Business Lincolnshire
The place to go for business growth

European Union
European Regional Development Fund

FACT SHEET

Managing your Finances: Budgeting

Quick Summary

- It is vital that you can understand the importance of budgeting. Without it, it could mean your business is failing without you even realising
- Understand the many different benefits of creating and using a budget plan regularly
- Understand all the different types of data needed to produce a budget

Introduction: Budgeting Basics

It's essential to plan and tightly manage your business's financial performance. Put simply – without budgets your business could be failing without you even realising. Creating a budgeting process is the most effective way to keep your business - and its finances - on track. A famous saying once said, "By failing to prepare, you are preparing to fail" – Benjamin Franklin.

The budget plan

A budget plan helps you to:

- Control your finances
- Ensure you can continue to fund your current commitments
- Make confident financial decisions and meet your objectives
- Ensure you have enough money for your future projects

It's important to note that a budget plan is not a forecast. A forecast is a prediction of the future whereas a budget is a planned outcome that your business wants to achieve.

When running a business being prepared also means avoiding the urge to tunnel-vision. Focusing on day-to-day problems and forgetting the bigger picture can lead to some major issues for your business later down the line. Successful businesses invest time to create and manage budgets, prepare and review business plans and regularly monitor finances and performance. Structured planning can make all the difference to the growth of your business and will enable you to concentrate your resources on improving profits, reducing costs and increasing returns on investment. Budgeting is the most effective way to control your cash flow, allowing you to invest in new opportunities at the appropriate time.

Are you a new small business owner? You might run your businesses in a relaxed way and may not see the need to budget. However, if you're planning for your business's future, you will need to fund your plans. A business is no different to any other long-term investment/goal. Weddings, birthdays, holidays, parties – if you don't plan and budget, they won't happen. Or if they do, it will be extremely poor in execution.

If your business is growing, you may not always have time to be hands-on with every part of your company. This is fine. Don't feel pressured into micromanaging every single aspect of your business, as this can actually do more harm than good. You may have to split your budget up between different areas such as sales, production, marketing, etc. You'll find that money starts to move in many different directions through your organisation - having a budget is vital to ensuring that you stay in control of expenditure.

The benefits of a budget plan

To summarise, a budget plan will offer you a number of benefits, including being able to:

- Manage your money effectively
- Allocate appropriate resources to projects
- Monitor performance
- Meet your objectives
- Improve decision-making
- Identify problems before they occur - such as the need to raise finance or cash flow difficulties
- Plan for the future
- Increase staff motivation towards a common goal

Creating a budget

A budget should not be complicated. You simply need to work out what you are likely to earn and spend in the budget period. As mentioned before, when your business grows your total operating budget is likely to be made up of several individual budgets, such as your marketing or sales budgets.

Begin by thinking about the following:

- What are the projected sales for the budget period? Be realistic - if you over-estimate, it will cause you problems in the future
- What are the direct costs of sales - i.e. costs of materials, components or sub-contractors to make the product or supply the service?
- What are the fixed costs or overheads?
- You should break down the fixed costs and overheads by type
- Cost of premises, including rent or mortgage, business rates and service charges
- Staff costs - e.g. pay, benefits, National Insurance
- Utilities - e.g. heating, lighting, telephone or internet connection
- Printing, postage and stationery
- Vehicle expenses
- Equipment costs
- Advertising and promotion
- Travel and subsistence expenses
- Legal and professional costs, including insurance

Your business may have different types of expenses and you may need to divide the budget by department. Don't forget to add in how much you need to pay yourself and include an allowance for tax.

Once you have figures for income and expenditure, you can work out how much money you're making. From here you can figure out ways to reduce your production costs to increase profits, as well as predicting where and if you're likely to have any cash flow problems.

By being proactive, rather than reactive, it gives you time to take actions towards any potential budgeting problems. Once the budget is done, it doesn't end there. Try and stick to your budget as much as possible, and review and revise it as needed. Successful businesses often have a rolling budget that keeps up with their evolving business. Using an outdated budget can cause you to make inefficient business decisions.

How to use your budget

If you base your budget on your business plan, you will be creating a financial action plan. This can be useful, particularly if you review your budgets regularly as part of your annual planning cycle.

Practical uses for your budget can be:

- An indicator of the costs and revenues linked to each of your activities
- A way of providing information and supporting management decisions throughout the year
- A means of monitoring and controlling your business, particularly if you analyse the differences between your actual and budgeted income

If your business is growing or/and you are planning to explore new business opportunities, make sure to review your budgets regularly. It'll help you make business decisions based on confident logic and understanding of your businesses financial capabilities.

There are two main areas to consider when reviewing your budget - income and expenditure.

The businesses monthly income

Every month you should compare your actual income with your sales budget. To do this, you should:

- Analyse the reasons for any shortfall - for example, lower sales volumes, flat markets and underperforming products
- Consider the reasons for a particularly high turnover - for example, whether your targets were too low
- Compare the timing of your income with your projections and check that they fit
- Analysing these variations will help you to set future budgets more accurately and also allow you to take action where needed.

The businesses expenditure

Regularly review the expenditure against your budget. This will help you to predict future costs with greater reliability. You should:

- Look at how your fixed costs differed from your budget
- Check that your variable costs were in line with your budget - normally variable costs adjust in line with your sales volume
- Analyse any reasons for changes in the relationship between costs and turnover
- Analyse any differences in the timing of your expenditure - for example, by checking suppliers' payment terms

To continue reading on this topic area, please take a look at the Factsheet titled: Tools for Managing your Finances – Cash Flow

Need more support?

Get in touch!

For more information visit **www.businesslincolnshire.com** where you can request support from one of our advisers by filling in the online contact form.

@businesslincs

businesslincolnshire@lincolnshire.gov.uk