Budgeting: Realistic dreams vs. playing it safe.

There's a saying in business that sales managers typically create budgets using the 'this year's numbers plus 15%' approach. I can say that from personal experience that is sometimes not too far from the truth and applies in companies of all shapes and sizes.

The budgeting process all too often suffers from contradictory pressures from two different groups within a company; the Board who want to see a fast return on investment and have made predictions and sometimes promises to that effect; and the sales team who know that they will be held to account for the agreed targets.

Of course, in life most solutions to challenges involve compromise and budgeting is no different. Companies must find the correct balance between the bull and bear forces within the Management team. Let's analyse the pros and cons from both sides:

The sales team needs to dream

In his excellent book 'Winning' Jack Walsh (former CEO of General Electric) devotes an entire chapter to budgeting in which he deals with the problems inherent in the typical planning process. Key amongst them is that performance related pay can if incorrectly applied drive conservative behaviour. A sales manager knows that once a budget is submitted two things will happen; the Board will increase the targets and bonuses will be attached at trigger points beyond the maximum figure declared. If the pay structure relies too heavily on a bonus element then this will naturally drive the wrong (by that I mean too conservative) planning behaviour.

Budgets are important because they are the platform for all growth decisions going forward including the levels of investment, recruitment and the opening of new markets. So a conservative budget will stunt the development of the company perhaps for many years – because these things are compounded year on year. In his book, Jack Walsh encourages CEO's to adopt the radical approach of allowing sales managers to 'dream' i.e. instead of cutting the cloth to fit current resources define a future sales' position that could be achieved if financial constraints were relaxed. This raises the bar and even if (in the real world) such constraints exist it allows the budget process to take place in a much more positive environment. Moreover, it might be that extra funding could be sought to allow parts of the dream scenario to take place – investors like confident, positive pitches after all!

The Board needs to be realistic

The 'dot com' boom & bust may have faded into distant memory but Boards must heed the warning at budget time. The pace of business life is unquestionably faster these days but we shouldn't confuse the ease of communication with the ease of business growth. Some fundamentals still generally apply and particularly in the more traditional businesses. A business will take time to become established in new markets, particularly if it is involved in new technologies that need to be demonstrated and become trusted by customers. Investment in training, promotion and trials will all help to accelerate the introduction of new tech but to only a certain extent and if growth promises are made to investors that are unrealistic this will in all probability lead to challenges within the business.

Boards must be strong in front of investors and defend the need to be realistic (without being conservative) in planning. If at the end of the day, the technology involved is good and offers true value to the customer then the business will be successful in all probability.

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