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Apart from all euphoria that accompanies the start up of a business, the new entrepreneur should ask himself the question if his company is bound to be **profitable**, realistically.

In this context, a positive financial result means recovering profit to increase equity on the one hand, and making money to increase the bank balance, on the other hand.

In order to avoid as many insecurities and surprises in the framework of the planned business activity a concrete business plan with concrete figures should be compiled to take all expectations, chances and risks of the planned entrepreneurial activity into account.

If these expectations, chances and risks are expressed in figures this procedure is called budget planning.

Goal of Budget Planning

Budget planning or compiling a company budget resp, should cover the following two issues.
First: Can I gain profit with my business activity?
Second: Will this planned profit lead to additionally gained money to increase my bank balance?

Obviously, profit doesn't necessarily mean the same as money.

Contents of Budget Planning

A budget always consists of at least two components: one **profit-oriented part** for compiling the planned profit and one **liquidity-oriented part**, for determining the planned money surplus.

The profit-oriented part of the budget deals with the question, if this business activity can yield profit. This profit-oriented part is compiled in a **profit plan**. The profit from the profit plan increases the equity of the enterprise, a potential loss reduces the equity of the enterprise.

The **liquidity part** of the budget aims at finding out whether the planned profit from the profit plan can be seen in form of additionally gained money in the enterprise. It consists of a **finance plan** which is sometimes supplemented by a **budgeted balance sheet**. A liquidity or money surplus from the finance plan increases the bank balance of the enterprise, a liquidity or money deficit resp reduces the bank balance of the enterprise.

Planning of profit and liquidity can only develop their full effect together and should be regarded as a unit and therefore be applied together.

Components and Structure of Budget Planning

In the **profit plan**, based on the planned sales of the business activity, variable costs that are connected to them are deducted. This leads to the **contribution margin** of which the expected fixed costs are deducted in the next step. This finally leads to the planned result before tax, or later on, after taxes on income.

Compiling the finance plan is the next step after the compilation of the profit plan. In the **finance plan**, liquidity or **solvency** resp is planned, based on the planned result after tax from the profit plan. Supplementing the result of the profit plan, the finance plan considers mainly depreciations, provisions (for taxation eg), changes of receivables, liabilities and stock, as well as investments, loans, deposits into the enterprise and withdrawals out of the enterprise.

Profit plan and finance plan are supplemented ideally by a **budgeted balance sheet** which presents available assets and capital structure –

equity and borrowed capital – of the enterprise. The budgeted balance sheet results from the opening balance sheet modified by all changes from the finance plan.

Procedure of Budget Compilation

The procedure in the framework of the (first) budget compilation is oriented to available information and expectations on the development of the enterprise at the exact date of the budget compilation.

Normally, **forecasting** based on the figures of the directly previous business year, is a pre-condition in active planning. When compiling the budget for the first time it is naturally left out in the framework of founding an enterprise.

Instead of it, **planning of fixed costs** is the beginning of planning considerations. In this planning step, the fixed costs are listed that have to be reckoned with in the planned business year. From planning of fixed costs a target value results for sales and contribution margin that has to be achieved to cover the fixed costs of the enterprise.

Based on these target values a detailed **planning of sales and contribution margin** should be carried out in the next step to show expected sales in figures per customer and/or per product or service resp, eg for the planned year. The variable costs which are considered here are related to the respective sales and are use of goods or services received.

The outcome of profit planning is the planned profit before or after tax resp which increases equity.

Beginning with the result after tax from the profit plan, liquidity planning is the next step for compiling the finance plan in which liquidity or solvency resp is planned. The result after tax from the profit plan is transferred into cash flows or money flows resp in the finance plan.

Result of the finance plan is the planned money surplus or deficit of the enterprise.

A budgeted balance sheet, finally, can be derived from the opening balance sheet, adapted by the changes in liquidity from the finance plan.

Literature

Egger/Winterheller
Kurzfristige Unternehmensplanung

www.seebacher.com
Collection of articles on budget planning