Identify your budget as a critical tool in greater profitability and business success
Learning Objectives

- At the end of this module, you will be able to:
  - Identify the importance of building a budget as a critical tool for your success.
  - Use a budget to effectively manage your business.
  - Identify best practices to create and maintain your budget.
The Federal Deposit Insurance Corporation (FDIC) recognizes the important contributions made by small, veteran, and minority and women-owned businesses to our economy. For that reason, we strive to provide small businesses with opportunities to contract with the FDIC. In furtherance of this goal, the FDIC has initiated the FDIC Small Business Resource Effort to assist the small vendors that provide products, services, and solutions to the FDIC.

The objective of the Small Business Resource Effort is to provide information and the tools small vendors need to become better positioned to compete for contracts and subcontracts at the FDIC. To achieve this objective, the Small Business Resource Effort references outside resources critical for qualified vendors, leverages technology to provide education according to perceived needs, and offers connectivity through resourcing, accessibility, counseling, coaching, and guidance where applicable.

This product was developed by the FDIC Office of Minority and Women Inclusion (OMWI). OMWI has responsibility for oversight of the Small Business Resource Effort.
A business budget is a financial roadmap to success, a vision of where you want to take your business for the upcoming 12 months.

A budget helps you measure success; it tells you where your business is working and where it might be veering off course.

Best practices can help you to successfully build and maintain a budget and, ultimately, increase your company’s profitability.
What is a Budget?

- A budget is a plan for revenues, expenses, and profit over a certain period of time. It should be part of your overall business plan.
- Typically an annual budget is developed and broken down by quarters, months, or weeks. Software is available to help maintain your budget, e.g., Quicken or Microsoft Money.
- A budget is your financial projection of your business (based on current assumptions) taken as a snapshot at a point in time.
- Research has shown that having a budget:
  - Allows you to run your business instead of your business always running you.
  - Enables you to see if you have a cash flow or spending problem, especially if you track your costs and income daily.
  - Gives you a greater sense of control because you can better deal with financial issues as they arise.
Business budgets are “balanced,” e.g., revenues minus expenses equals profit/net income.

The best budgets use the “nuts and bolts” operational data that you deal with every day in running your 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, and # of ad campaigns at average $ cost, etc.

Take into account your fixed costs (rent, overhead, loan payments, etc.) versus your variable costs (labor and materials per product or service hour) to understand where your costs are, and how flexible your budget is.

Typically, expense budgets are more easily created than revenue budgets because your commitments are known quantities.

Be conservative when budgeting revenues. Include a small amount of contingency for unexpected expenses to increase your chances of maintaining a positive cash flow.
Budget your revenues on a cash basis, e.g., budget revenues in the period you will receive payment, not the period in which you performed the work or sold the goods.

Build your budget using the day-to-day information you use to run your business.

Use your budget regularly as a roadmap to operate your business.

Factor in some extra padding. Having a safety net will provide some comfort during a slow week or month.

Share your budget with your staff. If they know what the business goals are, they can help you get there. Often the best ideas for improvements come from the people closest to the work.
A budget is critical for five primary reasons:
1. Helps you predict cash flows and avoid surprises.
2. Shows your banker/investors how you plan to pay back a future loan.
3. Quickly highlights areas that need improvement.
4. Helps you keep your operations running smoothly.
5. Helps you project the future and take actionable steps.
Because you build a budget from your forecasted operational data, it includes the expected ups and downs (seasonality) in your revenues and expenses.

A budget is especially helpful if:
- You have alternating slow/busy seasons.
- Your revenue stream comes in huge chunks followed by long periods of no revenue.
- You have expenses that vary greatly month to month.

By knowing when you will have excess cash and when you will have more expenses than cash coming in, you can plan for when your cash levels will be low.
2. Demonstrates Loan Repayment Strategy

- A budget signals to potential lenders that you have planned and know what it will take to pay a loan back in a timely fashion.
- A budget also gives lenders something to react to; an underwriter will compare your revenue and expense plans to industry norms to see if they are reasonable.
- Lenders are not likely to loan you money unless you have a payback plan (i.e., a budget) backed up by reasonable facts.
3. Quickly Highlights Areas That Need Improvement

- Use your annual budget to compare actual revenues and expenses every month.
  - **For large variances:** either revise your estimate (both revenues and expenses) or take actions to influence your company’s performance. For example, if revenues are falling short of the budget, and you cannot raise them, then you will have to cut expenses to meet your profitability goals.
  - **For small variances:** watch them over time and make sure that they do not lead to a large variance or a budget miss.

- Revise your budget to take into account major changes in your business, but remember to keep it balanced.
Because the budget is built by using operational metrics, the two should always be in sync; if you have a variance to budget, then something in your operations is driving the change.

If your revenues are under budget, take a look at the data you used to build the budget.

For a service company:
- Number of services performed by type: How many are you actually performing each month? How long are they taking? Has the mix changed?
- Average price of service: What price are you actually charging for the service?
- Assume payments are received within 30 days of the invoice: How quickly are invoices being sent? How quickly are customers sending in payments?

You might need to make operational adjustments such as:
- Retraining staff
- Adjusting pricing
- Enforcing payment terms more stringently
- Improving invoice processing
A solid budget helps you answer the following questions:

- If demand for your business is growing, and you are reaching the limits of your existing staff, how do you know when to add that next employee?
- If customers want more of a selection of your products, how much more inventory can you afford to carry?
- If you want to offer another service at a fair price and make a decent return, but an upfront initial investment needs to be made, when is the best time to make the investment and expand your service offerings?
Things to Keep in Mind As You Create a Budget

- Create manageable and meaningful categories of revenues and expenses; they should mirror how you currently track income and expense.
- Use the category size (% of the total) to decide if you 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 your budget against your industry’s financial information to see if your business is in line with industry averages; if not, find out why or make necessary adjustments.
As you create your budget, look for ways to save money, such as:

- Buy necessary office supplies in bulk at discount warehouses.
- Purchase used office furniture.
- Buy locally to save on shipping.
- Don’t buy something just because it’s cheap. If the quality is inferior, you’ll have to spend more money eventually to replace it.
- Shop around for vendors/suppliers that offer the best price for the best quality.
- Network with other small business owners:
  - They may be willing to barter for services.
  - They may be interested in going in with you to buy bulk products.
- Ask vendors/suppliers for a better price. They may tell you no, but they may tell you yes, too.
- Bundle services, such as phone, internet, cable/satellite, fax, web hosting.
Look for Potential Cost Savings

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– Go paperless or digital and save on the cost of paper and printer cartridges. Also consider:
  • Paying bills online to save postage fees.
  • Scanning documents you need to save to save physical storage fees.
  • Receiving email faxes to save paper and printer fees.

– Use cloud services to back-up your data, access your data at any location, or share data with multiple people. If cloud services are not for you, consider investing in a computer back-up system. The initial cost may be high, but it will save time and money if you don’t have to recreate your work due to a computer malfunction.

– Recycle shipping boxes.

– Consider using social media (Twitter, Facebook, LinkedIn) for marketing your services. Be mindful that while there is no cost initially, you will need to spend considerable time maintaining these services for them to be effective.
Creating a solid budget by using key operational data you use to run your business will help you make crucial decisions about your business.

Comparing your actual financial results against your budget every week and tracking the variances is extremely important.

Tracking and using your actual versus budget variances will help drive improvements and plans for the future.
Sources and Citations

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