

Steering the ship during times of extreme uncertainty

AN FP&A PERSPECTIVE

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As business professionals, we have all heard leaders rant about how we live in a volatile environment. We have heard examples of black swan events that have shaken the business landscape and transformed organisations. The term black swan event, coined by Nassim Taleb, gained popularity during the 2008 crisis which started in the US banking and housing sectors and had far-reaching effects across many sectors in the global economy. While some large companies collapsed and many people lost their jobs, that crisis may seem like a walk in the park when it is compared to the one we appear to be witnessing now.

The COVID-19 pandemic has now spread to almost every country on the globe, impacting an increasing number of lives every day. As social distancing becomes the new normal, economic activity is slowing down and the future seems to be more uncertain than it has been for the last few generations. The cost to the world economy has been estimated to be around \$2.7 trillion.

As we enter this phase of unknowns, business becomes extremely challenging. FP&A has a critical role to play in steering each ship through these uncertain waters. This will, however, require a change in mindset and the adoption of different techniques.

One of the key factors in successfully navigating through this level of uncertainty is a simple acknowledgment that you don't know. You don't know what will happen. You don't know how long this will last. And you don't know what the best way to handle it will be. Therefore, in acknowledgment that I myself do not know, and fully encouraging alternative views, I attempt below to highlight a few approaches that may prove valuable at this time:

1. Dump your long-term plans

Let's start by agreeing that all financial projections we had for 2020 are now redundant, most likely adversely impacted unless you happen to be a mask or hand-sanitiser manufacturer. Be aware of the sunk cost fallacy and do not become its victim. Yes, your latest range of luxury watches was supposed to take the market by storm. Indeed, its advertising campaign with the biggest celebrity in Hollywood had only just started. However, should you still go through with the same level of marketing spend because you have already incurred the high costs of product development and paid for that celebrity's time? Clearly, the current market is not a place where you would expect luxury watches to fly off the shelves. Therefore, reducing sales projections and cutting advertising spend would be a better approach.

2. Think short-term and scenario-based

With the degree of ambiguity in the current market, there is a wide spectrum of likely scenarios that may occur within the coming year. In such an environment, planning cycles need to be shorter. Rolling forecasts, with shorter time frames (weekly), are more relevant. A more adaptive and iterative approach such as scenario-based planning may be a good approach, especially with its focus on key business drivers. For an FP&A professional, it is vital to ignore the optimism bias and build a realistic plan for all scenarios. All organisations should work through a worst-case scenario to be aware of the time frame in which they will run out of cash and their sensitivity to different environmental factors.

3. Develop an 'options' mindset

In times of certainty, businesses tend to be comfortable making long range, large commitments with an aim to gain economies of scale. In an extremely volatile environment, an 'options' mindset is much more beneficial. In other words, delay any expensive decision as far as possible or choose an alternative that allows you an option. This strategy can be applied in many areas other than simply derivative options. For example, new machinery is available today at an upfront cost of \$1 million but there is also an option to buy the same machinery in a year's time, worth \$1.1 million, for \$80,000. The second scenario may be more worthwhile since the company's need for the machinery may become clearer over the course of the year. This value may justify the cost of the option.

4. Communicate and align teams

For FP&A teams, the importance of clear communication with internal and external stakeholders and alignment to their plans cannot be stressed enough. This is even more critical in times of uncertainty. FP&A needs to establish regular two-way communication with business teams. The FP&A team can then guide the actions of the business based on scenario budgets whilst absorbing information about on-ground realities that may require plans to adapt. It is also vital that the FP&A team communicate the updated planning approach to their external stakeholders, e.g. the Board, investors and bankers, to ensure that they are aligned on the organisation's approach during volatility.

In the coming weeks, we will dive deeper into the different areas that FP&A professionals need to be mindful of while operating in this new world of unknown. Until then, take care and stay safe.