Preparing a Budget

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Ok, you say, I know I need a budget, but how do I prepare one? The most common budget period is one year, but this can vary depending on whether or not your business has seasonal or cyclical fluctuations. For example if you run a Christmas decorations shop, or a costume shop your business is going to peak during certain times of the year.

The budgeting process usually begins with the collection of accounting data. In order to prepare a strong and achievable budget, you must analyze each item of income and expense from the prior year. If your accounting system is a mess and the figures are inaccurate, the numbers used in your budget will be useless. This is why it is so important to keep good records. Quicken and Quickbooks are excellent programs to help you with setting up an accounting system that is easy to use and understand.

If you can review your prior year's figures with confidence, try to cultivate your strong areas and look for ways to increase performance or volume. For example, if one particular product sold well, take a closer look at that product. What you did to market it, etc. and try to model your other products in the same vein to accomplish the same results.

You also need to analyze your weak spots. If possible, set up some type of internal control over the weak areas. A cost analysis will help you determine if you are actually making money on the sale of a certain product. This is a big problem with new business owners. They don't do the research or due diligence in determining the need for their product. In effect, they spend a great deal of time and money with a product that is never even going to break even. You cannot get emotionally tied to your product. If it is not selling, let it go and move on to what is selling.

If your business is in its first year, your budget will involve a little more homework. Keep in mind that a budget is an expression of your goals. Try to determine the number of billable hours you might reasonably expect to charge for within a year's time. If you are in sales, try to establish the number of items you will be able to sell. After determining the revenue portion, you should look to your expenses.

Some expenses, like rent, will be fixed because they do not change from month to month. For example, if your office space rent is $3,000 per month, you must still pay $3,000 per month, regardless of whether or not you have made any sales or earned any income. This is why working out of a home office, if you can, is so much better. You can substantially cut your rental costs down.

Another type of expense is a variable one. In budgeting, this is known as a variable "cost," which is a cost that increases with the level of sales or income. They are variable because the more income you generate, the greater the costs you will incur (this just means the more you sell, you more you have to buy).

If you have others working for you, sales commissions are an example of a variable expense—the greater the sales revenue, the greater the sales commissions.

You need to be sure to do research before starting your business to determine what comprises your fixed and variable costs.

Certain types of businesses have an established profit margin. This information may be available by simply asking other professionals in your field. Your accountant sees thousands of tax returns and may be able to give you an idea of the average “cost of sales” or “profit margins” for your type of business. The averages for certain industries are also compiled by financial ratings organizations such as Dun & Bradstreet, Moody’s and Standard & Poor’s. For example, if you are starting a coffeehouse, you could compare your sales, gross profit ratio, and net income to the averages for the retail sales/coffee industry compiled by Dun & Bradstreet.

It’s amazing how many home based and small-business owners don’t know if they’re making a profit on service, parts or sales. Others don’t know whether they’re making or losing money on a particular job. The purpose of the accounting and budgetary process is to help you answer these questions and make the right management decisions. You can’t plug the leaks in your revenue ship if you don’t know where the holes are.

Again, using a program like Quickbooks allows you to see where time is spent for a particular project, what your costs are, how many employees were needed to complete the project and the time it took them (which gives you an idea of salary differential for certain projects).

If for example you are running a consulting business, Quickbooks allows you to track the number of hours you work on a project and what your costs are. In most consulting businesses your time is your valuable commodity. You need to be compensated for the time you spend on a particular project or with a client.

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