



The Complete Guide To Business Budgeting and Budget Management





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Introduction

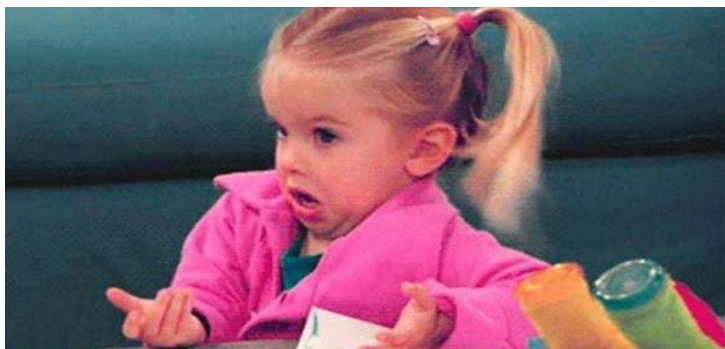
Running a business without a budget opens oneself up to a host of financial problems, including failure. But what is a business budget and what does budgeting mean?

At its core, a business budget lets companies know how much money they have, how much they've spent, and how much they need for future initiatives. With budgeting, business owners can stay out of debt, reduce costs, earn profits, and make decisions aimed at growing their business. This is true for both large and small businesses.

This article takes a deep dive into business budgets, types of budgets, the meaning of budgeting and why it is essential business practice.

What is a business budget?

A budget is a detailed, formal spending plan for a business for a specified time period (a month, quarter, or year). It is a forward-looking document estimating a company's expenses and revenue within that period. A budget provides the necessary information for a business to fund and fulfil its commitments and make a profit while making sure it has money left over for unexpected expenses and future ventures.





Components of a budget

Understanding a business budget requires a clear understanding of its components:

01 Revenue

This is the projected income from sales, investments, or other sources. This estimate is usually based on past financial records or, in the case of a new business, from the revenue of rival companies. While estimating revenue, it is important to take note of lean periods when business and revenue are down and factor in a financial cushion to tide over them.

02 Expenses

This component is split into:

Fixed costs, or expenses that remain constant, such as rent, lease, utilities, salaries, insurance, legal and accounting fees.

Variable costs, or production-dependent fluctuating expenses, such as raw material prices, labour costs, packaging charges, shipping and transportation fees.

One-time expenses, such as money spent on a new building, furniture, equipment, software, or product patent.

03 Profit

This is what is left after subtracting estimated costs from revenue. Profit is key to making investment decisions.



04 Cash Flow

This is money that flows in (income) and out (expenses) of business and helps companies predict future earnings. It is important to know not only how much money is coming in or going out but also when (peak and lean seasons) to make the right projections.

Some people might confuse a business budget with a cash flow statement because both track how money travels in and out of a company. The difference is that a cash flow statement is a summary of the movement of money while a budget serves a greater purpose as a tool for decision-making.

Types of budgets

There are different types of budgets in use, depending on the size, resources, and market position of businesses. A company typically has a Master Budget, which presents a broad overview of its finances. Within the Master Budget are multiple lower-level budgets.

Budgets might be specific to a department, subsidiary, or project. Depending on the time frame, they can also be long-term or short-term. Annual budgets are the norm but many companies also have monthly and quarterly budgets. Similarly, a business can use a long-term budget to plan financial goals three, five, or even 10 years down the line.

Then there are static and flexible budgets. With fixed revenue and expense estimates, a static budget isn't affected by ups and downs in sales. It is mostly used by organisations with fixed funds, such as government agencies and non-profits. A flexible budget, on the other hand, adjusts to changes in production and sales volumes or external economic factors. It is ideal for businesses that are new or seasonal or have varying income.



What does budgeting mean?

A search online will result in various budgeting meanings. But to put it simply, budgeting is the process of preparing and using a budget. It is also called [budget management](#) or [spend management](#). Budgeting means analysing data specific to the business as well as historical and current market trends to make informed business decisions. These decisions can range from the marketing strategies to be deployed for a venture to plans to expand the business into overseas markets. For small businesses, intelligent budgeting helps them use their modest financial resources to make the most of a business opportunity.



Five stages of budget management

01 Financial analysis

Budget planners must have keen analytical skills to ensure projections are accurate and goals realistic. By researching company records and market conditions, they must accurately determine the company's financial health and use that knowledge to make good business decisions.

02 Financial forecasting

Financial forecasting helps companies predict their performance in a pre-determined future by providing valuable insights into, say, areas where they might incur extra expenses or where investments should be added or removed altogether.

03 Budget preparation

At this stage, a company determines its revenue, expenses, and profit, breaking these down by month, quarter, and year. It also sets goals and takes important decisions (such as identifying high-priority goals and projects that require maximum funding). It is good practice to set aside an emergency fund to account for unexpected challenges.



04 Budget implementation

Many businesses fail to do this as they find their budgets restrictive. However, they must remember that a budget improves financial control. If a company struggles to implement its budget despite having the will to do so, it might be because the spend management plan has shortcomings that need to be examined.

05 Budget evaluation

Companies mustn't forget to go back to their budgets periodically to check if the actual numbers match the projections. This will lead to necessary revisions and keep the budget relevant. Regular reviews also ensure budgets change with the way a business evolves.



Components of a growing company's budget

At the top is the Master Budget, which has two components, the Operating Budget and the Financial Budget. These, in turn, are broken down into sub-budgets:

01 Operating Budget

It presents an overview of a company's projected income for a period, usually up to a year. Its objective is to set financial goals and check the results. An operating budget can be created every month or quarter and relies on the following sub-budgets:

Sales Budget

It lists the expected product units, per unit price, and total revenue expected from their sale. To arrive at these estimates, budget planners depend primarily on feedback from salespeople and to a lesser extent on other information sources such as the state of the economy and pricing policies. The Sales Budget – also called a Sales Forecast or Revenue Budget – is the first step in preparing the Master Budget.



Production Budget

The next step is to determine the number of product units to be produced, taking into account the number of units already in stock and the final number that is needed. This is the only budget to be stated in unit terms instead of dollar terms. Companies use the Production Budget to adjust production levels.

Direct Materials Purchases Budget

Next comes the materials purchase budget, which states how much additional raw material is required to produce the projected number of items and how much this will cost.

Direct Labour Budget

Production requires manpower and the labour budget specifies the number of work hours and workers required and their cost.

Overhead Budget

Excluding direct materials and direct labour expenses, the Overhead Budget accounts for all other production-related costs – for use of machinery, equipment and factory premises; for indirect materials such as machine parts and safety devices for workers; for indirect labour such as supervisors and security wages; and compliance charges related to government regulations on safety, emissions, and hazardous material.

Administrative Expenses Budget

It details the administrative expenses related to the production and sale of goods, such as employee salaries and benefits, taxes, expenses associated with buying office supplies and hiring professional advisors and consultants, and so on.

Ending Finished Goods Inventory Budget

It helps set the per unit product price based on material, labour, and overhead costs.



Cost of Goods Sold Budget

This budget details direct expenses incurred on producing a company's goods. It includes direct costs for raw materials and labour and excludes indirect expenses such as those associated with distributing the goods or hiring sales personnel to sell them.

Budgeted Income Statement

Combining information provided in the eight sub-budgets, this is a statement of a company's net income – the earnings left after deducting the cost of goods sold, other expenses, taxes, and interests – for the budget period.

02 Financial Budget

The second component of the Master Budget, the Financial Budget serves as a strategic plan for managing a company's assets, liabilities, income, expenses, cash flow, and investments. It helps companies arrive at their net profit (earnings minus operating costs, taxes, and interest) at the end of the budgeting process. The Financial Budget is mostly used by larger firms to carry out long-term plans, but it can be invaluable to small and growing businesses as it presents a clear view of their financial resources, which can greatly help in decision-making. Like the Operating Budget, the Financial Budget is split into sub-budgets:

Capital Expenditures Budget

It is a list of expenses incurred on the purchase and maintenance of fixed assets such as machinery, equipment, and plants. Most small and growing businesses don't own their own factories and, therefore, have conservative capital expenditures. A typical Capital Expenditures Budget for a growing business might include money spent on buying software or leasing equipment.



02 Cash Budget

This is of special interest to small and medium businesses, which typically operate on cash. Usually prepared on a monthly basis, a Cash Budget tells companies how much money they have (net working capital) at the month-end. They also pinpoint areas where the company might be overspending or underspending.



Budgeted Balance Sheet

A statement of expected assets and liabilities at the end of the budget period. It is drawn from information provided in the Capital Expenditures, Cash, and Operating Budgets.

Additionally, many growing businesses have department-specific budgets such as an IT budget (hardware, software, personnel, outsourcing costs), HR budget (recruitment, training, learning and development, salaries and benefits), and a marketing budget (advertising, social media, and website development).

5 budgeting benefits for small businesses

01 Meeting financial goals

All companies have financial goals – from cutting costs to increasing investments. Attaining its financial goals means a company has succeeded. But without a budget, it might not know if these goals were fulfilled at all. Another way budgeting helps businesses set and achieve goals is by replacing guesswork with accurate information and insights, maybe about opportunities waiting to be explored that they didn't know about.



02 2. Ready for emergencies

In business as in life, one must plan for the unexpected. Budgeting does just that. Take the Covid-19 pandemic, which saw scores of businesses shut shop. Those that survived probably had a little fund cushion to fall back on. As previously mentioned, setting aside a contingency fund is crucial in budget management. It can help companies tide over emergencies like economic recessions and even the general unpredictability of running a small business.



03 Planning ahead

Running a business without a budget is like flying blind. Not knowing where its money is coming from or going can make companies incapable of making long-term commitments to customers/suppliers or taking advantage of opportunities. It can also deal a death blow to expansion dreams. Surely, no small business wants to stay small forever.

04 Being debt-free

With few financial resources, small companies rely on external funding to keep the business running. Failure to pay their debts can lead to loss of reputation and shut down funding avenues. To avoid this fate, businesses must meet monthly or quarterly repayment obligations and set these in their budget management plans.



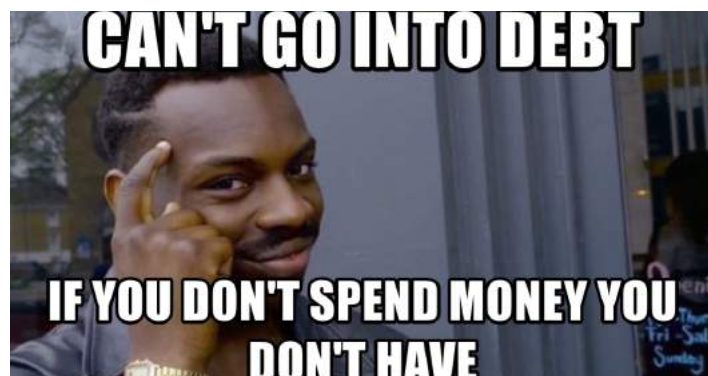
05 Better decision-making

To make any business decision, an organisation needs to know how much money it can allocate for that purpose. For instance, can it afford to offer employees a raise or hire advisors to improve productivity? With the clarity a budget provides, such decisions aren't that difficult to make. From wise allocation of resources to knowing the right time to scale up operations, small businesses have much to gain from the improved decision-making budgeting brings.

5 risks of not having a budget

01 Spending money you don't have

Budgets help businesses forecast spending, keep up with payments, manage cash flow smoothly, and inject efficiency into expense management (employee-initiated expenses). Without a budget, a company might be spending money it doesn't have, resulting in debt and worse.





02 Denial of funding

Banks and other financial institutions won't lend to a company unless it has a budget detailing where the funds will be invested and how revenue will be raised to repay the debt. For the same reason, investors won't put their money in a business unless they see a spend management document. For small businesses, a lack of funding doesn't just put the lid on expansion plans. It could very well put the survival of the business on the line.

03 Poor product pricing

Companies price their products on the basis of what they need to spend to produce them. Without the accurate cost estimates budgeting provides, they might not be setting optimal prices for profitable products. Or, they might be wasting their resources on products with insignificant profit margins.

04 Failed commitments and unhappy clients

Without proper spend management, small businesses may run out of funds and fail to deliver on their commitments, leading to unhappy clients who won't think twice before moving to more competent rivals. Such a loss of reputation can be permanently damaging for small companies and start-ups.

05 Helpless in changing conditions

Doing business is fraught with challenges and changes. It isn't possible to predict every change but a budget gives businesses the flexibility to adjust quickly – perhaps, by cutting costs in the face of a sudden dip in sales. On the other hand, the absence of a budget makes businesses less agile and incapable of adapting to change.



How budgeting works – the methods

Are you a start-up, a small business, or a large corporation? The size of a business is one of many factors determining what budgeting methodology works best for you. Others include spend patterns, sales performances, and scale of resources.

Incremental budgeting: This involves adjusting your previous budget by an increment or percentage to arrive at your current budget. It suits established businesses with historical data and companies whose funding patterns aren't subject to sudden changes. Incremental budgeting is easy, uncomplicated, and common practice. But it can promote unnecessary spending and doesn't account for external factors (changing market conditions).

Zero-based budgeting: Here, a business creates a fresh budget from scratch, assuming it begins at zero. Each dollar requested must therefore be justified. Zero-based budgeting is ideal for companies of all sizes, but particularly for those that want to focus on specific goals. It ensures resources are allocated efficiently and unnecessary expenses curbed. However, the process can be time-consuming.

Value proposition budgeting: This method lies midway between incremental and zero-based budgeting. It determines whether the value created from a product for the company and its stakeholders, including customers, justifies the cost of producing it. By helping companies prioritise products with high customer value, it helps reduce unnecessary expenses. As such, it is considered a good fit for small businesses.

Activity-based budgeting: It analyses activities – any activity that incurs a cost – to predict expenses. With activity-based budgeting, companies can pinpoint where each dollar goes, making it easier to cut costs where feasible and predict how much profit can be earned. On the flip side, this type of budgeting is time-consuming, expensive, and requires expert analysts. It is commonly used by large companies with considerable revenue.





Cash flow budgeting: As the name suggests, this method estimates how much cash flows in and out of a business over a specific period. This insight helps businesses use allocated funds wisely, ensuring there is enough to maintain day-to-day operations and also a little left over at the end of the budget period. Cash flow budgeting is suitable for all businesses, but it might be difficult for companies with thin profit margins.

Surplus budgeting: This comes into play when the estimated revenue exceeds total expenditure, resulting in a surplus. Surplus budgeting helps companies make prudent use of this surplus – for example, should it be used to grow the business or put aside for use during an emergency?

Budgeting methods can also vary according to the type of accounting used:

Cash accounting: This method records income only after it has been received in the company bank account and expenses after the money has left the account.

Accrual accounting: Here, revenue is recorded when it is earned, not when it enters the bank account. Similarly, expenses are recorded when they are billed, not when money leaves the account.



Principles of successful budgeting

To come up with a well-thought-out budget, business owners must stand by these principles:

Be realistic

Set goals that can be reasonably achieved. Similarly, make sure the company doesn't overestimate its projected income. Inaccurate projections not only cause operational problems but also harm a company's credibility.





Be flexible

Running a business can be unpredictable and budgets should be built to adapt to changing conditions. Whether it is an unexpected spike in raw material prices or a sudden shortage of shipping containers (which much of the world witnessed in 2021), make sure your budget has the elbow room to account for the unexpected. Again, earmarking savings for an emergency fund should be a golden rule of budgeting, if it isn't already.



Be accurate

A budget must be accurate when it comes to tracking expenses – especially purchases made in cash, which are often the biggest source of budget leaks. A budget that doesn't account for every dollar will present a distorted expenditure estimate, which can endanger the entire budgeting process.

Be inclusive

When a company holds its employees responsible for results, it should also include them in budget preparation and seek their opinion at the goal-setting stage. By incorporating their work experience and knowledge in the budget, employers can significantly increase their chances of success and boost their commitment to work.

Hold regular reviews

Weekly, monthly, quarterly or yearly, a company's financial goals and budgets must be revisited periodically to ensure the results match the projections. The review process should be standardised and a team set aside for it. Evaluations require manpower, time, and effort, but they are the only way to ensure the budget is fulfilling its function.



Be a budgeting pro with Aspire

Budgeting for business can be difficult, but [Aspire](#) can help you take effective control of your company spend. In tune with the industry best practices stated in this article, our budgeting solutions include:

- Spend limits and notifications to prevent overspending
- Real-time visibility into all company expenses
- Delegation of budget owners within teams for better accountability
- Automated receipt reminders, seamless uploading, and easily available transaction records
- Integrated accounting software for error-free transactions
- Interest-free credit for all those times you need ready cash.

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