Chapter 6
Feeding Financial Analysis

Perspective

Truly effective financial planning and decision making can only be done when based on operational system drivers and data. Actual sales and supply performance, projected sales and supply plans, and inventory values from the operational planning and execution systems should drive future financial plans (cash flow, profitability, projected inventory valuation, budgeting, etc.), because the numbers in these systems are driving actions, activities, and all the detailed decisions in the areas of sales, supply, sourcing, inventory, capacity, etc.

Financial projections can be made directly from S&OP data[1] and these can feed key financial planning and analysis processes, or S&OP data can be extracted and fed to financial planning systems where projections are made. Projections based on S&OP data, and the related financial processes are the ones discussed in this chapter. More detailed financial projections can be made using the numbers in the master scheduling, material planning and capacity planning systems, but these projections are outside the scope of this book.

Financial planning and analysis activities fed by S&OP data typically include:

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[1] The advantage of projections developed from the sales and operations plan is that they don't depend on detailed planning numbers, which may or may not exist in periods beyond a few months into the future. Of course, the principal disadvantage is that when volume numbers like the ones from the S&OP sales plan are used, assumptions have to be made about the mix of items within that volume, and additional work is required to establish average cost and selling price data based on this forecasted mix.

Since the financial projections were developed from the sales and operations plan, it is possible to look into the system and track a financial number back to sales and supply decisions causing it. A top manager or financial planner can take a number like the projected value of finished goods inventory in month three, trace it back to the projected finished goods inventory in month three for each product family, and trace this back to the sales plan and supply plan that caused it. If there is a problem with the financial plan, it is possible to see it in advance and attempt to correct it before it happens.

Notice that what we are talking about here is using S&OP to feed financial projections in the future. It is not designed to be a perfect revenue predictor for the current month. For this kind of prediction, look to the systems that manage mix not volume.

- Budgeting and business planning for future years.
- Projecting current year revenue, margin, and profit based on current sales plans and forecasts, and actual performance to date during the year.
- Reconciling revenue plans, targets and budgets from the business plan to current operational projections.
- Projecting future cash flows.
- Projecting inventory investment based upon future sales and supply levels, and planned or actual average cost of goods sold.
- Capital planning.

Budgeting and Business Planning

The dollarized sales and operations plan should be fed to the annual budgeting process. Each year, beginning several months in advance of the fiscal year, the rolling projected demand, supply, backlog, and inventory plans that exist as part of S&OP become the primary input to budgeting process. Since the sales and operations plan stretches out over an eighteen month horizon, even a company kicking off the budgeting process six months ahead of the fiscal year start date will have enough visibility into anticipated full year results. Assuming that this is the best estimate of both the marketplace and supply capabilities, in some sense it is already the "budget" for the next fiscal year. And while the numbers may change several times before the start of the next fiscal year, because their source is the S&OP process, any new data or information will immediately be reflected in the financial planning numbers used in the formal budgeting process.

There are several reasons to use the dollarized S&OP numbers in the budgeting process:

1. Product and market intelligence is already reflected in the numbers, and as conditions change, so do the sales and supply plans.
2. The numbers are easy to get and processes already exist to maintain them.
3. The numbers coming out of S&OP tend to be more valid than numbers developed outside the operational systems – they are subjected to constant scrutiny, reviewed monthly and debated across key groups and people in the organization, and they drive the detailed activities in the company. Executive