

Making Your Budget Work

The 5 Factor Rule

Rule 1- Flexibility: Budgets are the world's oldest management tool and the reason they are still around today is they work- if used properly. If conditions change significantly within and outside the business, it should be possible to change your model by modifying and updating assumptions to reflect the reality of the current situation. Budgets are usually based on projections and estimates, and where there is a variance, it is important to understand why as it may just be a learning curve, a short term timing difference or a prompt to make changes to existing processes and adjust your model.

Rule 2- Revenue & Cost Projections: Know your costs (fixed, variable and unit costs). Do you know your product sales mix and product profitability? Are pricing wars an impending threat to your projected profits? Due to changes in economic activity or buying behaviour, you may not be experiencing the revenues you had projected, and to compensate for the difference, you may need to consider making adjustments to your pricing/ marketing mix. In addition, knowing the product mix variance can help track changes and provide an insight into reasons for any revenue loss or growth, when diagnosing budgeting problems. You must have good management information to quickly react to this as well as to enable you to re-assess your budget or forecast.

Rule 3- Cashflow Monitoring & Forecasting: Budgets should focus on cashflow as well as profit and loss. Are you doing as much monitoring and controlling as you should? Do you know the timing of income from sales, commission, asset disposals or even donations? Are you aware when money goes out and where it is spent? If your business cycle is seasonal or constantly in peaks and troughs, take steps to reduce the impact of any negative periods to minimize possible funding gaps. Establish and track budget Key Performance Indicators (KPIs) against actual for an early indication of problems e.g. debtor age, debtors over limit. Update budgets regularly if cash is tight by producing a rolling 3 - 6 month 'estimate' of the amount of cash you require. Understand fully actual results vs. forecasts. Use an accurate forecast to give you an indication of your borrowing requirements or excess cash available for investment, development or other liabilities.

Rule 4- Prudence: It is better to overstate your costs, understate your revenue and err on the side of discretion, when creating your budget. Making conservative estimates is a time-tested strategy when checking that your cash flow is going to hold up. Look into making savings anywhere possible, without putting the business at risk. It is often easier to deal with positive budget variances than negative ones.

Rule 5- Assess: Review your budget monthly to ensure you can meet liabilities as they fall due. Adjust this if need be and where you discover warning signals, do not bury your head in the sand and hope conditions will change on their own, speak to someone immediately. You might be risking the survival of your business by doing nothing, even if your company has been around for 100 years! There is always a little extra cut that could be made somewhere or maybe a new sales angle that you could consider. Could you have someone else look at your finances with a fresh pair of eyes? Might you be overlooking something obvious?

If you need help with the preparation of business plans or strategic advice, contact us for more information. If you are a pre or post funded company or an investor interested in carrying out a financial health check or due diligence, contact our financial management team by responding to this article, emailing clientcare@efm.uk.com or calling 0845 129 990/ 01582 516300 or simply visit www.efm-network.com for more information.