**A Practical Look at Driver-Based Planning**

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I hadn’t thought about the exact definition of “driver-based planning” until the question came up in the context of [our planning benchmark research](http://www.ventanaresearch.com/ibp/) showing that only 6% of companies with more than 100 employees do driver-based planning. Broadly defined, the term could be applied to the use of any spreadsheet-planning model because these almost always have built-in **volume-times-price formulas, which are components of driver-based plans.** However, this is not what most people have in mind when they talk about driver-based planning, and that’s reflected in the low percentage of those employing the technique.

As I use the term, there are **two conditions** that must be met for driver-based planning. The first is that the **volume-times-price amounts** used in defining activities and their financial consequences remain discrete and discoverable by participants throughout the planning, analysis and review processes. The second is that there are **persistent volume and price connections between plans of the various groups** within a company. Typically, activities that take place in one part of an organization drive actions in another. For example, the sale of a product or service drives fulfillment activities that can be direct (shipping inventory or providing consulting hours) or indirect (administrative tasks such as scheduling or order processing).

**Most budgeting exercises reflect the relationships of activities in various parts of a business, but they do so indirectly and imperfectly**. They simply consolidate monetary data of each part of the organization, and the final result at best captures only a small percentage of the underlying unit/volume assumptions that produced those forecasts. **While this might work reasonably well in setting a company budget, it’s difficult and time-consuming to update and manage changes in plans in a coordinated fashion**. In our research that just 10 percent said they react to change in business conditions in a very coordinated fashion, while one-third said lack of coordination occurs frequently and is an issue. In spreadsheet-based budgeting, it’s very difficult to consolidate these unit amounts. Companies that have adopted a dedicated planning and budgeting application may be able to do somewhat more, capturing and reporting on volumes and prices (which may be the result of informal “sandbox” calculations), **but these figures do not “drive” other parts of the budget.**

To clarify the term, here’s a simple, partial example of driver-based planning. A company’s objective is to have 10 percent of a market in unit terms; to achieve that it must sell 10,000 product units at an average price of 5, which translates to a revenue target of 50,000. Based on experience, it will take 250 sales to achieve this goal, based on an average transaction size of 400 units. If each sales call costs 10, the budgeted expense for the period is 2,500. If the close rate is 17%, generating these sales will require 1,500 leads. If each lead costs 0.50, lead-generation has a budget of 750. Direct operating activities can drive administrative ones in that the number of receivable and payables clerks can be a function of sales volumes and purchase orders processed. Other factors can be figured in as well.

**The point in creating a driver-based model is not to produce one that is overly detailed (say, one that mimics the chart of accounts) and/or complex**. To make such a model accurate and actionable, planners must focus on key performance drivers (and key performance metrics derived from them), which are the most important determinants of revenues and costs across all business functions and which draw the connections between them.

In an organization that has done this, budget-setting and performance reviews can be more explicitly about key objectives and how to achieve them. The effort can make budget allocations more rational and less political (although, human nature being what it is, there’s no guarantee they will be). In reviewing results, variance analysis can easily distinguish between the “things” and their costs, allowing decisions on action items to be better informed and made sooner.

Toward this end, driver-based planning enables people to ask meaningful questions. For example, in reviewing results, were there more sales trips than expected? Was that because there were more transactions closed or because the average units per transaction were lower than assumed? In which territory or territories did this occur? Given these results, do we need to change the sales process or incentive compensation? Was travel expense higher than budgeted because there were more sales calls? Were these calls more or less productive than assumed? What does the answer to this mean for sales training or management? If travel expense increased because the cost per trip was higher, why was this so? Or was it some combination of both?

Keeping units and costs separate and discoverable enables managers to better assess the performance of business units, managers and individuals. It makes it simpler to separate the impact of controllable components (such as average units sold, lead conversions or scrap rates) and uncontrollable elements (such as commodity costs or payroll taxes).

**Moreover, it’s easier to re-plan faster and with better coordination when a company uses driver-based planning models.** Changes in prices or costs have revenue and income implications, but if the basic driver relationships remain valid, management can quickly see their impact on the company’s revenues, expenses and cash flow. With the right software, executives and managers can work interactively, exploring different operating plans to adapt faster to changing market, competitive, supply chain and regulatory conditions.

I think that this sort of driver-based planning **promotes more operationally focused performance management rather than budget-focused management**. This is important because we need to recognize that planning and budgeting are two separate functions. **Planning focuses on “things”** (headcount, units produced, sales calls and less-than-truckload shipments, to name four) while **budgeting is about money** (revenues, expenses and costs, cash flow and so on). The purpose of budgeting is to control spending to ensure the company has enough income and cash to operate. It’s about not failing. The purpose of planning is to figure out how a company can best implement its strategy and achieve its objectives. It’s about succeeding. Budgeting strives to get to fixed numbers. Planning is more open-ended because there are multiple ways of achieving an objective. Companies need to do both, but as [I’ve noted before](http://robertkugel.ventanaresearch.com/2011/06/08/218/), **they ought to focus more on planning and less on budgeting.**

**Driver-based modeling and planning also make it easier to implement a** [rolling forecasts methodology](http://robertkugel.ventanaresearch.com/2011/09/06/rolling-forecasts-are-a-good-first-step-toward-smarter-financial-planning/). Many companies have adopted rolling forecasts as a way of dealing with today’s volatile business environment.

Software is a necessary component in making planning and budgeting more valuable as business tools. Dedicated applications eliminate desktop spreadsheet’s technology barriers (mainly the lack of referential integrity and limited dimensionality) that make it too difficult to use these spreadsheets to create and maintain driver-based models. But few companies have taken advantage of these dedicated applications’ ability to support driver-based planning. **It’s imperative in today’s volatile economic environment to replace the relatively static annual budget with agile planning. Driver-based models are a cornerstone of agile planning.**

Regards,

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