

Budgeting: Growth Strategies

A brief guide to optimising your budget for growth



In collaboration with

In today's evolving market dynamic businesses are facing new and emerging challenges which include sophisticated technological advancement, uncertain global trading conditions, innovative competition and an up rise in talent who cannot correlate to the archaic processes and systems which businesses have operated with for decades.

Coupled with these dynamic challenges is the need to invest and drive a budgeting mindset across an organisation, which will contribute significantly to the execution of a growth strategy.

Developing an effective budgeting process requires a number of essential elements, with the top five being:

- Executive leadership buy-in and time investment
- Investment of time in order to align the organisational strategy and financial forecasting
- Adequate qualified resource
- Access to key business information which can be quantified throughout the process
- Effective operational processes.

Outlined in this short whitepaper are several budgeting strategies which businesses can implement in order to optimise the process, whilst effectively contributing to growth.

Strategy	Strengths	Considerations
<p>Incremental budgeting: This approach relies upon the previous year /period budget or actual performance as a base, with incremental increases in budget to factor for the new or subsequent period. The methodology involves making decisions on the level of increase or decrease required to the existing budget in order to develop a balanced budget. This budgeting approach is prevalent across businesses as it is simple yet conservative.</p>	<ul style="list-style-type: none"> • Safe, stable and gradual change. • Limited maintenance required. • Operation in departments is consistent. • Systems are easy to operate and understand. • Impact of any changes can be assessed quickly. • Inter-budget coordination is easy to achieve. 	<ul style="list-style-type: none"> • The process simply enshrines the current budget, with modest changes, and is responsive to the internal needs and pressures. • Strategy plays no part, nor long-term planning as the approach is based on real-life market positioning. • Lacks incentive for developing new ideas and reducing costs. • Runs on the assumption that activities will remain the same.
<p>Performance budgeting: Performance budgeting involves using metrics in determining how much to increase or decrease a budget. Areas which demonstrate improvement in metrics are rewarded with new funding. Where metrics are poor or deteriorated, budget funding is reduced. This approach, whilst theoretically logical can prove to be difficult in practice.</p>	<ul style="list-style-type: none"> • Comprehensive view which identifies the performing and underperforming departments. • Clear information. • Evidence based observation as it ties results with funding. • Creates classification consistency as each budget is based on a real metric that is tracked. • Improved accountability. 	<ul style="list-style-type: none"> • Requires specificity to operate efficiently. • Goal oriented approach leads to no qualitative evaluation. • Unwillingness to decentralise which makes it difficult to implement. • Easy to create goals on paper but difficult in the real world due to unexpected external forces.
<p>Responsibility-centre budgeting: This approach involves decentralising and turning budgetary decisions over to leaders. Under this model of budgeting, each unit is held accountable for its own revenues and expenditures. Responsibility centre budgeting aligns revenues and expenses, creating greater financial flexibility and improved responsiveness to change.</p>	<ul style="list-style-type: none"> • Promotes transparency and accountability. • Facilitates delegation of decision making. • Aids the promotion of Management by Objective. • Enhances accountability. 	<ul style="list-style-type: none"> • Senior Management are forced to rely on management control reports than on personal knowledge of an operation due to decentralized decision making. • May lead to additional costs as a result of additional management, staff and record keeping. • Interdepartmental conflicts because of appropriate transfer price, assignment of common costs or revenues that were jointly generated by two or more units working together.

Strategy

Zero-based budgeting:

This process utilises a continuous bottom-up approach by allocating funding based on programme efficiency and necessity, thereby releasing capital to reinvest for growth. ZBB creates cost savings for organisations by making smart choices on where to spend. Success, however, depends on accountability, with leaders needing to have an in-depth knowledge of their departmental activities.

A more workable approach would be a rolling ZBB process which places a certain portion of the budget under the microscope each period and consider how consistent those programmes are with the strategic plan and the organisation's mission in comparison to others.

This form of ZBB strikes a balance between cost reduction and growth ambitions while providing the essential funding for viability and success.

Strengths

- Efficient allocation of resources as it is needs, requirements and benefits focused.
- Managers are driven to search for cost effective ways to improve operations.
- Inflated budgets are detected.
- Outsourcing opportunities are identified.
- Staff motivation is increased as a result of responsibility in making decisions.
- Helps identifying uneconomical expenditure.
- Delegation of authority is more effective.

Considerations

- Reasoning every item becomes cumbersome when there are intangibles.
- Requires specific training of management and employees.
- Time consuming.
- Reasoning every expense may seem not feasible or practical.
- Requires commitment and a professional approach to ensure dedicated implementation.
- For a large organization with diversified business lines, the method becomes more complex.

Driver-based planning:

Business plans and financial forecasts are based on core business drivers which are integral to an organisation's success. This approach uses metrics to drive outcomes instead of a forecast of outputs and results such as cost of goods sold or sales dollars.

Using the DGM approach provides organisations with the flexibility to adjust numbers as conditions change.

Examples of drivers include the following:

- **Profit-based drivers** including customer demand, change in methods of distribution, volume of the production. Profit-based drivers can also give insight into the financial performance of a business, which allows management to make informed decisions regarding the effects of changes in performance drivers over the forecasting period.
- **Working capital drivers** including labour cost, purchase price changes, and cost of capital.
- **Risk drivers** including regulatory changes, foreign exchange rate fluctuations, and inflation.

- Improves the forecast accuracy allowing organisations to ignore unnecessary items and focus on material drivers.
- Integrity of data is improved as the numbers are dependable.
- Easier to forecast and plan more frequently by using Key Performance Indicators (KPIs) into models to generate financial forecasts.
- DBM increases the efficiency and effectiveness of reporting, analysis and planning.
- Foundational component for the establishment of rolling forecast framework.

- Selecting inappropriate drivers if the decision is wrong in the first place.
- Obsolete drivers
- Leaders such as the CEO and directors could have a different perspective of drivers.
- Effectiveness of the drivers depends on how responsive and flexible the reporting style and functions are in the finance department.

Rolling forecasts:

Rolling forecasts are quarterly projections for five quarters or above. When a period/year ends, a new period is added to the cycle which becomes the first period.

Rolling forecast models allow management to adapt to a changing economic environment throughout the business cycle 'What if Analysis' can be implemented to this approach to gain further insight by including multi-variable scenarios. Rolling forecasts enable a continuous business outlook, can help save time and assist in making more accurate predictions. Successful businesses often have a rolling budget, so that they are continually budgeting.

- Highly accurate because mistakes can be rectified quickly.
- Predictions are not based on past results, rather it is based on drivers such as customer satisfaction, growth, market share etc all built into one system.
- Better response to time sensitive decisions because you can accommodate recent changes or trends in the budget.

- Reluctance of companies to change from traditional budgeting methods.
- Preparation is costly and time consuming.
- Require training and increased work load on staff.
- Complicated to figure out 'how' to evaluate performance because it won't be viewed every time.

Financial empowerment and regular review and adjustment of your budget is necessary and central to ensuring your business remains aligned to the business strategy and changing market conditions.

Forecasting cash flow for expansion is a critical element, therefore reviewing your actual expenditure against budget regularly will aid businesses in achieving milestones, whilst ensuring future budgeting needs are predicted more effectively.

Despite challenges, creating and implementing a robust budget will keep a business aligned, improve profitability, and will prove pivotal to businesses who are either aiming for expansion, growth or to sustain their position.

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