Companies need a new approach to financial planning and performance management—one that informs rapid realignment of plans and actions and ensures organizational resilience.

by Ankur Agrawal, Kapil Chandra, Matthew Maloney, and Michele Tam
Planning has never been a particularly easy task, but the spread of COVID-19 has made it even more difficult. Finance professionals are used to accuracy, consistency, and relatively predictable planning cycles, not the unclear economic conditions and time horizons of a global pandemic. As one executive told us: “The five-year plan that we would be sending to the board right now is completely out the window. How do we plan in this environment when we don’t know what is going to happen?”

Clearly, companies’ existing plans and assumptions will need to be revised in light of the rapidly changing global health situation, which is creating uneven economic effects across all industries (exhibit).

In normal times, financial-planning teams generally use a range of driver-based models for budgeting, forecasting, and root-cause analysis. Over the years, they have likely cultivated their own standard reports and preferred views of information. Few

Exhibit

The economic impact of COVID-19 varies by industry and sector.

Preliminary views of hardest-hit sectors (as of April 3, 2020)

<table>
<thead>
<tr>
<th>Average stock-price change, %</th>
<th>Industry-specific context</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Commercial aerospace</strong></td>
<td>-46</td>
</tr>
<tr>
<td>Preexisting conditions, challenges with airlines’ balance-sheet resilience, and high fixed costs cause near-term cash-flow issues and uncertainty about long-term growth.</td>
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<tr>
<td>It may take years to recover from production and supply-chain stoppages: critical vendors are in areas affected by the virus, and tier-3 suppliers are particularly susceptible to liquidity challenges.</td>
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<tr>
<td><strong>Air and travel</strong></td>
<td>-44</td>
</tr>
<tr>
<td>There is an immediate effect on demand, some 5 or 6 times greater than that of Sept 11, 2001; about 70–80% near-term demand erosion is due to international travel bans and quarantines.</td>
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<tr>
<td>Bookings for summer travel season in the northern hemisphere are being affected by the public’s fears about the duration of the virus.</td>
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<tr>
<td>Faster recovery expected for domestic travel (about 2 or 3 quarters); slower recovery for long-haul and international travel (6+ quarters).</td>
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</tr>
<tr>
<td><strong>Oil and gas</strong></td>
<td>-42</td>
</tr>
<tr>
<td>Steep drop in oil prices is driven by the virus’s impact on short-term demand as well as the surplus resulting from OPEC+ decision to increase production.</td>
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</tr>
<tr>
<td>Oversupply expected to remain in the market even after demand recovers, and post-2020, unless OPEC+ decides to cut production.</td>
<td></td>
</tr>
<tr>
<td><strong>Automotive</strong></td>
<td>-29</td>
</tr>
<tr>
<td>Existing vulnerabilities (such as trade tensions, declining sales) are amplified by acute decline in global demand; Mar 26 survey of US auto consumers indicates 70% are deferring purchases by about 6 months or no longer intend to purchase.</td>
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</tr>
<tr>
<td>Despite ongoing Chinese economic restart, there is continued supply-chain and production disruption as majority of EU and US OEMs have temporarily closed plants and Hubei manufacturing remains at about 50% capacity.</td>
<td></td>
</tr>
<tr>
<td><strong>Insurance carriers</strong></td>
<td>-29</td>
</tr>
<tr>
<td>Reduced interest rates and investment performance are affecting returns—especially for longer-tail lines.</td>
<td></td>
</tr>
<tr>
<td>Disruptions are expected in new business and underwriting processes due to dependence on paper applications and medical underwriting.</td>
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</tbody>
</table>

1 In the past 30 days, for selected sector indexes.

Source: IHS Market; press reports; S&CF Insights; S&P Capital IQ; Corporate Performance Analytics by McKinsey; McKinsey Global Institute analysis
Financial planning and performance management under this unprecedented period of turmoil requires a new, systematic approach, one that will allow the CFO and finance team to quickly alert the company to options emerging as a result of the coronavirus.

Specifically, the financial-planning team should focus on the following five steps: get a clear view of the company’s starting position; build a fact base and use it to develop a range of scenarios; align on a financial plan with the “direction of travel”; determine best actions and moves; and, finally, identify the “trigger points” that will prompt the business to adjust and adapt forecasts and financial plans with alacrity.

In this period of pandemic, companies are at wildly different levels of liquidity and risk tolerance. Regardless of their starting points, all of them can use all or various aspects of this five-step planning process to cut through the uncertainty and make the best possible decisions.

The financial-planning team’s primary responsibility is to help guide the organization through the worst of the crisis—as opposed to the mandate for the plan-ahead team, which is to look beyond the day-to-day of the crisis and develop a view of how the future may unfold. Once the worst has passed, however, there is also an opportunity for the CFO and the finance team to use the crisis as a starting point for deep discussions with business-unit leaders about how the overall planning process may need to change in the next normal.

Get a clear view of the company’s starting position
The company needs a clear view of its starting position in the wake of the pandemic. To get this, it should convene a COVID-19 financial-planning team, supported by a range of cross-functional experts (for instance, in sales and in supply chains). Together, the financial-planning team and cross-functional experts can build a solid fact base, one that tells a comprehensive story about historical and current market and financial trends, as well as potential future indicators. The financial plan that the company rolled out in January 2020 can be a good anchor point for this exercise, as it can help to establish any assumptions that will need to change as a result of the pandemic.

The team should build a driver-based model from revenue to cash, looking monthly (or weekly if liquidity is at stake). It should compare the latest trends and the key operational drivers of the business (those inputs that have the most impact) prior to the crisis with the key drivers of the business since the crisis started. What has changed? What specific liquidity risks have emerged? How sensitive are these drivers to current uncertainties in the market? It is also important to look at business drivers within the industry (vendors, customers, and geographies) and how those have changed pre- and postpandemic. The outcome from all this will be a baseline set of facts to compare against emerging scenarios. These scenarios will become the new “true north” for the financial-planning team and the anchor points of the financial plan for the next 18 months.

Develop a range of scenarios
With a reliable fact base in hand, the financial-planning team should be able to quickly model three or four scenarios for how the pandemic might play out within its industry: a best case (optimistic), a worst case (pessimistic), a momentum case (continue on the current trajectory), and a most-likely case. In this way, the team can ensure that a breadth of outcomes are being explored; the organization cannot simply pick the middle scenario as the most likely case.

Each scenario must be assessed along three dimensions: depth of the decline, duration of the decline, and the time required to ramp back up. Each scenario must also accurately reflect the company’s starting point: A company experiencing a slight decline in sales as a result of COVID-19 (grocery, for example) may only need to plan for small, nonstructural changes to ensure that it successfully weatheres the
The financial-planning team may want to revisit performance plans—emphasizing the implementation of initiatives rather than aggregated financial results.

crisis. By contrast, a company that has lost half of its sales as a result of the pandemic (hospitality, for instance) may need to plan for a revamp of its entire cost structure and even its entire business model. Hence the “best” and “worst” cases will look different for different companies, even in the same industry.

The financial-planning team should build financial forecasts that exclude any investments or upside from any strategic initiatives—essentially, the momentum cases for each scenario. The team should then stress-test forecasts and initial business assumptions against its scenarios. It will need to take time horizons into account—looking three months out, initially, but eventually extending that to 12 to 18 months. Throughout this modeling exercise, it is important for the financial-planning team to use conservative estimates and assumptions without trying to be overly precise.

It can then build a view of capital and capacity constraints due to COVID-19: Given near-term and midterm considerations, which strategic initiatives might be accelerated, slowed, deferred, or canceled outright? A company in a strong cash position may accelerate opportunities to shore up its supply chain—buying more raw materials or making advance payments to ensure access to resources. By contrast, a company facing liquidity issues may need to pursue the extension of payment terms with suppliers and defer some initiatives until the crisis abates.

Establish the ‘direction of travel’

Once the fact base and scenarios have been created and pressure-tested, the financial-planning team, with input from the executive leadership team, will need to decide which scenarios make the most sense to pursue and then build a detailed financial plan around them.

Depending on the level of disruption the company faces, the direction of travel might focus on sustaining the existing business and restoring operations as quickly as possible, or restructuring the company to match the changing demand environment, or shifting the business model to meet radically different customer behaviors, or shaping a whole new business.

In all these cases, the financial-planning team will need to clarify the company’s cash-conservation approach in a COVID-19 world, including a near- and midterm evaluation of cash flow. This approach should be applied and communicated to each functional and geographic area; everyone should understand what will be spent on operations, sales, marketing, and other critical areas. The emphasis, in times of immediate crisis, should be on what will maximize cash flow to sustain the company, not on overall company size or revenues.

Internally, the financial-planning team may also want to revisit performance plans—emphasizing the implementation of initiatives rather than aggregated financial results. This may be necessary for two reasons: first, previous compensation rewards may
be linked to targets that no longer apply given the economic effects of COVID-19. And second, the context has changed so dramatically that any new initiatives may require employees to take on a completely different mindset and embrace new activities—for instance, asking a brewer to shift production resources from a traditional task (making beer) toward a new COVID-19-related one (using runoff alcohol to make hand sanitizer). It may also be necessary to consult tax experts given the degree to which the public-policy landscape and stimulus bills may vary by industry and geography.

**Determine best actions and moves**

With scenarios in hand and a direction of travel agreed upon, the financial-planning team must work with senior leadership to identify a coherent set of initiatives, determine how to execute on them, and track their performance across multiple time horizons. They will need to find the right combination of no-regrets moves, big bets, and real options. Typically, such moves will fall into one of three categories: initiatives that were built into the financial plan as of January 2020, initiatives that had been considered during the planning process but that were not included in the financial plan, and initiatives that may be required now as a result of the crisis.

Based on the financial-planning team’s mapping scenarios, for instance, leaders at a midsize industrial company decided to shift resources away from those products that had seen a radical drop in sales due to the spread of the virus and toward products that were holding steady. The company also decided to invest in the conversion of some production lines so it could make personal protective equipment, urgently needed during the pandemic.

Meanwhile, senior leaders at a retail company that was in distress worked with the financial-planning team to build a list of priority initiatives and to map all potential levers required to carry them out successfully—cost, working capital, capital expenditures, and so on. It performed a deep-dive analysis of the products and services associated with these initiatives, as well as sales expected in the near and long term, to ensure that resources and priorities could be appropriately lined up. With this information in hand, senior leaders revised their list of priorities, deferring several initiatives and cancelling a few initiatives outright.

**Identify ‘trigger points’**

Particularly in times of crisis, the financial-planning team must closely monitor the company’s liquidity and earnings performance and any changes in the market. In our experience, senior leaders can fall into the trap of wanting to track multiple key performance indicators (KPIs) when only about ten variables matter. The financial-planning team should formally identify the most relevant indicators (or “trigger points”) among all the business and operational drivers reviewed throughout the process. For many, this will include cash and sales figures but could also encompass customer-retention rates and sales-pipeline metrics. At one grocery retailer, for instance, it was critical to monitor inventory to avoid stock-out situations.

The team can then build a dashboard, which can be reviewed daily by the financial team and monitored for what has changed and any interventions required as a result of these changes—whether that means pulling different levers to achieve desired outcomes or modeling new scenarios. Initially, the dashboards created by the financial-planning team are likely to be “bootstrapped” using Excel and other common software. Ideally, they would be updated as often as possible to ensure that decision makers are receiving the most up-to-date, most reliable information.

In addition, the financial-planning team should identify those KPIs that would signal that the company is moving out of the crisis phase and entering the next normal; McKinsey research shows that companies’ early recovery from downturns usually results in outsize gains in the market.¹

**Institutionalize new ways of working**

By following the approach outlined in this article, financial-planning teams will inevitably begin to establish a range of new capabilities within the

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finance function—for instance, rapid planning and forecasting; cross-functional collaborations; and dynamic dashboards, KPIs, and triggers.

In the next normal, companies should consider ways to build on these capabilities and embed them into day-to-day forecasting and performance-management processes.

They may want to shift permanently to shorter planning cycles, more frequent review of KPIs, or the use of zero-based budgeting models. The types of dashboards, nerve centers, and spend-control towers being developed to track finances during COVID-19 could be repurposed postcrisis to vault the company into its period of recovery. Finance organizations could further empower members of the financial-planning and analysis (FP&A) team to act as “sentinels” for recovery and resilience (see sidebar, “Playing catch-up: Bolstering FP&A capabilities”).

For those finance functions and FP&A teams that have not explored automation and other time-saving technologies, the crisis may be a jumping off point to do so—freeing up members of the financial-planning team to serve as strategy partners and value managers rather than report generators.

**COVID-19** is a global public-health crisis with tragic consequences. It does not have to be an economic disaster as well. Finance executives have a clear role in helping their companies through the pandemic with both a steady hand and a will to succeed. The times demand nothing less.

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**Playing catch-up: Bolstering FP&A capabilities**

The role of financial planning and analysis (FP&A) is heightened in times of crisis, but some companies are finding that—just when they really need them—they lack the accelerated analytics, business insights, and digitally driven solutions FP&A teams can provide.

In pursuit of various cost efficiencies, some companies have gradually reduced their investment in FP&A capabilities over the years and have inadvertently focused the function’s efforts on arduous reporting and planning requirements instead of higher-order translation (from strategy to action) and analytical skills. During events such as COVID-19, these are exactly the types of skills required from FP&A—the ability to quickly clarify for business leaders the underlying drivers of the business; help them identify specific actions and initiatives required to manage through the immediate crisis; and, led by a focused plan-ahead team, anticipate actions for recovery.

There are several ways companies and FP&A organizations can begin to close this gap. In times of crisis, when the finance team is being pulled in many directions at once, the FP&A function should strive to convene agile teams of problem solvers to steer scarce analytical and strategic resources and capabilities to the priorities that matter. When financial acumen is in short supply, the FP&A team should reach out to others within the finance function who possess the relevant skills—and even to leaders in adjacent functions like operations and marketing who may themselves have spent time in FP&A. And given the uncertain labor market, this may be a good time for companies to look outside to find FP&A leaders with the required expertise.

There is no substitute, of course, for ongoing investment in FP&A capabilities. The companies that want to get it right should bump "FP&A talent development" up higher on the list of organizational priorities, and they should measure and monitor the function’s progress in this regard. An intentional approach to bolstering FP&A capabilities is the only way to ensure that companies can generate the critical analyses and executive support they need, in both good times and bad.