

Budgeting is a Tool for Running Your Business

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My company is getting ready to budget for 2008. This is something we've been doing for a couple years now, and I like it, but I'm having a hard time getting some of my managers to buy in to the time and effort it takes to get set up. Do you have any suggestions on what to say to them about why we should be budgeting? Any hints on shortcuts we can take?

Budgeting is a planning and development tool, as well as a control tool. And it's a tool to play "what if" before you find out how things might work out real time. Those are a couple reasons why you and your managers want to take it seriously. I'll go into more detail in a minute.

To answer your second question, there are some shortcuts you can use to help speed the budget process, and to get a back-of-the-envelope picture of how things might look under different scenarios. We'll take a look at how to employ some of those tricks to get a feel for the future.

Question #1: Why take the time out of your busy schedules to play with budgeting? Most owners look at their businesses through a rear view mirror. They get monthly or quarterly statements from their accountant, or they punch up Profit and Loss Statements and Balance Sheets on their accounting system. Both are retrospective. Game over. Results in. Nothing can be done

to change things. It's the way it is. Who wants to live like that, especially if the game didn't end as well as you hoped it would.

Budgeting is a tool to play the game of running your business on a theoretical level. It's sort of like going to scrimmage practice during the week, so you can play a better full-dress game on the weekend. Budgeting is a way to play with different conditions, to see how things might end up.

If you like the results of your budget, you can implement the conditions you set up. If you don't like the "what if" results, you can play with conditions until you get something more to your liking. Then all you have to do is focus on implementing the conditions you set.

Of course some conditions may have more play to them than others. For instance, it's probably unrealistic to think you'll double income in 1 year, or cut cost of goods sold in half. On the other hand you might be able to reduce your tools budget, cut office supplies, better control payroll and overtime. You might have to lower your distributions if sales are down, or delay spending on a new system, if you're short on profit. Stick to changing around things in a realistic manner.

What are some short cuts to budgeting? Coming up with categories of income and spending are your best bet. Try to

have 2-5 income categories – products or services that you sell. Set up cost of goods sold (COGS) % estimates for each income category, which will vary depending on which product or service you sell. Estimate which products or services you expect to sell, in what volume, and then calculate COGS % for each item to be sold. Sum up all income, and all COGS. Deduct your total COGS from your total income, and you have gross profit – which is the money you'll have left to use to run the guts of the company, and make a net profit. If you're not making enough gross profit, change the mix – sell more profitable stuff, and reduce sales on less profitable items.

When it comes to running the guts of the company, and estimating what that will cost, again, you can work with a few categories. Here are the ones I like to use:

- General & Administrative – fixed – for all of the items like rent, utilities, cleaning services, that you have to pay for every month, and they're always about the same amount
- General & Administrative – variable – for all the items like telephone, interest on loans, supplies, that vary in cost from month to month
- Salaries and Benefits – don't forget to include payroll fees and the two months / year with extra



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payrolls if you're on a bi-weekly pay system

- Marketing and Sales – plan out what you want to spend on growth in the upcoming year.

Deduct these four items from gross profit, and you'll find out, theoretically, what you'll have left over next year to use to pay principal on loans, and for profit / shareholder distributions (that's you, the owner).

If you like the outcome, keep the categories as they are. If you don't, start making changes on paper, until you get it to play out the way you want.

Looking for a good book? Try *Finance for Non-Financial Managers* by Robert A. Cooke.

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