BUDGETING

Wine Business Monthly's Budgeting Issue

Michelle Ausburn

Michelle M. Ausburn, CPA is a partner at BPM, one of the largest California-based public accounting and advisory firms. Ausburn's area of expertise is GAAP-compliant financial accounting and reporting. She serves middle-market, privately-held, family owner-managed, and institutionally owned businesses and publicly held companies. She has experience working with companies in the start-up phase through ownership transition, including IPO. Ausburn spends the majority of her time working with wineries, vineyards, real estate entities, négociants, custom crush facilities, wine and spirits distribution companies, natural and organic food companies, and non-wine agriculture. In addition to providing traditional audit and review services, she offers guidance in the areas of business combinations, consolidations, lease accounting, inventory valuation, revenue recognition, and evaluation of internal control. She currently serves on the Executive Committee of the North Bay Leadership Council Board of Directors.

EVERY FINANCIAL PROFESSIONAL KNOWS that having a financial road map is key to the success and sustainability of any business. But quite often, this process of developing and following a plan is time-consuming, onerous and overwhelming. However, having an adequate, proactive budgeting process can be the difference between a successful or struggling business. This becomes even more critical in times of growth or of economic downturn.

Throughout the wine industry, budgets are frequently prepared and monitored in companies, both large and small. In more corporate environments, the exercise of budgeting is often inherent in the culture of the accounting and finance function. At a smaller or newly established company, where resources may be more limited, budgeting may not be used for day-to-day decision-making but rather be performed more haphazardly or to satisfy a specific need, such as investor or lender requirements.

There are many elements to consider when developing a budget. In a manufacturing environment, a production or inventory budget, which is a component of an overall budget, should be at the top of the priority list. Production planning is the practice of understanding how much inventory is needed and at what cost. This should drive purchasing decisions related to raw materials that will impact your overall cost of wine and ultimately profitability of your business.

Spending for inventory purchases is a necessary foundation for future sales. What you invest today is expected to generate revenue in the future. In the wine business, the amount of time that passes between when expenditures for inventory purchases are first made and when that inventory is converted to cash could

be significant and range from one year to five years or more. To add to the complexity, the industry is affected by external factors, including weather, government regulations and high levels of competition. Many of these uncertainties are difficult to control, therefore, making cost management over what is within your control even more important.

To start thinking about a production budget, you first need to determine how much wine you think you will sell. This will drive how much wine you will need to produce. Levels of production will then drive the amount and timing of purchases of raw materials. Grapes, bulk wine, glass, corks, capsules, labels, cartons and packaging are generally the most significant costs of manufacturing wine. Understanding in advance what these costs are and the impact they have on your overall cost of wine will provide useful information for a broad range of management decision-making, including implementing strategic initiatives and individual pricing.

The timing of expenditures should also be considered as it impacts cash flow. Some vendors may offer appealing quantity discounts, but it may make sense to only buy what you need when you need it. Having excess raw materials on hand can be costly. You may end up having to dispose of materials that were not needed, or they may be taking up needed production or storage space. On the other hand, not having enough materials on hand can lead to disruptions and delays in later stages of the production process that can be inefficient. Also consider your individual cash flow situation and ability and likelihood of taking advantage of early payment discounts, if offered by your vendors.

If you have historical information, start by gathering data of all the costs incurred for these components over the last few years as a baseline to develop your expectations of cost in future years. This is only a starting point. Depending on your individual circumstances, what you have spent in the past may not be reflective of what you will spend in the future. You should therefore also consider current and anticipated future plans. You may have entered into long-term fixed fee contracts to secure a supply source at a predictable cost. Conversely, having a policy that requires annual renewals can prompt discussions with suppliers that could result in lower prices and favorable payment terms.

The process of budgeting doesn't end here. The real value of budgeting comes from monitoring actual performance against the budget. There may be reasons for variances, but unless they are identified, evaluated and addressed thoroughly and timely you won't derive much benefit. Your budget serves as a financial road map for the success of your business so don't get caught off track.