



HOW EFFICIENT IS THE MANAGEMENT OF YOUR COMPANY?

THE PRACTICE OF BUDGETING

This is one of the key questions that generally bothers shareholders and managers. In our various consulting projects, we repeatedly come across similar questions or slightly different formulations of it.

In order to answer this question, we have launched a special product tailored for SMEs that we call “express diagnostics”. As in case of health diagnostics, this is a set of procedures called to assess the health status of the business, including the efficiency of various processes, innovation in management tools, and so on.

Simply put, this is a series of questions based on which we assess the efficiency of your business management. In this note, we will present key questions relating primarily to the budgeting process.

Do you have a budget or any kind of financial forecast for planning at least one year ahead?

(The diagnosis shouldn't start with this question, of course; however, we start from it in this article for illustration purposes):

There are many cases in our practice where companies never manage to find time for budgeting, considering this as a waste of time or pointless arithmetic. However, I'll cite here a description given by the director of one of our client companies that I believe to be very apt:

“... budgeting is not useful in itself, as those forecasts almost never come true. However, the process of budgeting and the gathering of the entire management team of the company around this exercise is extremely useful and valuable.”

It is this process that facilitates the creation of new ideas and thoughts for turning the steering wheel of the company to this or that side, and for carrying out this or that activity. When heads of different functional divisions gather around one table, natural disagreements between them become balanced and coordinated; and by listening to each other, they produce ideas that none of them would have produced in silos typical to many organizations.

Of course, only the availability of a budget cannot make the management of a company efficient. It is very important that a budget has certain characteristics:

– You shouldn't make the budget an end in itself and a bottleneck to efficient and fast decision-making.

This was unfortunately the case for one of the biggest companies operating in Armenia, where it was clearly evident even from outside, that the company decisions are slow and difficult due to over-complex budgeting process. In order to avoid this, it is desirable that at a certain stage of development, instead of thousands of rows and details of budget, companies use more flexible KPI systems where instead of scrupulous planning of detail expenditures, one focuses on outcome indicators. This will provide enough freedom of decision making to the heads of functional divisions.

– How often is your budget reviewed and updated?

Is it a “living” tool? Very often, directors of companies answer positively to our question of whether the company has a budget or not. But when getting the details, we discover sometimes that it has only a formal character. Most often the accountants prepare the budget and then hide it away in a drawer until the process restarts the next year; in more rare cases, the entire staff collaborates on its preparation however, eventually also completely forgets it due to the lack of time; yet in a third case, the budget is made only at the request of a bank or another organization and is never used in the real management process of the company.

Having a purely formal budget does not contribute to the effective management in any way. To be a real effective tool, the budget should be an open tool on the desk of the manager, and an object for daily or monthly monitoring. Budget deviations should be analyzed in detail, the driving factors should be understood, and appropriate conclusions should be drawn or rectifying actions implemented. For example, in one of our client companies an expenditure was periodically over the budgeted level, worsening the overall company's margins. Monitoring and analysis made clear that this was a consequence of poor cash management. By introducing KPIs for cash cycle acceleration, it became possible to improve margins.

– Which software program is used for budgeting and monitoring?

In our reality, accounting applications are used by almost all companies today, but the use of special software for other management tools is only gradually spreading. There are cases when due to the complexity of managing huge Excel files, both the management staff and the budget planners of the companies avoid using the budget as an everyday tool for management.

Whereas, all main ERPs available today allow to link the budget to financial and management reports (for example, in case of availability of an appropriate module for 1C software application, etc.). In case the budgeting process and making any changes to the budget take too much time, it will cease to be useful and will be gradually forced out of management practice.

Diagnostic analysis is surely a multi-faceted study, and many of our questions cover different areas of management. The examples of other questions that we ask during the analysis include the following:

- *What are the key indicators, the levels of which you monitor daily?*
- *How much is the level of receivables?*
- *What is the stock level on average?*
- *What factors do you use to determine the compensation of your employees?*
- *How often do you conduct performance appraisal of your employees?*
- *What IT systems do you use?*
- *Do you collect data resulting from your company's operations and do you analyze them and incorporate in decision making? We'll discuss these and many other questions in detail in our coming articles. We are happy to share our experience with you in your transition to the next level of efficiency.*



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