping like-minded individuals with similar skills, outlook and culture. By and large this arrangement has served businesses extremely well even though most organizations execute their transactions through business processes which transcend functional boundaries. Despite the supreme importance of the process oriented view, most businesses carry out their business planning in discrete functional silos.

Similarly, strategic planning tends to be vertically aligned with strategy being driven in a ‘top down’ fashion through the organizational structure. The downside for both strategic and operational planning is that the dominance of vertical alignment can give rise to dysfunctional management behaviour and inconsistencies when trying to resolve optimum operational performance across the business.

In a robust economy and stable markets this vertical perspective of a business works agreeably well. Organizations can ‘forgive’ the fuzzy edges, inefficiencies and inconsistencies that arise between different functional areas. But in all other cases – actually the majority of cases – business plans should be horizontally aligned between different disciplines if, for example, resources available to the business are to be kept in balance with predicted levels of activity. Furthermore, more volatile trading conditions necessarily require a more agile, integrated and confident management response that can only be achieved by functional areas working in alignment with each other and in the context of overall financial and operational planning.
At the same time our fundamental understanding of the organization is being challenged. The notion that an organization can draw neat boundaries around its operations is outmoded as organizations find themselves increasingly drawn into the networked economy in which business processes are constantly being re-written as suppliers, customers and even competitors (on occasion) collaborate to produce and consume products and services in all manner of imaginative interactions. Global trends such as mass customization of products and services, customer self-service, and sourcing are altering the balance between business transacted within a company and that carried out beyond the factory gates.

“When the need for both vertical and horizontal alignment is not well understood performance management adds to misalignment in an organization.”


These trends expose the inefficiencies of traditional departmental or functional planning processes. The functional or vertical perspective bears little relationship to the way that businesses trade or incur cost. Horizontal alignment truly reflects the new market paradigm and there is a pressing need for operational and financial planning to follow this trend if it is to be relevant to business decision making.

Enterprise Business Planning (EBP) does exactly this. It seeks to address the limitations of a purely functional approach to business planning by allowing management to link plans across the business, optimize its resources, obtain broadly based consensus and adjust for risk and uncertainty. It ensures an appropriate balance between operational feasibility and financial desirability. But how is this achieved in practice? How does EBP reconcile the needs of vertical alignment and a more process oriented view? Where does advanced business planning sit within a broader performance management regime and what are the enabling technology and platform precursors?

This white paper describes how businesses can transition to an EBP based approach so that they can develop more dependable plans and yet remain more nimble in the face of unprecedented change.

Historically, organizations have built up their budgets and plans along functional lines – simply because that is the way that people are usually organized. But business processes do not respect functional boundaries. For example, the ‘Quote to Cash’ cycle embraces Inventory Management, Sales Department, Logistics and Finance. The true costs of sourcing a product, delivering it to a customer and getting paid are driven by the process – not by functions. This means that plans in one area need to be consistent with projections in another if resources are to be allocated efficiently and satisfying a performance objective in one place is not to have unforeseen consequences in another. For example, a sales demand plan can only be executed efficiently if matched to supply and finance. An overambitious sales plan which exceeds the ability of an organization to supply or manufacture finished goods may lead to excessive costs as the organization seeks to replenish stock from alternative suppliers or unplanned production runs. This in turn may deny other projects the working capital they need.

Similarly a revenue plan in a professional services organization, such as a law firm, has to be consistent with an HR plan and financial plan in order to ensure that there are sufficient fee earners available to produce the projected billable hours. Enterprise business planning recognizes the vital importance of these interrelationships and provides the enabling technologies which allow different functional areas to collaborate during the planning cycle.

Although conceptually, the idea of enterprise business planning is relatively straightforward it has proven to be illusive, because of over reliance on spreadsheet-bound processes, a lack of control over data quality/management, limited use of advanced planning tools and the cultural impediments that afflict many planning processes.
By contrast, an enterprise business planning system provides a platform in which planning models are inextricably linked and can be shared by users in different functional areas. Technology such as this not only supports real-time, analysis, reporting and decision making around operational plans but also binds them tightly into financial plans. As a result, EBP’s more cohesive approach brings benefits in addition to a more corroborative way of working.

In the absence of specialist tools, businesses tend to opt for 'broad brush' assumptions in financial plans which merely approximate the more granular assumptions used in operational plans. For example, inventory levels, product mix and warehouse capacity are the stuff of operational plans yet in many settings, assumptions around these items can have serious implications for working capital, depreciation, impairment calculations and supply chain costs. An EBP environment provides the finance function with deep insights into operational matters which would otherwise be obscured, remain unresolved and provide scope for error. On the other hand EBP overcomes these limitations by 'forcing' congruence of goals and assumptions between operational and financial plans allowing them to be expressed in the same or tightly coupled models – something that is virtually impossible to emulate in a spreadsheet environment.

Around 93% of managers gather or analyze information in spreadsheets and 54% spend more or the same time gathering information than analyzing it.3 While there is no denying that spreadsheets are powerful personal productivity tools, they suffer severe limitations in the context of EBP which is foremost an exercise in negotiation and collaboration. Multiple rounds of iteration have been shown to improve data quality, management buy-in and the accuracy of plans4, but one cannot drive collaboration on the back of a personal productivity tool.

The familiarity of the Excel interface has its benefits. For finance professionals a grid of numbers is as compelling as a canvas to an artist, but the spreadsheets suffer enormous disadvantages in an enterprise planning environment, such as the:

- inability to create a multidimensional perspective, critical for multiple planning scenarios, without cumbersome pivot tables.
- lack of specialized planning functionality and financial intelligence that help to populate quickly a planning model with data and preserve financial integrity.
- lack of a data model to support an enterprise business planning environment that links all operational plans to each other and to financial plans.
- absence of data integration tools and quality management tools that permit data to be ‘harvested’ in a controlled way from underlying operational systems such as HR, Payroll and ERP systems.
- difficulty of consolidating plans from different functional areas based on individually captured spreadsheets.
- inability to report flexibly across business units, budget holders and other dimensions.
- complexity of formula building and maintaining the model.

Neither can organizations improve work flows with cumbersome spreadsheets, generated independently by each functional area. Integrated planning is a process of negotiation between different managers across the organizational hierarchy. It requires an intimate link and dialogue – something that cannot be achieved with disconnected spreadsheets emailed between locations. With a spreadsheet based system planners are effectively confined to operational silos where each one is cut off from the other and the key processes in which they are stakeholders5. This disconnect between responsibility centers makes it impracticable to share plans, resolve planning conflicts on a timely basis, or respond efficiently to change. This in turn has implications for the effectiveness of planning since change is a constant feature of the business life.

In the end, those charged with planning often have to resort to impromptu meetings which in a geographically dispersed organization create logistical issues and expose the whole planning process to delay.
Managing Risk and Uncertainty

Managing data in an EBP environment

In common with all planning tasks there is a need to take a balanced view on the amount of data and its level of granularity. This is even more so in an enterprise operational planning environment that merges complex information from different functional areas. Nevertheless, operational planning, as distinct from strategic planning or the annual budget process is typically at a more detailed level of granularity and modern solutions are required to address this challenge.

The more difficult issue to manage is the quality and integrity of master data – the ‘DNA’ of the EBP process. It defines the structural information, such as organizational hierarchies, account codes, time periods and product group dimensions that constitute the ‘shape’ of the business. Just like DNA it acts as a blueprint that has to be propagated perfectly throughout the operational planning process. If it is misshapen or damaged then it prevents subsequent stages of the process from working perfectly. So the alignment of master data across each of the functional areas is critical to the integrity of the whole EBP process.

Sara Lee sees that Enterprise Business Planning needs robust enabling technology

The principle at the heart of enterprise business planning is to join up the budgeting and forecasting efforts of different functional areas of an organization in a concerted effort to achieve a co-ordinated and intellectually consistent plan. Although in principle this may sound straightforward, delivering a practical solution is full of process, people and technology challenges – a situation only too familiar to Bill Nienburg, who is responsible for Sales and Operations planning (S & OP) at Sara Lee, the global consumer products company.

S & OP is being recast as enterprise business planning, spanning traditional demand planning, trade and promotion forecasting, financial planning and other functional areas where a common view of demand is critical. “One key to achieving an enterprise plan is to ensure that the data structure is strictly governed by master data (information such as accounts, products and financial hierarchies), that the data structure is consistent applied across the various functional applications, and that the organizational design makes sense against that data structure,” says Nienburg. “And you need a strong toolset and process to manage this otherwise it can quickly get out of sync,” he adds. Nienburg recalls how master data was aligned when a new enterprise SAP application was implemented but that consistent review against business rules has been necessary to maintain the integrity of the data and therefore, the process.

Another critical component of enterprise planning is the linkage with finance. “Gross Sales Volume in the constrained demand plan should flow and integrate with the equivalent Gross Sales Value in the financial plan. The right way to assemble the most accurate statement of demand volume, including base consumption, initiatives, new products, etc is through the S & OP process. It helps to drive the right visibility, transparency and alignment through your organization.”

But embedding the process takes time and Nienburg highlights the importance of recognizing the critical nature of people issues in developing an enduring process. “Although people were signed up to an enterprise planning approach and would attend joint planning meetings, complete adoption required ‘letting go’ of previous, less integrated planning and decision making processes. You must not underestimate the cultural and change management components,” he warns.

However, having faced these challenges Nienburg reports that Sara Lee is on the right path to greater functional alignment in the planning process, greater insight into the business and more pro-active business decisions. Although the S&OP has still has greater potential to drive business strategy, even tactical measures like forecast accuracy both at a national level (how much product to make) and local level (where to deploy it) are improving.

Reflecting on what has been achieved, Nienburg points out that bringing about change is the usual combination of people, process and technology, and that all are equally important. “Sometimes the importance of the toolset is understated in S&OP conversations,” he says.
However, in practice the shape of the master data differs from one functional area to another. For example, the sales department may refer to stock units differently from the production department which can give rise to anomalies when comparing demand plans to manufacturing output. Similarly the payroll function could have a different method of recording salary bands and staff grading than the HR department. Clearly in an enterprise business planning environment, where plans are linked between different functional areas, it is imperative that master data is aligned to provide a common basis for planning assumptions, analysis and derived key performance measures (KPIs).

Typically, enterprise operational planning relies on a variety of data sources beyond the strict boundaries of the functions involved. Efficiently managing these data flows is key to the smooth running of an EBP platform. However, the relationships between data structures in these varied applications can be relatively complex as elements in one structure may not have a direct equivalent in another structure, a position exacerbated by the popularity of multidimensional and segmental reporting. Furthermore, in recent years the task of migrating data from one system to another has become more challenging because of the volume and breadth of financial and non-financial information that needs to be captured.

Although still relatively new, Financial Data Quality Management (FDQM) software is making a profound impact on the efficiency of controls and processes around data collection, mapping and uploading to an enterprise business planning system. This essential tool which can augment the more multi-purpose ETL tools, which tend to be the sole preserve of the IT department, is well within the grasp of the non-IT specialist, empowering end users in finance to control interfaces, mappings and master data. As a result, the intricacies of EBP which require a deep understanding of the application can be managed directly by the people best qualified to deliver the change, liberating the IT department from the burden of maintenance, enabling a more rapid resolution of complex boundary issues, and promoting a more agile response to change.

Fig 1: Oracle's Hyperion Financial Data Management enables end users to manage data definition and integration and provides process and audit controls
Collaboration is the key

Collaborative technologies can make a real difference to the way that the enterprise planning process works. The key objective of collaboration is to remove organizational and geographic barriers in the planning cycle so that structured and unstructured information can flow unimpeded along the entire length of the planning process and that authorized users have visibility of information and the supporting process. For example, a change to an account line, planning assumption, or submission deadline should be instantly broadcast to every user that needs to know.

But collaboration is not merely confined to the communication of structured and unstructured information – important as this is. Collaboration also extends to the management of the process itself, such as the prior approval of a change to a planning assumption, the digital signature on a completed plan or the rejection of an explanation. Informality around these activities frequently reduces the dependability and speed of the planning process.

One of the biggest impediments to the smooth running of the EBP process is that these process tasks rely on a range of unrelated technical solutions. For example, a policy change may be communicated by an email or conference call, an approval of an account line change may be made on a manual form and a new deadline may be noted in an Outlook calendar and a commentary on a performance measure confined to a PowerPoint presentation. Individuals may have to launch five different applications and trawl through several manual systems to keep their finger on the pulse. By contrast, combining the applications into a single cohesive enterprise business planning environment means that individuals do not have to waste time searching for information, opening and closing different applications with different access rights and passwords. The ability to look across the process is not only time saving but provides a more fulfilling and enjoyable user experience.

Increasing productivity through workflow

Recognizing, the importance of human interaction is crucially important to EBP. Unlike factory processes which are often linear and predictable, or even transaction processes which can be routed across business functions with a fair degree of certainty, information processes, especially planning, can have a variety of outcomes. So process automation has to accommodate human decision making, management review and appraisal as well as collaborative working and control.

Workflow technology offers the dual benefits of communicating information bi-directionally within the same environment, as well as promoting an efficient and standardized process. It is one of the key transformational technologies capable of binding the EBP process.

Fig2: Oracle Hyperion Planning has flexible and powerful planning process management and workflow capability that allow the implementation of sophisticated review and approval processes
Workflow comes into its own in the approval or rejection of planning proposals. Draft plans and changes can be transferred across the reporting hierarchy between functions and passed to the next manager to review. Individual lines and planning assumptions can be viewed and challenged on-line and decisions taken jointly between planners in different functional areas. In the case of matrix management structures, where some account lines come under joint ownership, the visibility afforded by workflow allows conflicting objectives to be resolved before they become a problem.

An important consequence of workflow is the negotiation and dialogue around plans at every level of the organization and means that the process benefits from management review and problem resolution at an early stage. Replicated across the enterprise this manifests itself in better data quality overall, and ultimately fewer planning iterations. This not only relieves pressure in the process but also liberates time to be used more productively in analysis.

Most businesses are familiar with the relationship between risk and reward but in assessing potential opportunities and developing business plans rarely acknowledge risks and probability in a formal way. This is not to say that there isn’t a role for intuition and experience, it is just that the record shows that businesses that take risk and probability into account regularly outperform their contemporaries in terms of forecast accuracy.

Even then, sensitivity analysis tends to be a limited exercise concentrating merely on three common scenarios, “best case”, “worse case” and something “in between”. Usually, worked up in a spreadsheet these scenarios tend to flex one or two variables (assumptions) at a time and provide little insight into probable outcomes which in the real world reflect the collective influence of many variables (good and bad) impacting at the same time. So is there a better way?

“Once we start thinking about forecasting under conditions of uncertainty of sudden change, it becomes clear that a single forecast value for each time period is simply unrealistic. At such times it is obvious that any forecast could be increased or decreased by 5%, 10% or more without flying in the face of common sense. In circumstances such as these it is statistical folly to issue single valued forecast. What is needed is a range of forecast scenarios based on different assumptions in order to understand the resulting risk range.”

Avoiding Profit Warnings, Metapraxis Limited 2005

There is a growing appreciation of the value of mathematical techniques taken for granted in other forecasting environments but rarely applied in enterprise business planning. Engineers and scientists regularly make use of Monte Carlo simulation to refine their forecasts and set realistic expectations about the range of possible outcomes.
Northrop Grumman finds that Monte Carlo simulation helps the business to manage uncertainty and improve forecast accuracy.

Northrop Grumman is a multi-$billion information systems integrator and managed services provider, rated by outside industry analysts as the number one government systems integrator and the premier provider of software and information technology services to the defence and intelligence sector.

To maintain its leadership position, the business has to continually invest in a variety of projects which ensure that it is endowed with leading edge capabilities, such as unique intellectual property and prototype systems that enable it to compete successfully for large government programs. But as Dr Robert Brammer, Vice President and Chief Technology Officer, Northrop Grumman Information Technology points out, traditional investment appraisal techniques are left wanting when it comes to managing multi-million dollar investment appraisal decisions in a complex, volatile and uncertain environment.

"In years past we used classic discounted cash flow techniques to compare investment opportunities, but the impact of probability on anticipated cash flows was only recognized in an informal and subjective way. For example, a bid manager might claim that a particular cash flow had a probability of 40 percent but there was nothing to back up the assertion other than his business judgment."

Several years ago Brammer decided he needed a more objective and transparent approach to project appraisal which would lead to more robust and confident decision making. He introduced Monte Carlo simulation into the mix, a technique familiar to mathematicians and scientists but which had yet to make its mark in a business setting. However, the value of the technique quickly became apparent.

"We needed a better way of handling uncertainty in investment appraisal. The size and complexity of our programmes meant that probability distributions did not conform to normal probability distribution curves. We have to cope with multiple probability peaks and simultaneously with a very large numbers of project variables," says Brammer.

What Brammer finds particularly valuable in Monte Carlo simulation is the availability of 'Tornado' diagrams which highlight the most significant variables, i.e. the ones that drive project sensitivity. "One cannot feasibly work with all of the variables but knowing which ones matter the most gives a better picture of the sensitivity of forecasts and therefore which variables to focus on."

The technique has proved to be very accurate and over time Brammer has been able to demonstrate a correlation between early investments in R & D projects and the ability of the Group to win competitive tenders down the line. "If an investment costs a $1million but helps secure a contract of $500 million it is easy to demonstrate a return on investment," he says.

Another benefit is that decision making stands up to scrutiny. "I have to be able to convince myself that an investment is justified as well as field questions from others. Classic discounted cash flow is subjective but using Monte Carlo simulation we can determine the probability distribution of winning a contract, the probability of the customer coming up with the funding and the probability of being able to agree terms and conditions."

The success of Monte Carlo simulation is catching on and it is likely that the technique will be rolled out to other areas of financial forecasting - perhaps using the method directly in the bidding process.

Monte Carlo simulation works by modelling a number of business assumptions in parallel, each having an assigned range of input values and probabilities. For example, a house builder may decide to model “House Sales” based on assumptions about interest rates, inflation, and unemployment, setting for each of these variables the range of likely values and their probability. Monte Carlo simulation then uses random number generators in combination with various mathematical probability density functions to generate thousands of scenarios. By summing the scenarios, the simulation provides a forecast of the results expected from integrating the interactions of all of the selected variables (interest rates, inflation, and unemployment in this case – but it could be more), presenting the probability of achieving each of the builder’s desired levels of “House Sales”.
Furthermore, models of this type can identify the most influential (sensitive) factors to take into account. For example, bad news on unemployment may in the majority of cases outweigh any other considerations and management can focus on this as the key determinant in deciding whether or not to turn its land bank into new builds.

**Fig 3: Oracle’s Crystal Ball Monte Carlo simulation can answer common “what-if” and forecasting questions**

![Monte Carlo Simulation Graph]

In minutes the house builder benefits from a comprehensive assessment of risk and a ‘real world’ simulation that could not be achieved by traditional financial forecasting techniques. Monte Carlo simulation is increasingly being seen in operational plans as well as longer term plans and strategies. Matching supply and demand profiles is an example, of how some organizations can use the technique to optimize their inventory levels, sales and demand plans.

**Cultural challenges**

Providing the enabling technologies and processes is one concern but integrating human behaviour is an entirely different matter. For many organizations, planning, budgeting and forecasting are closely coupled with remuneration and bonus schemes. This means that planning and budgeting are infused with the full range of human emotion and responses as well as hard-nosed business decision-making. The issues are magnified in an enterprise business planning environment where planners may have to step outside of their ‘comfort zone’ to negotiate and agree plans with a range of other functional areas.

With contributions from across the enterprise the question also arises as to who should be responsible for resolving the plans. Since everything within operational plans ultimately flows through to financial plans it is the finance function that is increasingly charged with the stewardship of enterprise business planning.
For organizations looking to implement Enterprise Business Planning below is a checklist of attributes that can be used to assess progress towards an Enterprise Business Planning environment.

**Do you?**

- Execute top-down and bottom-up planning
- Set corporate financial goals and targets for revenue, margins, expenses, head count, and capital expenditures
- Cascade plans and forecasts throughout departments and divisions
- Use bottom-up budgeting to create a detailed build-up of financial and operational assumptions by cost center, department, division, or business unit
- Match plans against the original financial objectives or targets set by senior management and external stakeholders
- Align top-down and bottom-up budgets and plans by performing several iterations throughout the annual budget process
- Align plans across business functions to drive consistent execution of strategy
- Allocate capital and resources optimally across the organization
- Assess the integrated impact of business decisions
- Integrate operational and financial planning to ensure that financial goals can be met
- Use rolling forecasts instead of end-of-year forecasts to continuously capture changing market conditions
- Use statistical forecasting and optimization techniques to deliver predictable results
- Model revenues and margins based on operational business drivers such as unit sales forecasts, product mix, key input costs, and selling prices
- Map changes in plans and planning assumptions to financial targets and operational constraints
- Evaluate operational costs and environmental impacts across the entire value chain
- Execute simultaneous analysis of the impact of plan revisions on financials and operations

**Useful KPI's for an Enterprise Business Planning environment include:**

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<td>Planned contribution to company goals</td>
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<td>Planned contribution to other business domains</td>
<td>Realized contribution to other business domains</td>
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<td>Asset utilization rate (people, facilities)</td>
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<td>Cycle time to prepare budgets</td>
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Summary

In the face of unprecedented change and volatility management has to respond even more quickly to the shifting sands of consumer demand and market uncertainty as well as the burgeoning requirements of the networked economy. Traditional approaches based on business functions working in isolation and supported by inappropriate spreadsheet technology place management at a severe disadvantage in terms of robustness, accuracy and timeliness of decision making in response to changed circumstances.

Enlightened companies are seeing the benefits of a cross-functional capability in which the planning effort is aligned with core business processes and integrated so that planning assumptions are normalized across the enterprise. The outcome of this is broad consensus around predicted outturns and there is greater assurance that operational performance is technically, operationally and financially feasible.

However, such an approach requires investment in enabling technology that provides for collaborative working, enhanced productivity through workflow and data management tools which maintain consistency of data quality and definition across the business. But cross-functional working also requires sophisticated modelling capability that interleaves plans and assumptions in one functional area with another, ties together operational and financial plans, resolves differences in planning granularity and enables on-demand analysis and reporting. It also needs a heightened appreciation of the benefits of risk and probability modelling and the benefits this can bring in terms of better describing the range of business possibilities available to management.

Positioned within the overall Enterprise Performance Management Framework, enterprise business planning ensures that management can keep its finger on the pulse, reduce planning iterations, accelerate decision making and ensure that financial performance is more dependable regardless of market volatility.

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