3 Ways to Improve Your Budgeting and Forecasting

Budgeting and forecasting are two of the most important financial exercises performed by businesses, regardless of their size. Unfortunately, they are also two exercises that many businesses fail to perform accurately or efficiently.

The biggest common problem is that most budgets and forecasts are created without any room for flexibility. Managers are told at the end of the year to make projections for revenue and spending for the next year, but these often end up being optimistic best guesses that are manipulated for the financial benefit of their department.

Here are 3 steps to help you improve your company's budgeting and forecasting processes:

1. Build flexibility into your budgeting and forecasting. This is the most important step to better budgeting and forecasting. Static and inflexible budgets and forecasts can lead to many different financial problems.

Traditional annual forecasts and projections made by managers are often inaccurate and obsolete by the end of the first quarter. However, managers are still expected to meet them and important business decisions are made based upon them. This leads to frustrated employees who are held accountable for hitting unrealistic numbers — and worse, faulty decisions and plans that can end up being very expensive.

Instead, your processes should include a review of your budget and forecasts at the end of each quarter, if not each month. Doing so will allow you to make necessary adjustments that will improve overall accuracy and lead to better business decision-making.

2. Create rolling forecasts and budgets. This is a flexible alternative to the traditional static annual budgeting and forecasting process that most companies follow. It enables you to regularly update your forecasts and budgets based on actual current business results, not what managers guessed might be happening many months ago.

The rolling process involves using actual quarterly financial data to update your forecasts, which typically extend out for five or six quarters. Each quarter, you will update your forecasts for the next quarter based on the most recent quarter's results. You will then adjust your budget so that it reflects these new, updated forecasts.

With this process, detailed monthly forecasting at the category level is only done for the next quarter, not the entire year. Subsequent quarters' forecasts are broader, since they will likely be updated in the future. Rolling forecasting and budgeting will enable you to better align your budget with your strategic plan while also improving the accuracy of your forecasts and budgets.

3. Budget to your plan, instead of planning to your budget. This is a fairly simple but often overlooked concept because it requires discipline on the part of ownership and management. It requires that spending decisions be made based on actual revenue, rather than on opportunities that such spending might (or might not) lead to. Budgeting to plan considers the true impact that spending decisions will have on the company's finances.

For example, a business might have an opportunity to grow by acquiring a competitor or taking on a large new client. However, doing so will require assuming significant debt in order to finance the acquisition or buy new equipment or additional inventory. Budgeting to your plan will consider how these costs will impact the budget in both the short and long term and then plan accordingly. Conversely, planning to your budget will just move forward with the debt and figure out later what the impact on the budget will be.

Budgeting and forecasting are too important to leave open to inaccuracies and inefficiency. By following these 3 steps, you will go a long way toward improving your budgeting and forecasting processes. If your small business needs help in setting and managing your budget, feel free to give us a call.