The Building Blocks of a Sound Budget Start at the Top

A successful budget is built on accurate data, but few numbers are so important—and so difficult to get right—as projected revenue. Growing revenue powers income growth which is what fuels future business expansion.

Complicating things further, "revenue" is a word that represents many moving parts. How do you keep track of them all? How do you make your projection as accurate as it can be?

Naturally, you need to start at the beginning. Have a look at where your company stands with regard to the two basic building blocks of revenue:

1. Volume: Think about what your production capabilities will be over the next year, and how they could change. Are there factors related to procurement or your own manufacturing process that could change your ability to meet your expected volume? Are there new products that might shift resources away from current product lines?

2. Prices: Understand where your prices currently stand. Where are you in relation to your competitors? Do you have pricing power? How might that affect your volume? Understanding the supply and demand curve for your products will provide keen insight to these questions and put you ahead of your competition.

Once you've established a sound analysis of these building blocks, move on to the cost side of the equation:

3. Raw materials costs: To accurately predict your margin structure – and, therefore, how much profit your company will make - you need to be aware of how the costs of raw materials might fluctuate. Are there any disruptions to your supply chain on the horizon? Can you count on your suppliers to continue to supply raw materials so you can sell your product at the current price? If customers are very price conscious how can you hedge raw materials to maintain your margin?

4. Transportation and manufacturing costs: Similarly, if there is potential for significant fluctuation in your transportation or manufacturing costs, consider other options. Could you transport goods in a more efficient way? Manufacture in a different location? Lean out your operations? If not, and the risk is large, does it still make sense to continue offering that product.

5. Selling, general and administrative costs: Linking SG&A expenses to revenue generation can be difficult but is an important exercise. All departments should be able to define how they bring value to the organization. Until then, their role within the company is, and should be, at risk.

6. Product Mix: Finally, when looking at revenue you can't look at each of your product lines as independent entities. How are they working together? If the cost of one is rising, you might have to shift your focus to another, or even phase out that product line altogether. The sale of one product may depend upon another product. Aligning objectives to promote the best product mix is an important budgeting goal.

At the end of the day, all of the above factors interact in different ways to shape your profitability. Changes in your product mix may inspire you to toy with changes in price; likewise, transportation costs may cause you to rethink your assumptions about volume.

It is only by taking all these factors into consideration that you can have a good picture of the profitability you can expect, and it’s only then that you can start to plan for the future.