Budgeting

"Don't save what is left after spending; spend what is left after saving."

-Warren Buffet

Fundamental Concepts

- A business budget is a financial roadmap to success, a vision of where we want to take our business for the upcoming 12 months.

- A budget helps us measure success; it tells us where our business is working and where it might be veering off course.

What is a Budget?

- A budget is a plan for revenues, expenses, and profit over a defined period of time.

- Typically an annual budget is developed and broken down by quarters, months, or weeks.

- A budget is our financial projection of our business (based on current assumptions) taken as a snapshot at a point in time.

- Research has shown that having a budget:
  - Allows us to see if we have problems on the horizon.
  - Gives us greater control so that we can better deal with financial issues as they arise.

Budget Fundamentals

- Be conservative when budgeting revenues!!!
- Typically, expense budgets are more easily created than revenue budgets because our commitments are known quantities.
- Use our budget **regularly as a roadmap** to operate our business.
- Share our budget with our staff.
  - If they know what the business goals are, they can help us get there.
  - Often the best ideas for improvements come from the people closest to the work.

Budget Fundamentals Cont.

- Business budgets are “balanced”, i.e., revenues minus expenses equals profit/net income.

- The best budgets use the “nuts and bolts” operational data that we deal with every day in running our business:
  - Revenue examples:
    - # and size of sales
    - # of billable hours at average $ rates
    - # of customers, and average $ order sizes, etc.
  - Expense examples:
    - # of employees at average $ hourly rates
    - # of materials used at average $ cost
    - rent/mortgage payment
    - # of ad campaigns at average $ cost, etc.

Why is a Budget Critical to Our Success?

A budget is critical for five primary reasons:

1. A budget helps us predict cash flows and avoid surprises.
   - it includes the expected ups and downs (seasonality) in our revenues and expenses. (Seasonality is better captured yearly than monthly).

2. A budget shows our banker/investors how you plan to pay back a future loan.
   - lenders that we have planned and know what it will take to pay a loan back in a timely fashion.
   - Lenders are not likely to loan us money unless you have a payback plan (i.e., a budget) backed up by reasonable facts.

3. A budget quickly highlights areas that need improvement.

- We use our annual budget to compare actual revenues and expenses every month.
- **Revise** our budget to take into account major changes in our business, but remember to keep it balanced.

4. A budget helps us keep our operations running smoothly by providing feedback data.

- Because the budget is built by using operational metrics, the two should always be in sync!

5. A budget helps us project the future and take actionable steps.

Things to Keep in Mind As We Create a Budget

- Create manageable and meaningful categories of revenues and expenses; they should mirror how we currently track income and expense.

- Use the category size (% of the total) to decide if we should break the category down further.
  - Categories that are more than 50% of the total should be broken down.
  - Categories that are less than 2% of the total should be combined with similar revenues or expenses.

- Check our budget against our industry’s financial information to see if our business is in line with industry averages; if not, find out why or make necessary adjustments.

The Master Budget and Budget Formats

A Formal Summary of Company Plans

- It sets specific targets for marketing, sales, production, administrative, capital acquisitions, and special projects.

- It culminates a budgeted income statement and balance sheet.

A. Marketing Budget
B. Sales Budget
C. Divisional Budget
D. Overhead Budget

Marketing Budget

Projected qualified leads

X Projected cost per lead

= Budgeted marketing expense

This also equates to the estimated number of potential sales deals to close and allows for a lead to close ratio for performance metric.

Recommended – about 12-20% of projected revenue

Sales Budget

	Projected Sales
X	Selling Price per Unit
=	Budgeted Sales Revenue

Additionally, Sales per Unit identifies how many things we have to produce. This will help operations develop their budget.

Production Budget

	Budgeted Sales in Units
/	Number of people and/or materials necessary to produce the good or service
=	Budgeted Unit Counts of Material, Head Counts, and Direct Man Hours
X	Labor Rates
X	Material Expenses
=	Budgeted Direct Labor Cost and Direct Material Cost

Overhead Budget

Units/Services to Be Produced

X Variable Costs per Unit/Services

= Total Variable Overhead

+ Budgeted Fixed Overhead

= Total Budgeted Overhead

Capital Expenditures

- Capital expenditure, or CapEx, are funds used by a company to acquire, upgrade, and maintain physical assets such as property, industrial buildings, or equipment.
- CapEx is often used to undertake new projects or investments by the firm. This type of financial outlay is also made by companies to maintain or increase the scope of their operations.
- Capital expenditures can include everything from repairing a roof to building, to purchasing a piece of equipment, or building a brand new factory

Key Takeaways

- Creating a solid budget by using the key operational data we use to run our business will help us make key decisions about our business.
- Comparing our actual financial results against our budget **every** month and noting the variances, is extremely important.
- Using our actual versus budget variances will help drive improvements and plans for the future.

Questions