New Light Strategies

Simplify your budgeting process and drive revenue growth

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You may or may not be aware of it, but the annual budgeting process drives the de facto strategy of your firm. And yet it's often performed in a way that makes the exercise nothing more than a time-consuming administrative burden. It could, (and should) however, become your firm's most important strategic weapon for growth and increased profits, but only if it's done correctly.

In our various past experiences as consultants and as partners and senior executives in well known professional services firms, we've seen what works and what doesn't. The correct approach to budgeting is one of those areas that, more than any other, can genuinely be a factor that separates a successful profitable firm from one that's merely treading water. What should be done is to simplify the budget process and put the emphasis and focus where it matters most - namely on the revenue potential of the practice.

Implementing a strategic budget process is not difficult. A simple but comprehensive budget model can be built and easily implemented with the right guidelines and approach. There is really no good reason not to shift. If you are still doing annual budgeting in the old way, you should read on.

Let's look at how budgets are typically done.

Budgeting is generally done as a comprehensive bottom-up process, either by the practice managers and their teams, or often by partners on their own or assisted by support staff. With this traditional approach, the budgeted revenue is derived by calculating what fees the current and planned staff can produce. Hours are spent on populating spreadsheets. Each person's charge-out rate, billable hours, expected annual leave and other assumptions are entered. The end result is the production of detailed spreadsheets calculating the people costs and the fees they can theoretically (or arithmetically) produce. Other costs and overhead expenses are similarly budgeted in absolute detail, working either from past history or, occasionally, using a zero-based budgeting approach. The budgeted profit is then compared to a past or a desired profit figure. Arbitrary changes are often made to either the budgeted revenue or expenses, or to a combination of both, so as to arrive at the final required profit.

What's wrong with this traditional budgeting approach?

The problem firstly is that the revenue is derived through an inward-focused approach which says that if we have *x* number of lawyers, we can produce *y* dollars of revenue. In using this approach, very little consideration is given to the market for your services. It assumes that a practice can - and can only - produce revenue directly in proportion to the number of lawyers in the firm. Could an arithmetic approach to revenue budgeting ever create the required level of strategic thinking?

The second problem with the traditional budgeting approach is that expenses are budgeted from a historic perspective or based on a wish list of initiatives. There is typically very little direct correlation with the revenue. Revenue-cost drivers aren't used to determine what level of expenses are required to support the firm's revenue budget. Without using revenue-cost drivers you simply don't know whether the expense budgets are reasonable. They could be too high or too low.

There's a better way to budget. It's simpler, starts with revenue and is more strategic.

The better way to budget is both simpler and puts the emphasis on determining market-focused revenue budgets. Whilst there are firms that prepare their budgets in this way, most firms don't. What's proposed is that the partners focus their attention on determining the revenue that can reasonably be expected in their market. This approach is outward-looking - the partners consider their expertise and services and what business needs they're addressing. The number of lawyers in the firm and all other bottom-up considerations are, in the first instance, set aside.

There are significant benefits to this approach. Firstly, it is the logical place to start - the market and your existing and potential new clients determine what your fees will be. Secondly, this market-focused approach steers the partner towards addressing fundamental questions such as "is my expertise and service offering still in demand in the market place", "are there new clients who would be interested in my services", and "are there new services that I can develop that will serve a broader market or that my existing clients require". These questions, and others triggered during the budget process, result in the partners thinking about and addressing the most critical business factors.

Why is it that the market-focused approach delivers improved results?

We've seen this approach deliver positive results. One recent example clearly demonstrated the different results achieved between two homogeneous groups of partners. The first group, after some discussion and debate, agreed that the market-focused approach to setting revenue budgets had validity and they embraced it. They followed the systematic process as set out for them and looked critically at their current services, their current clients' needs and at the broader market opportunities. The second group of partners decided not to adopt this budgeting approach. The end result - 12 months later - was that the first group showed real growth and profit improvement. They significantly outperformed the second group who had stuck to the traditional budgeting approach.

Why does the proposed alternate approach produce superior results? We believe the answer lies in the way our minds drive human behaviour. Having an outward, client- and market-focused approach appears to create a more expansive mindset and encourages a positive behavioural response. One can almost physically see the partners raise their eyes and lift their heads - looking upwards and forward.

Now that you have the revenue budget, it's time to determine the remainder of the budget.

Once the revenue budget has been determined by the partners, the rest of the budget can be calculated with direct reference to the revenue. Yes, the revenue budget drives the rest of the budget, not the other way round. Applying the appropriate drivers to the revenue, you can determine how many and what mix of staff are required to produce the budgeted revenue. For instance, the number of staff and their related costs required to produce a certain revenue budget can be calculated based on ideal team structures and using standard billable hours, charge out rates and remuneration. Similarly the expense budgets, for example the IT and human resources budgets, can be calculated by direct reference to the revenue budget, using appropriate revenue-cost drivers.

Up to this point in the budget process, all focus has been on determining the revenue budget and from that, the calculated production and expense budgets. It is only now, for the first time, that the budget is compared to actual staff and their costs. This is done to identify the staffing gaps between "what should be" (the budget) and "what is" (the actual staff). This is where the firm considers and addresses its staff planning needs. Similarly the support functions within the firm will assess and consider their staffing requirements, operating costs and initiatives against the expense budgets that have been calculated off the revenue figures.

A better outcome is achieved.

What's now been achieved is a budget that starts with a focus on what revenue is achievable in the market place and then, calculated from there, what the required and reasonable production costs and overhead expenses should be. The end result is a profit budget that has both a market and an economic logic associated with it. It can be rationally explained. People can be held accountable to achieve it.

Implementing this alternate budget process is not difficult. It requires knowledge to provide the correct structure in respect of the revenue budgeting process and the experience to know what questions partners should consider when they prepare their revenue budgets. In addition the appropriate production and expense drivers must be identified. Once these are done, a simple but comprehensive budget model can be built and implemented. The exact same principles, process and methodology applies in respect of periodic and rolling forecasts.

Firms that apply this approach to their budgeting and forecasting, will find that they increase their revenue within a relatively short period of time and that they have a clear path to increasing their profit. The budgeting process is changed from one that's considered to be a burden and distraction from the real work, to a process that's valued and that delivers significant benefits.

The time to act is now.

Why are we talking about budgets and budget approaches at this time of the year; when it feels like you've just finished the last one? The fact is that changing a budget approach requires proper planning, testing and communication. Too often we've seen firms leave their planning till February. By then it's too late if you're going to make any changes to your process. By February you've run out of time. If you're doing forecasts at half year (and you should be), this is the ideal time to be implementing the new revenue-based and market orientated approach. You'll start to get the benefits immediately and it's the perfect opportunity for a pilot run in advance of a full budget process.

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