

Behind the Counter

Budgeting for the Small Business

One of the keys of a successful small business, it has been said, is the ability to develop a Budget. Budgets are useful for determining what direction the business should be going and steering the company in that direction. Budgets are also used for cash flow planning and to determine where the business has had its problems. They can also be used to provide a realistic analysis of the financial position of the business. Budgets are usually created for 1-2 years with data that is relatively easy to get and prove. Forecasting is a form of budgeting that expands out for a number of years with data that is not as easy to verify. It is more of a 'what if' analysis. If 'X' happens in the future, then I forecast that the business will need 'x' sales and will have a net income of 'x'. The terms budgeting and forecasting are used interchangeably.

Most entrepreneurs have a great idea to get into business, but have never been faced with the issue of budgeting or cash flow planning so many don't know where to start.

Where to start the budgeting process depends on the business. One business scenario is when the business that starts off with a contract. Then the business owner knows the value of that contract, when the money will be coming into the company and what the overhead expenses are and what they, as the owner, will need to invest into the company to keep it running. This is the easiest type of company to budget for.

The next type of business may have an excellent business idea, but will rely on marketing to 'get the word out' and may only obtain business through word of mouth. This is more difficult to budget for. In this case the business owner will need to look at the expenses that need to be paid by the business to keep it going. These would be the 'fixed' expenses such as the overhead items that would need to be paid whether the business is producing product or services or not. The business owner can determine the monthly expenses and then figure out how much cash on a monthly basis is required to keep the business running. That cash requirement can also be translated to the required sales to obtain that level of cash. The business owner then knows the amount of monthly personal investment that will be required to keep the company afloat. As the business

grows, that monthly investment will become smaller and will eventually disappear as sales increase.

If it is a business that has a product or service that can be measured in units, then the cash required can be translated into a price per unit to figure out how many unit sales are needed each month to break even. This would be over and above the production costs of producing that unit. Any excess can then be plowed back into the company for increased marketing efforts.

Let's take a look to see how this will work. If a company has monthly fixed expenses of \$2,000 then it needs at least \$2,000 to stay in business on a monthly basis. So to translate that into units, if the company made one unit per month that cost \$100 to make, then the unit would need to be sold at a price of at least \$2,100 to break even. As your production increases or becomes more efficient, you can allocate your overhead costs more effectively over a greater number of units which may allow you to lower your prices and attract more business. What I have discussed here is what is called basic cost accounting.

Budgeting is definitely a good idea for small businesses. The first year's budget can be used as a benchmark to test the assumptions made by the business owner and the ability to achieve those assumptions. Then the budget for the following years can be amended by the lessons learned in the first year. The business owner can then look at the comparative numbers (actual vs budget) and examine what went wrong – or what went right.

Most new business owners tend to be somewhat optimistic in budgeting, so when the results do not come in as planned, the business owner is forced to take a more realistic look at the business and the business practices. It is a good idea to be conservative in budgeting to really experience the market effect of your product or service.

When using the budget to predict cash flows, the company will need to take into account any 'on account' sales and when payment for those sales will be received.

Gabriele Banka is a Certified General Accountant and the owner of Banka & Company Inc. She can be reached at 250-763-4528 or info@bankaco.com.