

Budgeting for a Home Run

By John Vamos

A budget is not a business plan; it's a scoreboard and a reality check. Let me explain how it works and how you can use it to know your business better.

Budgeting is the only serious measure of your performance. Instinct is one thing and, in SMEs, it is a big thing, but nothing beats numbers in black and white to remind you of what you expected would happen and what, perhaps, didn't! The point is not how important the budgeting process is, it's more like putting a 'stake in the sand' and doing some serious contemplation that says, 'If we know what we're doing, and we do it well, then things should turn out this way'.

Let's start with the end in mind. The ability to know what to change in business, where to spend more or less time, see what is and isn't working. Perfect performance in these areas is the hallmark of effective business management. So how do you do that?

Variance Reporting

It still surprises me that the concept of variance reporting is so new to many business people. Put simply, it is the difference between what you thought might happen, and what actually happened.

At BCS, variance reporting forms the foundation of our finance meetings and our executive management team meetings. You may have reviewed articles about job descriptions and key performance indicators. Well, our reports are all built around the Key Performance Indicators of each staff member, their predictions relating to how things should be (budget!) and the actual results they achieved.

The difference between what you expected and what actually happened is the scorecard that helps establish how clearly you understand your market, how well your products are performing, the success of each of your marketing initiatives, and the list goes on. In fact, the list is endless. You can't create effective variance reports unless you start with such source information.

Building Budgets

So, budgeting is simply a process for predicting what you think will happen for your business based on your best efforts and endeavours. While there are many standard formats for budgeting, to make it effective don't be bound by formats that rob you of the opportunity to see and understand your business your way.

If you are about to prepare your first budget, think of all the ways you earn money and all the places you spend money. Then, get whatever information you have about last year's performance. Look at each of your account categories and think about the historical information at hand. How accurate is it? Make any adjustments that help you establish an accurate figure for the past. Now think in the context of your business plan.

Now that was a low blow wasn't it? We get all this way and then you find out that your budgeting process is meaningless if you don't have a business plan. The clearer the picture in your mind about what the future will hold, the more accurate the predictions about the results. It's the process of creating the business plan that makes the budgeting process more accurate, not the outcome of the plan. Thinking through the business activities gives you the right to set those 'stakes in the sand' I referred to earlier.

Now, look at your list by account category, and begin making predictions about how much money you will earn from each of your sources of revenue. Then, understand exactly what resources you will require to generate that revenue. Make predictions about those expenses and complete your first budget.

Next step is to conduct a reality test. Get the staff who have an impact on each category to assess your predictions. Let them see what you see. Budgeting is not the time (if there ever is one) for secrecy. The more they know the better their contribution will be.



It is important to understand that a budget is not a business plan. The two go hand in hand but they are the result of very different thought processes. This is the mistake that many business advisors make when calling on their clients to prepare a business plan. It is ludicrous that many of these so-called advisors still see financial plans and cash-flow projections as business plans, but nothing could be further from the truth.

Financial Scoring

Think of the sporting coach. I doubt very much whether the coach would enter the dressing room before a game and offer as the last instruction before the players take the field, "Hey team, let's make it 37 – 24 our way."

This is conceptually what you're doing if you start to consider financials as business plans. Financials are the scoreboard. We make a prediction of what we would like the score to be at the end of the game, but focus all our energy on what we are physically going to do to make sure those things happen. What does the coach really do? The coach says to the team, "If we do this and that and the other, and we stick to our plan, then when we look up at the scoreboard at the end of the game, we'll find that it reflects our efforts."

Comparing budgeted to actuals is looking at the scoreboard at the end of the game. It allows you to identify where you went wrong, where you went right, what you need to do more or less. Keep your budget as uncomplicated as you can. Let your accountant or book-keeper worry about break-downs and split-outs. You only need these if you are unable to explain the difference between your expectations and your actual performance. In cases like that, some further dissection of your financials may provide the clues as to what the problem might be.

Let's not talk only about problems, let's talk about solutions. Budgets can also be a catalyst for keeping your business focused on what works. The more businesses I see the more I realise how valuable it is to be able to concentrate on repeating activity that works.

These are the simple rules of budgeting:

1. Select a format (get some ideas from your business associates if you need to).
2. Keep it simple. Let someone else do the calculus! Leave it basic to start with.
3. Brainstorm the key revenue and expense categories.
4. Look at past data and make adjustments if necessary.
5. Review your business plan.
6. Make the predictions.
7. Share the information with staff.
8. Confirm the changes.
9. Assign responsibility for monitoring.
10. Amend job descriptions if necessary.
11. Add variance reporting to your regular meeting agenda.

Speed over accuracy. Having a budget quickly is important. Many people get hung up over accuracy and fail to complete their budgeting process. Don't worry; you'll be right most of the time and only budgeting matched with regular variance reporting will allow you to develop an instinct about your business that will lead to even more accurate budgeting in the future.

