SIGNATURE ANALYTICS

An introduction to

Strategic Budgeting

This comprehensive guide outlines the importance of building a strategic budget for your business.

BEST PRACTICE eGUIDE

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As a **Business Owner**, What is the One Thing That You Want **More** of?

You probably said money, because who doesn't want more money? Besides money, you probably wish you had more time. More hours in the day, more days in the week, and more weeks in the year to get everything checked off of your ever-growing list. And if you want to understand your business's money better, you need to start with a budget.

Budgets are a challenge. If you don't know where to begin or when it's complete, creating one feels like a burden. On top of that, the initial plan is usually outdated as soon as you finish building it.

Most business owners do not sit down and create a strategic budget. Sometimes it's because they don't know where or how to begin; oftentimes, it's because they do not take the time to create one. Since it can be such a painful exercise for many business owners, the budgeting process is rarely prioritized.

Your budget shouldn't be regarded as another piece of paper but as a critical tool to your business's health. Would you spend more time planning a budget today if you knew it would save you valuable time and money in the future? One of the biggest problems is that if you don't know how to build a budget, you fail to understand and see the benefits of having one. The budget planning process is also an opportunity to step back and practice working on your business, not in your business.

Building a strategic budget provides leaders with a valuable tool to utilize and grow your business. The process can also teach owners a lot about their business. This process brings up many questions and decisions that will guide your company before you open for business, and every day after that.

In this best practice guide, we want to show you why **building a strategic budget** for your business is **critical** and one of the **best things** you do **for your business**.

A Practical Guide to Building a **Strategic Budget**

A business needs to have both a strategic plan and a budget.

The strategic plan lays out the future direction and goals for the business and the actions to be taken to achieve those goals in support of your overall vision.

Next, you need to tie your annual budget to the strategic business plan. The resulting strategic budget forecasts the money needed to implement the business plan's activities and the expected impact on revenues and expenses for the next twelve months.

As you proceed through the year and monitor the actual financial results to the budget, you will be able to quickly determine if you are on the right path to meeting the goals and objectives outlined in the strategic plan.

The budget then becomes the source of identifying the financial and operational key performance indicators (KPIs) to monitor and report on, ensuring business issues are resolved to meet your goals.

It is valuable to understand how business variables and market shocks can impact your business. Looking ahead by creating scenario plans and doing some financial modeling helps outline what trying times might look like, e.g., "if this happens, I will respond by doing this," or, "if this opportunity arises, I can take advantage of it by doing this."

Use your budget as a tool to hold yourself accountable when reviewing your budget against actuals. Be sure to include accountability partners, such as a board, a business partner, trusted advisor, or close friend. Then set up a cadence (monthly is recommended) to review with your team.

Why Your Business Needs a **Knockout Budget**

The strategic budget is a crucial component to helping business owners move from reactively managing the business to proactively managing it.

Without the strategic budget, businesses do not have the insight to understand and define their "needs" from "wants." As a result, an owner may not be optimally investing available cash and thus reducing available money for future needs.

A strategic budget can identify cash requirements. Action plans can include looking for investors, getting lines of credit, or delaying specific projects until cash is available. Strategic budgets will assist in evaluating potential mergers, acquisitions, strategic alliances, and exit strategies. Strategic budgets will also guide companies through turn-around plans.

Therefore, a **better budgeting process can result** in higher profits and greater stability within your business, increasing the likelihood of maintaining a successful company.

What Got You **Here**, Won't Get You **There**.

You can't continually replicate the success you had when you first started your business to get to the next tier of growth. Meaning, it is unlikely that the alignment of opportunity and effort that enabled your business to achieve revenues of $5 million will get you to $20 million.

As the business grows, not only does its need for growth capital change, but it also starts to face things it didn't suffer from as a smaller business. For example, competitors may not have noticed when you were a $1 million business, but as you grow and start taking market share, you become more than just a blip on their radar, and they will begin to compete with you.

As a business continues to age, exposure to more risk becomes part of the natural business cycle. Your strategic budget can be a vital tool in helping the business manage seasonality and economic downturns.

Putting Together the **Budget**

When putting together a strategic budget, we recommend building out a three-year plan.

Why three years as opposed to something greater like ten?

Anything further out than three years is likely to be as accurate as forecasting the weather. Sure, based on geographical history, you may be able to predict that in August 2030, it will be sunny in Southern California. Still, there's no guarantee that the San Andreas fault won't have turned the state into the city of Atlantis by then either. Also, most Fortune 500 companies have switched from 5-year to 3-year strategic planning, as there is little credibility to plans over more extended periods of time.

The budgeting process should be just as much about the team as it is about the numbers. During the beginning stages of putting together the budget, it's beneficial to involve your department heads (or leadership team) in the planning process.

Determine which people in the company:

- Can **influence** the business?
- Are **involved** in making the budget?
- Are going to be held **accountable**?

Participative budgeting is the bottom-up approach that includes the active involvement of people in your business who are impacted by the budget. This approach enables your business to create a plan that includes goals that align with each department's activities. Once these ideas or requests are submitted, they should be reviewed and approved by you, and that approval is then clearly communicated to your team.

When you **involve your department heads** in the **budget planning** process, the result is a higher concentration on the details, and their inputs can be **very valuable**.

For instance, the head of production in a manufacturing company will know when the machines require replacement or how many more years they will be able to run. This insight will give you a better idea of where costs can be cut or where more spending may be necessary.

Involving your team in the decision-making process helps contribute to the success of your business. When employees have a hand in helping to create goals, they are more motivated to hit them. Therefore, participative budgeting benefits not only your leadership team but the company as a collective.

On the downside, if you have too many employees involved in the process, it can inhibit progress and add cost to the budget. Also, because there are many confidential and sensitive HR issues discussed during the budgeting process, involvement should be limited. Sandbagging the budget is another potential problem and should be avoided.

How is Having a **CFO a Key Component** During This Process?

As a business owner, you have a macro knowledge of what you need, but the "devil in the plan" is in the details.

A CFO works closely with the business owner to make the big picture a complete one by quantifying it while also freeing up the owner to focus on more value-add activities and provide foundational support.

Maybe your business has **big plans** to expand in the next three years.

This type of plan includes a lot of details and assumptions to ensure that the goals are met. A seasoned CFO can support in developing this plan by working with the owner to create a three-year planning forecast for the business based on where the company is today and what the owner's strategic goals are for the future. This plan establishes a process checklist that includes periodic (at least monthly) checkpoints to ensure that the business is meeting goals, or whether the plan needs to be modified to achieve these goals.

A CFO can facilitate the strategic forecasting process by identifying questions that the owner needs to consider. **Depending on your business, example questions may be:**

- Do you still plan on **keeping** the business in this location?
- Do you see the business **expanding** into other areas?
- How much **larger** do you expect your company to grow?
- What **plans** do you have for your business to reach that growth?

Consider Some Questions Regarding Your Business as You **Create Your Three-year Plan**.

This exercise will push you to think about the future of your business.

The Value of Your **Budget**

The value of your budget can be immeasurable your business's success when based on the long-term plans and objectives of the business.

How can you use your strategic budget to control your business?

Identifying the cost drivers within a business is a critical yet valuable part of a strategic budget plan.

When you identify the cost drivers of your business, you are determining the factors in your business that incur costs. Your cost drivers are relative to the type of business you own. For example, if you are the owner of a manufacturing company where machines require assembling, your cost drivers could include assembly time and direct labor hours.

Determining the **cost drivers that impact your business** will enable you to make more accurate projections on expenses and improve your budget.

Budgets vs. Actuals Comparison

The process of comparing the budget vs. actuals involves using your financial data to assess how closely the company's generated revenue and spending meet your forecasting projections.

What can you determine from conducting this comparison?

This process of comparing your budget to actuals allows business owners to make changes or updates to their financial forecasts based on the numbers collected in the monthly reports. Analyzing the budget vs. actual comparison can help the business make improvements and see where the company can meet or exceed the profitability expected in the strategic budget.

Any changes should be reflected as a forecast. The forecast should identify requirements based on the latest data. However, the comparisons should always be actuals vs. budget to see how the company is performing versus what was expected before the current fiscal year began.

Budget Variances:

A budget variance which can occur for both revenues or expenses, results when the actual amount differs from the planned or budgeted amount.

What Causes Variances?

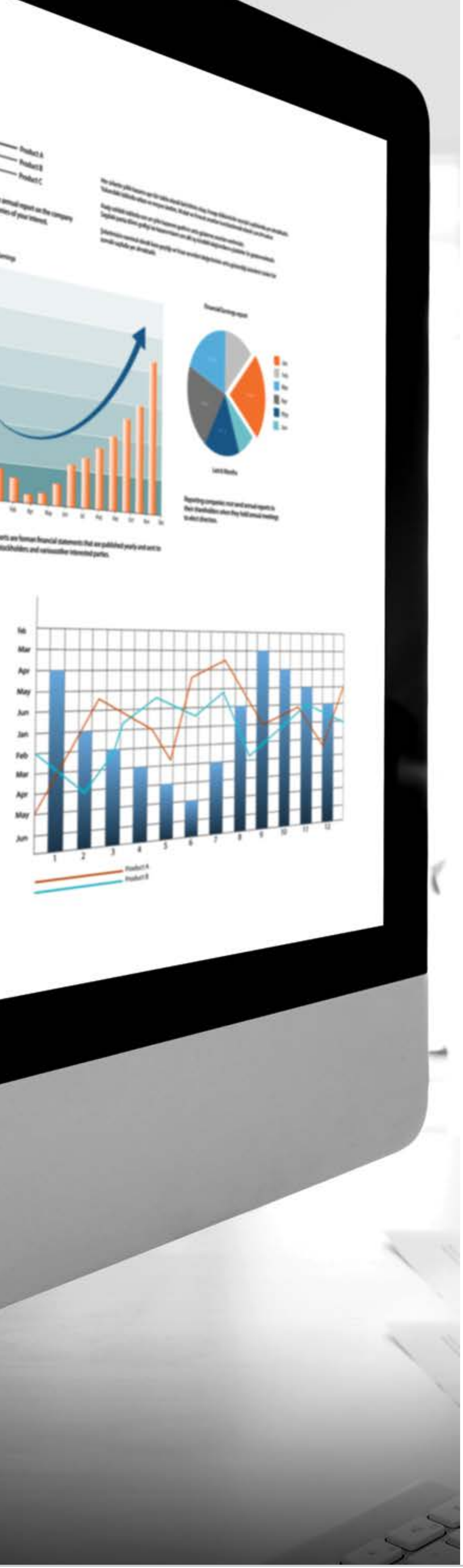
Many things can cause budget variances. Timing can be a factor in budget variances. For example, you are expecting an expense to hit in one month per the budget, but in reality, it hits two months before, or after, the expected date.

Unexpected costs can also be a variance. For example, an unforeseen event occurs requiring your business to hire an attorney whose services cost the company money that was not initially included in the budget.

What Can You Do About Variances?

It's essential to first **identify the variances** in your budget. The next step is to acknowledge the reasons for these variances. First, determine what the reason was for the variance. Then decide if corrective action is required whether the forecast needs to be updated.

Certain corrective actions could include cutting costs, re-allocation of resources, etc.



How to Use Your **Budget** as an Accountability Tool

Your budget, which can be monitored with performance reports, can work as an accountability tool for the entire company.

It can also serve as a **benchmark to improve** your company's performance, enabling you to analyze past performance against your current performance, as well as assessing your business's performance against those of your competitors.

From Scorecard to **Report Card**

A budget is a plan that everyone agrees to follow, and performance is measured against that plan. Only reporting numbers and nothing else will not go far enough. Your team will benefit from what the expectations are and what is in the plan, not just keeping score and reporting on performance.

Business **Metrics** and **Key Performance Indicators** (KPIs)

What are your company's core KPIs?

- **Key performance indicators** are measurements that allow you to see and evaluate the success of specific activities within your company.
- **Avoid vanity metrics** like page views and downloads. IInstead, focus on metrics that correlate to sales, revenue, and cost concerning your business's goals. For customer-based companies, you might start by defining KPIs that lead to conversions with your customers. Then determine the benchmarks you should use.
- **If the metrics aren't relative to your industry** or don't impact your business, eliminate them: just because something is easy to measure doesn't mean it should be measured.
- **Tracking KPIs** not only boosts the performance of your business and employees, but it can also help you keep a close handle on the financial health of your business. Identify 3-5 metrics that support your business's objectives, then work with your team to hit these respective goals.

Strategic budgeting is a critical tool for managing your business when setting and **meeting financial goals** for the year. It allows management to set expectations but then it is up to the supporting teams to work to meet those expectations.

As the year progresses, continually evaluate your team's performance. Based on that performance, generate updated forecasts, which could be the base for setting future strategic budgets. When assessing performance, consider controllable vs. non-controllable elements of the variances and handle them appropriately.

Before you begin the budget creation process, it may be beneficial to seek advice from financial experts who can, with your management team's input, analyze past trends to build a valuable tool that helps guide your business into the future.

Start **saving time** and **money** by making a **strategic budget** a priority for your business today. **Our experts** will **guide** you through the process and provide the tools to run and **grow your business** successfully.

Contact **Signature Analytics** and **Ask the Experts**

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