The Fractional CFO | Why Your Forecasts Keep Failing | Transcript

Amy Smith & Jill Prendergast

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Jill Prendergast:

Amy, thank you for joining me for this segment on why our forecast keeps failing or our budget is inaccurate. I think it's interesting in the number of organizations I've spoken with in the last three years about how they run a budget. Sometimes they never look at it again.

Amy Smith:

Nope.

Jill Prendergast:

Sometimes they don't revamp it after Q1 or even Q2, and they just continue to show their financials against it, but they don't necessarily know why it's not exact. And I, jokingly and non-jokingly, say to all of my clients, "Well, our budget is wrong about two weeks after we put it together and finalize it because there's going to be things that inherently change within two weeks."

But it's at least a point in time, right? It's a point in time, you set ideas down to paper, you said, "Here's where we want to be and let's see where we go." And I think the problem is too many owners and leaders say, "What is budget?" And they're so scrutinized to that original budget that they don't necessarily understand the change in evolution that's taken place in the market, in their business, with their workforce.

And those are some pretty critical data points that you can miss. What have you been seeing in your CFO engagements that have helped... have said, "Oh, we need to budget better"? Or the pushback you're getting on budgeting, I get pushback from even doing a budget. What are you seeing out in the market?

Amy Smith:

I'm seeing that owners do not pull together their budgets. They have no budgets at all. Or for instance, I had a client that they did their budget and they imported it in March of the next year that they were in. I said, "Well, that's really not a budget anymore." I mean, it is, but it's more a forecast, and they could change up that whole budget based on Q1-

Jill Prendergast:

Actuals.

Amy Smith:

... actuals. But they have nothing to go on that Q1 yet. So either they're not spending enough time looking at their business and understanding it to pull together that budget, or they're spending too much time budgeting.

Jill Prendergast:

There's also that. Yeah.

Amy Smith:

I've seen that where it's version 12 and you're like, "We need to get this done. What are we waiting on?" And they keep going back and keep making changes and changes. And then you run into, "Okay. Well, you're making so many changes. Now we're into Q2 and we need to then make all these changes."

Jill Prendergast:

Yep, because you have three months of actuals that don't usually align to that budget and nor have you been pulling them in.

Amy Smith:

Never. No.

Jill Prendergast:

So I think in the middle market industry, it's common to come across people who don't budget right now because a lot of times they're in a startup mode or they've been going just hot and heavy with growing their business or acquiring it from someone else and evolving it into something that they feel they can proceed for in the future. And they have so much going on that their budget isn't even a priority sometimes.

And that's something I even see sometimes in generational changeover that I've worked with clients where the parents are exiting and the kids are taking over, and the parents were really rigorous on budgets, and the kids are like, "Yeah, it's okay. We don't have to do it," or vice versa. And granted, we're CFOs, so of course we're like, "Financially, you need a budget, you need a forecast, you need these." It really tells you a lot about where you're headed. It triggers when you hire, when you spend capital.

Amy Smith:

Anything.

Jill Prendergast:

Everything goes into it. And I think everything going into it over-complicates it to where it's set to fail, right?

Amy Smith:

Yep. Yep.

Jill Prendergast:

And it's so important to not make it so cumbersome and to have it be just kind of a guiding light to you and the forecasts.

Amy Smith:

Exactly. And it also comes down to, I don't want to say materiality, but it does. If you look at, you don't want to spend a day looking at office supplies if your company is a construction company. And I've seen that where they spend too much time on things that... not that don't matter, but that aren't as important as other line items on the budget. And those are the real drivers of what is going to happen in your company and how you're going to make decisions.

Jill Prendergast:

Yeah. Working in the construction field, I need about four things to put into a budget. And that is: what is my contract and my pipeline? What is my payroll and where are my people going to be utilized? I have my SG&A. I can figure that out and it increases annually. To take a $55 million construction general contractor budget can take me about four to six hours and it gives us exactly what we need.

It doesn't take the rigorous two to three weeks they had been doing in the past to put together a budget. And four to six hours at one point, and then we look at it a few more times before year-end hits and we throw a few numbers in about backlog and that, and you've got to budget pretty quickly. There's ways to simplify it because I think sometimes it's so over-cumbersome that operations people are like, "I don't have time for this." So we as financial leaders have to figure out how to make it fast.

Amy Smith:

And accurate.

Jill Prendergast:

And accurate for them.

Amy Smith:

Yeah.

Jill Prendergast:

What do you think in your mindset that people should forecast and pay attention to? And like the office supplies you mentioned, what are the little ancillary things? It's like maybe look at your fixed costs and say, "What percentage is it compared to last year? Are we in line?"

Amy Smith:

Yeah. It comes down to what the business line is. It's different with a service company as opposed to a manufacturing company and a construction company and non-for-profit. I would say a lot of times you're looking at the back office expenses is probably the easiest one to do. And basically, you're looking at what the fixed costs are in the back office. But also, you want to pay attention more to what is driving the company and what's driving the decision-making, what's driving the revenue and the cost.

Jill Prendergast:

Manufacturing, I'm sure material increases is a top priority. In my world, labor increase is a top priority. So there's different niches to focus on. And then you get into some wholesale distribution, and it's like, if you're in automotive, "What's the automotive industry doing this year? What's the projection on that that can even lead into your wholesale distribution abilities?" And so there's just ways to tap into that and not make it so rigorous or sit back and say, "It's not failing; it was a point-in-time look."

Amy Smith:

Yeah. But that's why you have forecasts.

Jill Prendergast:

And reforecasts.

Amy Smith:

You have reforecasts. Some clients, I think they may not even need to reforecast if business as usual is happening, but once something changes in the industry or the market, that's when you really have to look at reforecasting and what's going to change. And as we said, not taking too much time doing it as well. So maybe just pulling out the particular line items that might change and reforecasting those instead of looking at the entire picture.

Jill Prendergast:

Yeah. I think there's a business I'm involved in. We do a 15% up and a 15% down or a 10% up and a 10% down. And then I fill in the fixed cost needs that we know about and those things. And we roll through actuals comparative to those two ups and downs, and we see where we're playing out every month. And how does that impact our decision?

And I've seen the owners make critical decisions off just that simple look. It didn't even take that much, but it gave them more information of a point that works for them. And this is an owner. I respect him highly, but he doesn't want a lot of data points. He doesn't want to spend the time to put together a true in-the-weeds budget, which I can fully respect based on the volume and the run that they do. So this helps us just as one look-in.

Amy Smith:

And also you can pull together different types of budgets. And so the owner just wants to see the high level. Maybe you have other departments in the company that want to see other more granular types of budgets.

Jill Prendergast:

Yeah. Sales teams, operations teams.

Amy Smith:

Yeah. And so then you do make those a little bit more detailed.

Jill Prendergast:

Yeah. Completely agree. What other things do you think people should be considering when talking budgets or a forecast within their organization?

Amy Smith:

I would say the most important thing is keeping your ear to the ground. Just understanding where your company is. What's working? What's failing? Sometimes entire lines of your budget should not even be utilized. Take them out. Sometimes you need to add in information to reforecast because so much has changed or because you're starting a new product line or something of that nature.

Jill Prendergast:

Or you're deciding you want to use marketing a little bit more. And so your sales are down, it's mid-year and you want to tweak. So you throw a marketing budget in or you beef up what you had so you can be social media focused and content-focused and revamp a website. I have a client that decided to do that mid-year because we weren't seeing the foot traffic we were seeing before. And within three months of that deployment, it definitely changed the narrative for them being sought out for new business. So they're just things that come from really spending time looking at it.

Amy Smith:

Well, an example too, I have a client that they wanted to go to a trade show that they've never been to and they didn't have it in the budget, but they thought it was very important to the business and where they wanted to go. There were new customers that they were going to meet. So we had to change things up and put all those funds into the budget.

Jill Prendergast:

I think the other thing people may not think about is when you have a budget or you have a plan and you're sitting down with a group of peers, you're able to talk high level about your business, which if you didn't have that, you might not be able to. And I think that's a critical element to be able to talk in a room full of your peers. And I have several clients who do it and other leadership I've worked for in-house that really rely on that peer group to give them information. But if they don't walk in with enough information, you can't walk away with enough.

Amy Smith:

Exactly. I think getting everybody in the same room to understand what their needs are is number one as well. Keeping your ear to the ground and communication as well. Because you're the owner of a business. You understand everything, but not everything. And that's when you have to rely on other people in management to tell you what your needs are.

Jill Prendergast:

Correct. Completely agree.