

Budgeting Best Practices



It's that time of the year again! Time to gather the team around and prepare the annual budget for next year. As such, we would like to suggest a few best practices on budgeting. Best practices that we, as a team, have learned over many decades acting as the CEO, CFO and/or COO for a variety of businesses – both large and small, domestic and international.



1. Strategy First, Budget Second

Before you start working on next year's budget, we consider it wise to first review your strategic plan. After all, the budget should reflect your strategic goals and priorities. It should help you allocate your scarce resources in alignment with your strategy. Therefore, we recommend updating your 3-5 year strategic plan and SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis as the first step of your annual budgeting process. Then, determine what you want to accomplish next year based on how it will help you achieve your long-term goals – and budget accordingly.



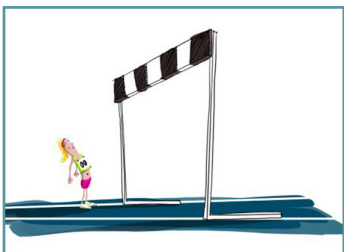
2. Question Everything

The preparation of a new budget offers a great opportunity to question existing business practices, processes, vendor relationships, etc. Do they still make sense in light of what has transpired over the past year and the strategic goals for next year and beyond? Should you discontinue product or service X given its low gross margin? Should you bring in-house some marketing expertise? Does it make sense to switch vendors or seek a different raw material or component for your product? There should be no sacred cows – question everything!



3. Faster, Better, Cheaper

One of the main goals of a business should be to develop sustainable competitive advantages – as they increase your chances of achieving long-term, profitable growth. In simple terms, competitive advantages often come from having a product or service that is either faster, better or cheaper than the competition (or all of the above). As such, one of the goals of your budget exercise should be to make your different business functions/ departments faster, better and/or cheaper. This will invariably result in a competitive advantage – or at a minimum, lead to greater operating efficiency and profitability.



4. Be aggressive, yet realistic

A very aggressive budget (either on the revenue or cost front) will often backfire. Very early on in the year the company's performance may start falling short of expectations, which can be demoralizing and time-consuming, as revisions will need to be made, team members may start playing the blame-game, etc. It will also cause you to lose face with the company's stakeholders – and as we all know, credibility is key in business. To avoid significant underperformance, be realistic and track budget-to-actual variances monthly – taking the appropriate corrective action swiftly.

Budgeting Best Practices *(continued)*



5. Cash is King

Along with next year's budget, make sure to develop a cash flow forecast with a very precise view of what the following 13-weeks will look like, and update this forecast monthly or quarterly. Take into account the seasonality of your business as well as the differences between GAAP Accounting and the cash realities of the business (e.g., the sale of an annual license may be recognized as revenue over the term of the license, and budgeted as such. However, the cash inflow may come in much sooner if the license is paid upfront). Remember that fast-growing businesses tend to require a lot of working capital.



6. Monitor and incorporate macro trends into your business planning and strategy

Shifting economic, demographic, political, technological and social trends can be a powerful force that may greatly impact your business – in a positive or negative way. Ignore them at your own peril. To account for them, consider developing more than one budget scenario, and ideally, have a plan for expense reductions if things don't go as planned. Perform "what-if" analysis to develop the appropriate contingency plans.



7. Create alignment by implementing a well-designed bonus plan

A well-designed bonus plan is fundamental in motivating key employees and aligning interests. It also has the great additional benefit of doing the "managing" for you. I.e., when people know exactly what is expected of them and that they will be rewarded based on how they perform against those metrics, they stay focused and increase their productivity. As a result, they require less guidance and oversight from you. Note: A well-designed incentive plan does not tie bonus payouts only to hitting the financial goals of the business (e.g., Revenues, EBITDA, etc.), but also to operating metrics specific to each department/function (e.g., churn rate, Net Promoter Score, etc.). In fact, operating metrics can actually be more powerful in incentivizing the kind of behavior that you want your employees to display, as they are more tangible and easier to relate to – which in turn should make it easier to achieve your financial goals.

If you need help developing a strategic plan, preparing your annual budget, designing an incentive plan or if you would like a fresh perspective from experienced executives, please give us a call or email us.



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