BUDGETING AND CONTROLLING (PART 14)

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The Process of Budget Compilation, Step 3: Planning of Sales and Contribution Margin

The last two articles of the series Budgeting and Controlling covered the recommended sequencing of the planning steps and described the first two steps, forecasting (BTV – Aktuell 2/2002) and planning of fixed costs (BTV – Aktuell 3/2002).

The recommended sequencing for the application of planning activities is divided into the following steps:

Step 1: Forecasting/budgetary predicting
Step 2: Planning of fixed costs
Step 3: Planning of sales and contribution margin
Step 4: Planning of liquidity

The current article deals with the third step, planning of sales and contribution margin, building on forecasting and planning of fixed costs. This process has led to the following results which form the basis for planning sales and contribution margin:

In forecasting all figures from the year previous to the planned year are transferred as a first step. In forecasting, all structures and figures on which the budget is based, are set up first and then they are revised in the next planning steps.

The result of forecasting is purely mathematical extrapolations for the planned year but no active planning considerations have been incorporated. Forecasting determines result, liquidity and balance sheet of the planned year, under the precondition that no changes in the framework of the basic data such as sales, costs, production and time allowed for payment occur.

In the second step, planning of fixed costs, a planned value based on values still carried forward from the previous business year, per item of the fixed costs, is determined for the currently planned business year.

The result of planning of fixed costs is a revised profit plan, in which the items sales, variable costs and contribution margin still equal the values of forecasting. All items of fixed costs, however, are planned values.

Based on the revised figures of planning of fixed costs the next step, planning of sales and contribution margin, follows.

From forecasting over planning of fixed costs, a financial target for the break-even point was determined which now has to be reached or exceeded in the planning of sales and contribution margin.

Based on the structure of the fixed costs in the budget when planning sales and contribution margin, sales and related variable costs are planned. This consequently leads to the contribution margin. The contribution margin which was compiled in this planning step must cover the planned fixed costs to achieve the planned result before or after tax.

Depending on the size of planned fixed costs and the height of the expected result step 3, planning of sales and contribution margin and step 2, planning of fixed costs, if need be, must be revised and matched several times in the application to reach a structure and a figure compilation that is realistically achievable.

Sales and their related variable costs must be planned in detail in some cases to achieve a realistic statement on the result and to be able to meet the target of planned fixed costs.

Matching planned fixed costs, the detailed sales and contribution margin planning step by step leads to a revised profit plan. In this way it provides a basis for planning of finance and liquidity, which will be dealt with in the next article of the series Budgeting and Controlling.

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