

Budgeting For a Small Business



Small business owners often find themselves tackling a wide range of tasks that would be covered by two, three, or even entire teams of people at larger companies.

With limited resources, time, and energy at their disposal, it can be tempting to let some of these tasks—such as crafting a budget—simmer on the back burner while they chase sales, develop products, or find suppliers.

But regardless of size, a small business budget is just as important to longevity and profitability as the budget of a megacorporation or government agency.

Without a strategic spending plan, small business owners may find themselves dealing with emergencies that create expense, delay, and lost profits that can quickly outstrip the cost of sitting down to create a budget.

Fortunately, business budgeting doesn't have to be complicated, time-consuming, or nerve-racking.

With some help from modern software tools and a few best practices, both new businesses and existing companies can take control of their budget planning to make better financial decisions and improve their bottom line.

Why Your Small Business Budget Matters

Successful companies invest in budgeting because they understand the importance of controlling spend.

Every dollar your company makes and spends has the potential to generate value, and meeting your business needs is a lot easier when you have a clear picture of not just the amount of money you're working with, but how it flows in and out of your business.

And for many small businesses, those dollars have extra value, because they're coming out of the business owner's pocket.

A 2019 report from Goldman Sachs found that 80% of small businesses were started with the owner's personal finances, and nearly half (47%) were sustained the same way.

The oft-quoted statistics about the monumental effort and significant luck required to sustain a small business beyond its first year may seem unnecessarily gloomy, but in many cases business failures can be directly attributed to the lack of things such as a proper small business budget.

Crafting one as soon as possible (ideally before you even launch your business), rather than waiting for disaster to force one upon you, will help strengthen your business against both expected and unexpected business expenses, put your income sources to optimal use, and help your business make it past the fabled one year and five-year benchmarks for longevity.

Consider some of the benefits your business will enjoy with a properly developed budget:

- More effective management of startup costs and income sources (e.g., personal finances, outside investments, etc.). Especially important for businesses with outside investors who expect their money to generate an optimal return in some form.
- Greater operational efficiency.
- Clear and convenient budgetary information available when applying for loans.
- Improved cash flow and strategic budget planning to take advantage of

greater seasonal business and guard against shortages during lean months.

- More control over profits and visibility into the best way to invest them in your business (e.g., product development, marketing, expansion, etc.)
- Improved longevity for your small business.

A budget isn't an ironclad guarantee your business will thrive, but it *is* a smart choice to make if you want to remove unnecessary guesswork and improve your ability to manage your finances on a daily, short-term, and long-term basis.

If you implement a PO System For Small Business that includes business budget management, like PLANERGY, you can ensure you stay within budget.

Whether you're a brand-new business or an old hand at navigating the stormy seas of entrepreneurship, charting your course with as much information as possible makes it more likely you'll reach your intended destination rather than foundering on the rocks of ruin.

Creating an Effective Small Business Budget

Your budget, like your business, will be unique. But every small business budget can benefit from a few well-established budgeting practices.

1. Review Your Revenue

When you're building a budget, your first stop is identifying all the income sources you have available to feed your business activities (usually on a monthly basis).

When you've collected and detailed all your income sources, tote them all up to calculate your actual monthly income.

The *actual* bit is quite important, as budgets should be based on *revenue*—the money that comes into your business before expenses are deducted—rather than *profit*, which is what's left after you've paid your expenses.

Aim for at least a year's worth of information if possible. A full twelve months'

worth of income statements is very useful in identifying income patterns unique to your business.

For example, a company that specializes in holiday items and decor will have very different seasonal income patterns than a business that offers general goods like office supplies.

Understanding the ebb and flow of your income is just as important to financial planning as the actual amount of available revenue.

If your business hasn't been around for a year, a small business budget template can help you calculate and document your estimated startup costs and expected revenue.

2. Deduct Fixed Costs

The other side of the financial coin for small business budgets is expenses. Your *fixed costs* are those that are both recurring and required to sustain business operations.

Keep in mind that, while they are always recurring, there's no set period for a fixed cost; they may recur daily, weekly, monthly, quarterly, or annually.

As with revenue, it's crucial to have as much data as possible, so aim for at least a year if possible.

Some of the fixed costs your business might incur are:

- Taxes
- Insurance
- Rent
- Supplies
- Payroll
- Asset depreciation
- Repayment of loans and other debt

After tallying your fixed costs, deduct them from your revenue and advance to step 3.

3. Calculate Variable Costs

Unlike fixed costs, *variable costs* are, as their name implies, based on usage rather than established and repeating patterns.

Variable costs may contribute to ongoing business operations, but they also include what are known as *discretionary expenses*, which are optional but generally enhance the growth, visibility, or profitability of the business in some fashion.

Some of the variable costs your business might incur are:

- Marketing costs
- Utilities
- Office supplies
- Repairing, upgrading, or replacing equipment
- Owner's salary

Understanding and tracking your variable expenses can help you plan for additional enhancements to your business (training, certifications, cross-promotional tie-ins, etc.), adjust your cash flow to cover unexpected expenses that crop up, and reinvest excess profits back into the business.

4. Create a Contingency Fund

You're building a budget, not a scrying mirror, so it makes sense to hedge your bets against unforeseen expenses (which rarely strike when you're flush with cash).

Diverting part of the funds you'd ordinarily invest in variable expenses into a contingency fund is a smart way to insulate yourself against Murphy's Law.

Having a contingency fund at the ready meshes well with other financial backups, such as small business loans or additional infusions from any investors you may have.

Unlike the latter two options, however, your contingency/emergency fund is liquid, available immediately, and doesn't accumulate additional debt in the form of incurred interest (although growing it with interest from a savings account is always a good idea).

5. Draft Your Profit and Loss Statement (P&L)

With your financial information at the ready, you can now create a *profit and loss statement*, or P&L.

This is a formal financial report that neatly documents and summarizes your revenue, expenses, and total profits and losses within a given period of time.

Your P&L needn't be overly complex. You can create a monthly P&L in just three steps:

1. Add up all your revenue for the month.
2. Add up all your expenses for the month.
3. Subtract your total expenses from your total revenue.

A positive result means you've made a profit; a negative one indicates a loss. That's all there is to it.

Obviously, a positive number is more cheering than a negative one, but it's important to remember (especially for new businesses) that many small businesses struggle to achieve profitability.

Small Biz Trends reported in 2019 that only 40% of small businesses in the U.S. are profitable, while 30% break even and another 30% continuously lose money.

6. Create Your Budget

Whether you're a brand-new business or an old hand at navigating the stormy seas of entrepreneurship, charting your course with as much information as possible makes it more likely you'll reach your intended destination rather than foundering on the rocks of ruin.

Your P&L looks to the past, but it's an invaluable tool for charting out your business' future financial health.

Review your P&L to identify:

- Any purchases that generated a beneficial loss (i.e., short-term profit loss, but long-term benefits in the form of stronger market position, more customers, greater operational efficiency, etc.)

- Positive seasonal trends (greater holiday revenue, back-to-school boosts, improved logistics due to mild weather).
- Negative seasonal trends (reduced demand, delays and damage due to inclement weather, economic downturns, natural disasters, etc.)
- Any unusually high profits with no immediately clear explanation.

In reviewing your P&L, your goal is to map out the ebb and flow of revenue carrying money into your business and expenses carrying out.

You can then establish baseline expectations for both revenue and expenses and begin to make adjustments accordingly.

For example, if your business has a “busy season,” it makes sense to ensure you’ll have additional cash available for seasonal staff and promotional materials during those months.

If you have a “lean season,” socking away a portion of the higher revenue collected in your busy months will help you stay afloat and avoid cash crunches.

Secrets of Efficient and Effective Budgeting

Many a small business budget has been scratched out on a napkin or a spare piece of paper.

But you can strengthen both your budgeting skills and your overall financial readiness by investing in a few best practices, including:

- Implementing modular, cloud-based purchasing software such as PLANERGY.
 - Start small and build over time, expanding your software environment to match the growing needs of your business.
 - Eliminate paper record-keeping and its associated waste and expense.
 - Gain instant transparency into, and control over, all your spend data.
 - Automatically collect, organize, and store all your data in the cloud.

- Generate budgets, financial reports, and other documents on demand.
- Use analytics to review your revenue and expenses to identify areas in need of improvement and potential opportunities to cut costs while increasing value for every dollar spent.
- Engaging an accountant to help with more advanced financial tasks and ensure you're meeting your tax obligations.
- Track and compare actual budget deviations to estimated ones on a weekly basis to help you further refine your budget and spending goals for next year.

A Balanced Budget Builds a Better Business

It may not appear on anyone's list of entertaining ways to spend a Saturday night, but building and maintaining an effective and accurate budget for your small business is essential to meeting your business needs.

Taking the time to review your revenue and expenses and draft a budget can help you plan more confidently for future growth, guard against unexpected expenses and financial disaster, and take advantage of opportunities to expand your business, innovate with new products, and boost your bottom line.

What's your goal today?

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