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CORPORATE BUDGETING PRACTICES

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by

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ABSTRACT

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Budgeting and planning are an integral part of any merchandising and manufacturing organization. Effective budgeting practices enable a firm to project sales and control purchases. The purpose of this research was to identify processes suitable to the corporate budgeting practices of small firms. This includes helping them to cut down on budgeting costs and using cost-effective methods to reduce the number of cycles in the process, forecast demand accurately, and streamline feedback processes. It is common for businesses to use Excel as their primary tool. However, for merchandising firms, it was found that recording levels of inventory using a barcode reader or otherwise is extremely important. Any computerized software or Excel will only be able to make correct projections only if the current levels of physical inventory are accurate and there is minimum leakage. Manufacturing firms claim budgeting practices have enabled them to identify redundant activities which are eliminated as a result.

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CHAPTER 1

METHODOLOGY

The main goal of this paper was to identify the significance of budgeting for small and medium-sized businesses to enable them to remain competitive in the globalized marketplace. This research was a two-pronged approach. A major part is drawn from the literature review, incorporating the reasons behind budgeting and nuances on which practices have worked or not worked for small and medium businesses. The content for the literature review has been gathered from journal articles and published research papers available on Google Scholar. UTA's online library resources, which provide access to journal articles, were also used.

The second part of this project stems from interviews with two small and medium-sized business owners about their actual budgeting practices and the difficulties that they encounter in planning and control. A combination of the material gathered from these sources has been used to write the senior thesis research paper.

CHAPTER 2

LITERATURE REVIEW

A budget is a forward-looking financial plan which shows the corresponding revenues and expenses - of an individual, business, or any system which makes money and generates expenses - over a specific period of time, usually a year. Budgets in businesses are used for planning purposes and as financial controls. They are forward-looking but draw on data from the past. For instance, when a company is budgeting for future sales, the accounting team will consider past sales and prior growth patterns to forecast or predict future sales. Creating budgets helps a business plan for the future. Budgets are especially instrumental for merchandising and manufacturing businesses who have to plan in advance to maintain an inventory of goods for resale and/or raw materials. Customers demand products in real-time. A company must be able to foresee and meet this demand. If the production cycle takes longer, then a business might want to maintain a comparatively larger inventory than they would if the production cycle was shorter.

The context in which firms plan their budget can well explain the difference in the budgeting practices and procedures, for instance, diversification, structure, and the firm's size. There are several variables that determine the budgeting practices of the firm. According to Andersen et al. competitive strategy plays a significant role in managing to account, including the best practices to adopt in planning and preparing a small-sized firm budget. Small-sized firms tend to depend on traditional budgeting processes - like comparing current year expenses to prior year statements - although diversified companies seem to apply a more sophisticated formal budget. Caramela et al. argue that a firm's size typically impacts the nature of budget practices that they adopt and also impacts their competitiveness in the market.

A cost-effective budget offers more than predicting and tracking income and expenses. A budget is a plan for the upcoming year that specifies how human, physical, and financial sources will be deployed to meet strategic objectives. Businesses establish budgets to track development towards their objectives, aid in controlling spending, and in the prediction of cash flow and profit (Borglum et al.). Small-medium sized businesses and enterprises (SMEs) can utilize their budget to remain relevant to resource trends they can apply to take the opportunity of unpredicted enhanced performance and respond in time to downturns in cash flow. This helps the business remain on track and thrive in a competitive marketplace. Rapid technology changes and complex world markets make preparing cost-effective budgets for small and mid-sized enterprises more challenging but still essential for them to remain active in a competitive market (Borglum et al.). Therefore, the application of cost-effective practices determines how well small-medium sized businesses and enterprises thrive in a competitive market. Experts and budget professionals, including those from successful businesses, have developed and suggested various practices that remain cost-effective for SMEs (Milano et al.).

Scholars show that annual business goals are the phases a business takes in implementing its strategic plans, and these objectives have to be funded by the budget. Good cost-effective practice has to develop goals, and there needs to beaccountability to achieve them. Experts, therefore, argue that this is the role of the management team or the owner. The cost-effective budget to be prepared will offer the financial resources to achieve the goals (Borglum et al.) For instance, if the business has outgrown the facilities, and the business owner aims to increase space, he or she has to have the resources budgeted to expand or move business operations. Some businesses also find it necessary to develop a marketing plan which helps in allocating finances appropriately. This means marketing the services and goods through a comprehensive marketing strategy. Therefore, for wise spending, the business needs a marketing plan and needs to spend money only as necessary. Budgets are vital elements of small businesses - they aid in outlining the costs and expenses to help in achieving the goals within the timeframe. Zor, Ummugulsum, et al. (p.658) argue that developing and keeping financial statements like the cash flow and balance sheet statements helps in developing backups for the small business. Such practices assist in maintaining records of the financial expense and portray the business more positively.

Research has also demonstrated the need to link the budget for a small-medium sized enterprise to its strategy. Since the budget demonstrates the way resources will be provided and the measures to be applied in assessing growth, budget progress is highly cost-effective when connected to the overall business strategy— connecting these two offers, every manager or owner needs a clear understanding of strategic goals (Borglum et al.). This leads to increased support for objectives, enhanced coordination of tactics, and, finally, a powerful business-wide performance. However, the question may remain how to connect the budget and business strategy. SMEs that use best practices have demonstrated that communication has a vital role (Michael and Bridge p. 848). The owner or the manager of the business has to lead in establishing and communicating strategic objectives. However, for the development of such goals, information concerning customers, as also technological changes, economic changes, and competitors, are needed - data that has to emerge from consumer-contact and market research (Michael and Bridge p. 848). Businesses that develop efficient channels for communication have an easier set of difficult but achievable strategic goals. Developing objectives prior to preparing a budget starts makes it easier for SMEs. If this happens, the business develops cost-effective budget practices that offer a budget that helps strategic goals and thus requires reduced revisions. The business then becomes faster and less costly, as well as less frustrating (Borglum et al.).

Some experts talk about tying expenses to revenue. This means that the business ties particular sections of the spending to revenue, as it has shown to help keep expenses under control. For instance, to thrive in a competitive market, the business can prepare the marketing budget as a portion of revenues and spend less when the business is taking less. However, it is advisable for the owner or the managers to remain careful to avoid cutting advertising too much in case sales slide. When such a strategy works, businesses should use the practice as it is cost-effective and can increase marketing (Borglum et al.).

Successful managers in small-medium sized businesses are known to track averages and real amounts. Suppose the budget developer is utilizing an easy spreadsheet to monitor expenses as well as income. In that case, the manager should consider developing a column that will help the business track real spending and income. For instance, in case the small business is having a quarterly exchange premium of $390, the monthly section will demonstrate monthly exchange expenses of $90, as the monthly columns demonstrate $0 expenses for such a period and the $390 in various months (Borglum et al.). In this case, the business owner will manage to keep enough capital on hand every month for covering every expense and define a revenue objective for 30 days to meet the debts in the whole year (Michael and Bridge p. 848).

Another cost-effective practice that has worked for small-medium sized businesses is that the owner is realistic when preparing a budget. It is evident that the fundamental basis of every budget is an estimate of the income of the business. Experts believe that the more accurate the business revenue estimate is, the less fluctuating and more effective the budget will be for the business owner. Business owners should keep in mind that the income estimate is usually the part of the budget that they are strong (Michael and Bridge p. 848). It is known that many entrepreneurs are over-optimistic and seem to overestimate projected sales. However, a budget with overestimated income will be as bad as the absence of a budget since it offers the owner a prejudiced sense of security that budgeted expenses will be covered (Borglum et al.). Cost-effective practices require that business owners or managers ground future sales on historical sales information to develop realistic revenue estimates. Therefore, when preparing a budget, it is necessary to base any deviation from previous sales on actual aspects. For instance, in case the economy falls into a slump, it will be risky to assume that the business sales will rise in the following year (Cucuzza et al.). Therefore, research recommends that business owners develop two budgets (Borglum et al.). One of the budgets will be utilized in case things go well for the business, while the second one will be used in case things do not go as expected and should have a "break-even" scenario and portray the lowest sales needed to meet overhead and maintain the business.

This is an indication that it is necessary for the manager to continuously assess outcomes of the previous year. To plan accurately, the capabilities of quickly comparing budget to real performance are vital (Andersen et al.). The business owner should focus on investing in a platform that will help the business draw information from other systems in the firm and apply the data for precise estimations and enhanced estimative assessment of the future. Application of previous performance information helps the manager to develop a financial operation model that can perform in any situation and help the business remain competitive in the market (Michael and Bridge p. 848).

According to Sarwary (p. 48), some business owners may decide to begin budgeting by estimating cost. Nevertheless, he shows that it is best when managers or budget developers for medium-sized enterprises begin by allocating the revenues and profits. Moreover, Burgos, Kittler, and Walsh et al. argue that the initial step is determining the sales, profit, or revenue on the business's budget line grounded on the industry or the ground of the business's records. New businesses can research the average industry revenue but set the right and flexible budget. In a competitive market, the medium-sized business should not expect to earn 100 percent on the first go. Sarwary (p. 48) further argues that the business owner or the SME managers have to determine their fixed cost and variable cost. This is a good way to make short decisions and also conduct sensitivity analysis. This is also supported by Ebai and Daiva (p. 83), who argue that determining fixed and variable costs are equally essential for the budget to be cost-effective. They demonstrate that the fixed costs, including travel expenses, credit card fees, sales commission, and other costs linked to business production and selling, have to be included first.

Ebai and Daiva (p. 83) argue that a cost-effective budget needs to keep track of the expenses. Keeping track of all expenses does, in fact, cost as well, but it remains a vital and substantial segment of budgeting in small-sized firms. Most small business owners experience financial losses since they fail to separate the business and individual finances. Therefore, Ebai and Daiva (p. 85) recommend that before the business owners experience such drawbacks, they should consider reconciling the business income and expenses monthly. This technique is cost-effective, and it is essential in preparing tax returns. In this case, the business will thrive in a competitive market, regardless of government tax tariffs.

Through analysis, Caramela (2019) demonstrated that involving employees in budget preparation is a cost-effective practice that can help the business. She argues that all pressure should not lie on the business owner. This means that the budget should involve all people in the business, and therefore every employee must understand its principles and add any insight or opinions they deem appropriate. According to Maple Holistics' manager, Nate Masterson, an appropriate budget is essential, and there are too many variables for the budget preparation role to be solely dependent on one individual (Caramela et al.). The business owner should ensure he prepares an ideal budget that has undergone intense scrutiny by a group of workers with various skills to efficiently manage a small business budget (Ebai and Daiva, p. 85). Moreover, employees must be aware of any shifts made that may influence them or the business for them to understand what to expect of them moving forward. The workers have to be updated on the financial short-term and long-term goals and what they are expected to do to meet such goals. Linking personal objectives to the wider objective of the business helps keep all employees operating towards a similar end (Caramela et al.). This makes the business stand in the market as a competitor and thrive as expected.

Another cost-effective practice that has shown to work for small businesses is designing processes that will provide finances in a strategic manner. Competing for finances is inevitable for any business (Lanzkron, et al.). This is because all business units and functions require resources for operating and capital expenses, which is normally in excess of real resources available (Andersen et al.). It is, therefore, vital for a business to develop a process to allocate resources that will support vital strategies for competitive marketing following excellent practices which result in improved outcomes. Such practices are coordination of assessment of operating and capital budget (Digest et al.). These practices will give the business owner insights into the means by which a shift in a single budget impacts other areas. Some practices can be the establishment of sophisticated measures for assessing the proposed budget. However, measures can differ by sector, although many consider the business' weighted average cost of capital (Digest et al.). Some measures may also look at the level of risk involved in completing a plan action, the benefit of the cost linked to differing action, and aspects like projected growth in interest rates (Caramela et al.). Application of these measures as well as cross-functional groups to assess action plans can help the business better choose plans that can give the expected outcome (Borglum et al.). The outcome, in this case, is having a small business thrive in a competitive market (Andersen et al). Moreover, by supervising the outcome of allocations efforts, the business can refine and enhance its processes.

Research has also demonstrated that it is necessary to define and be aware of the risks. Every business involves risks, and every risk can financially affect the business. SME owners have to put into consideration the short-term and long-term risks to effectively plan for the financial future. Zor and Ummugulsum et al. (p.658) recommend listing the guaranteed income and expenses every month to be aware of the business's risks. Such a case will help the business owner determine how liquid the business is and moving the business towards competitive marketing. It is also necessary to overestimate expenses in case the business operates basically from one project to another since all consumers are different and no two projects may work in the same way (Borglum et al.). It is, therefore, a good practice to get beyond the projected line-item cost, but slightly regardless of the situation for the owner to be ready in case they get over.

Scholars also find it necessary to link the performance measures other than meeting budget targets as a cost-effective practice that will help the business remain competitive (Caramela et al.). Most businesses still assess managers mainly on whether they hit the budget targets (Andersen et al.). Although this is logical, a single dimension may tempt them to play games with the target. However, this is not in the best interests of a small business that wants to remain competitive or to thrive in a competitive market (Borglum et al.). Small-sized firm owners should consider using an equalized group of performance steps to visually display development towards planned objectives and apply them in their incentive programs. In small-sized firms, unit managers must identify the steps significantly appropriate for business operations. They will find that some measures normally track progress and other financial (Andersen et al.). The manager will identify measures and then identify the expected targets that will help the business thrive in the market.

Most research on small-sized firms indicates that besides the lack of professional management competencies, failure to have formal planning and cost-effective practices are a significant barrier for small-sized firms striving to improve business performance and remain competitive (Andersen et al.). At the same time, empirical research indicates that planning and budgeting enhance decision-making in small-sized firms and are antecedents to increased sales. (Digest et al.) Hence, improved understanding of the aspects fostering and adopting cost-effective budgeting practices in small-sized firms tend to thrive in a competitive market.

Some experts also suggest that small-sized firms concentrate on the drivers of the business. Most firms are shifting to a plan grounded on such drivers to concentrate on the business's actual drivers rather than a number in the spreadsheet (Borglum et al.). This practice aims to identify and focus on the aspects that seem most vital to the success of the business in the competitive market and then develop arithmetic examples that help the leaders to run situations grounded on such drivers to be aware of the effect on project business outcome (Andersen et al.).

Most of the research work on budgeting in small-sized firms both in emerging and developing markets concentrates on the role of business-linked variables like strategic orientation, firm age, and size as explanatory variables (Borglum et al.). Although such variables are highly important, it is not the firm that will make the decision and act- the business owners of managers will decide whether to adopt cost-effective budgeting practices and the way to apply them (Andersen et al.). However, they will be different in characteristics like personality, age, and education. Therefore, it seems promising to increase further awareness of cost-effective budgeting practices in competitive markets for small-sized firms to broaden the perception of past firm's traits and include traits of their key personnel (Digest et al.).

CHAPTER 3

DISCUSSIONS WITH BUSINESS OWNERS IN DALLAS

(*Real names of interviewees have not been used for confidentiality purposes)

The first person interviewed for the purpose of this project was Sara*, the COO of a merchandising company ("Company"). Sara runs a small company that sells battery-powered vehicles (6V and 12V) for children to major stores and companies across North America. It's a family-run business. They import the product from a manufacturing firm in China and sell the product to customers in America at a margin. A range of their customers includes Amazon, Walmart, Macy's, Costco, and Nebraska Furniture Mart, just to name a few. To run such a large firm successfully, they need to follow certain budgeting practices in order to remain efficient and competitive. Due to the nature of their business, Sara believes they need to maintain a large inventory. A just-in-time inventory system is not feasible for them since they face extended product delivery times as their products are manufactured out of the country. It takes over a month for the product to be manufactured in China and delivered here. Whereas their customers in the US order and demand the product in real-time. They do not have contracts for many customers for later delivery. Thus, maintaining an inventory is of the essence, especially during the fourth quarter as Christmas and New Year are their busiest times of the year.

Sara uses a sales forecasting software to predict the sales of the current year based on data for prior years. In addition to this, the Company takes advance orders for the busy season from small local vendors. But, since most of their sales are online, where customers do not order in advance, they must largely rely on the number generated and use their best estimate for the year. Budgeting for sales is highly imperative as all the other budgets – purchases and labor required stem from it. If they fall short of fulfilling their order for online customers, negative reviews can really hurt their position in the market.

One of the challenges faced by Sara is the accuracy of inventory in her warehouse. The Company does not have an accurate system of monitoring inventory. All inventory for this million-dollar company is done manually. Purchase orders are entered into Quickbooks manually which, increases the value of inventory, and invoices are made, which deduct the numbers for each product. However, often the purchase orders made are not very accurate, as the count for each car or container imported is taken by hand, and there is a possibility of a great deal of human error. One of the main issues identified is there is no division of labor in the warehouse. The same people work on unloading the product when it arrives and packaging it to ship to individual customers. In preparing orders every day, they do not have enough time to keep track of defective products and restock customer returns.

In conclusion, even though small business owners realize the importance of budgeting and may attempt to use it as well – they may not always be successful if access to resources is limited and business processes are not closely followed and monitored. There is not enough incentive for the workers and managers to improve the system since they are paid hourly wages.

The second business covered for the purpose of this research is that of a cell phone wholesale reseller. They bulk buy new, used, and defective cell phones from cellular service stores, parent companies (Apple and Samsung). The company is owned by three partners with limited ownership and liability. John*, CFO of the company, spoke about the level of budgeting in their business. Budgeting is crucial for them to see which cost centers are developing profits or losses. Most of their clients are smaller stores or businesses with fairly stable demands. Large numbers of their phones are sold online on platforms like eBay and Amazon. Online demand is seasonal, rising in the holiday season, tax return, and stimulus season. Due to the wide range of phones being sold, the company does not know which model/brand will sell more in advance. Thus, they need to maintain inventories for all and must have agreements with their suppliers to procure more in the face of increased demand.

Inventory for this company is maintained with the help of a barcode reader. Each make and model of the phone is assigned a barcode number and every time inventory comes in or goes out the label is scanned, which automatically updates the system. For each line of phones, there is a reorder point that signals the purchasing department to replenish their inventory. Profitability for the Company is calculated overall as well as for each department. This enables them to realize which processes are efficient and which should be done away with. For instance, if the marginal revenue generated by polishing a phone before selling is $10 and the labor and other costs associated with polishing are $15/phone, then the process of polishing not worth the costs. Either it should be made more efficient or done away with entirely.

Since this is a medium-sized business with around a hundred employees, it faces incentive conflicts with employees. Because the employees do not benefit directly from the firm's achievement of objectives, they are not motivated to go out of their way to fulfill them.

CHAPTER 4

CONCLUSION

Looking at the available literature, it is evident that there are available cost-effective practices that businesses can use to thrive in competitive markets. One of the mainly discussed practices is evaluating and linking past performance to the budgeting process. This means the business will be able to use past data to predict the future and therefore allocate resources where they are required and are profitable. Budgeting in corroboration with Marginal Analysis can help businesses to identify which products and processes are adding to the profit and which are redundant and therefore must be discontinued. Often small family-run businesses do not have the capital to invest in budgeting software. However, if they can keep an accurate record of their transactions and inventory moving in and out, they can use a simple software like Microsoft Excel to help with predicting future sales and purchases. One of the important aspects of any budgeting software is that it should be updated constantly, i.e., on a weekly, monthly, or quarterly basis. As real sales and purchases are made, the program can be fed the updated figures to increase accuracy regarding future predictions. After budgeting and planning, another good practice is to identify and analyze the variances between actual spending and budgeted spending. Consistent large variances indicate the budgeting process is not working and should be tweaked to get accurate results.

Failing businesses may report a weak link or lack of a link between strategy and budget. Literature, therefore, suggests having a closer link between business strategy and operations to the business budgeting process. This is a cost-effective practice that will help the business, especially small-sized firms, remain competitive and ensure they can thrive in all seasons, including low sales season and booming sales. Another common practice from various experts and scholars is having unit managers take control of the budget and planning to make sure they do not lack in terms of financial processes. Others link the goals of the business to the budgeting process to ensure that resources are financed focused on what the business wants to achieve. This will include using variables cost and fixed cost in projections.

Overestimating expenses have also been shown to work for small-sized firms in preparing budgets as it is a cost-effective practice that will help the business remain in the market all through the year. This will include involving and understanding business risks and how those risks can impact the business. Therefore, when preparing the budget for small-sized businesses, it is necessary to consider long-term and short-term risks. Moreover, involving employees is necessary to ensure they understand what the business wants to achieve and therefore understand their roles in achieving these targets. This will ensure they are working to maintain sales and help the business remain competitive. Literature also provides the idea of reducing cycle times and reduced complexity. This means that small-sized businesses have the chance of adopting cost-effective practices that can help the business thrive in competitive markets and maintain their sales. The main suggestion is linking the budget to strategy, business goals, business drivers, and involving employees. The budget should remain realistic and overestimated to avoid drawbacks.

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BIOGRAPHICAL INFORMATION

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