BUDGETING

Introduction

Budgeting is the process by which estimates of expenditure and receipts are made based on actual performance of establishments in the past, and adjusted for forecasting future outcomes. For eg, estimates of customer number, sales revenue, food and other costs are forecasted and written out in what is called a budget, which helps to fix targets for future achievement.

A budget is therefore a plan expressed in monitory or other terms which governs the operation of and enterprise over a predetermined period. Most budgets are expressed in terms of money such as sales budget, Staff cost budget, while some may be written out as percentages or in units, such as staff numbers or expected customers or percentage room occupancy in a motel.

Budgets help to pin – point targets for various departments and provide a means of control for managers in production, service, sales and so on.

Budgetary control places responsibility for minimum levels of achievement on managers, who through constant comparison of actual results with budgeted target can monitor progress from time to time and take corrective action. Where a competitive spirit exists the targets may be exceeded in some departments to the advantage of the staff who earn bonuses on extra profits that the establishment makes.

Type of Budgets

Budgets can be of many kinds when viewed from different angles in any food service establishment is depicted in fig .1

Fig 1. Classification of Budgets

View Point	Budgets
1. Subject Matter	Capital
	Operating
2. Comprehensiveness	Master
	Department
3. Level of Sales	Fixed
	Flexible

Thus depending on the manner and view point from which targets to be set are seen by different managers the budgets will show the picture desire.

Capital Budgets

These deal with the capital funds and assets of an organization, and cover budgets dealing with assets such as equipment, plant, cash, proposed issue of shares and other instruments for rising funds for the organization.

Operating Budgets

These are usually concern with the direct operation of the business and cove for example sales, purchases, staff costs, administration, and maintenance and so on.

Master Budgets

These represent the forecasted all over targets set for the organization such as a profit and loss budget and incorporates all incomes and expenditures likely or estimated in an organization. Similarly a budgeted balance sheet may be prepared showing assets and liabilities of the establishment based on previous records.

Department Budgets

Each Department of the establishment sets its targets and prepares a budget for achievement. Such budgets include banqueting budgets, maintenance and so on depending on the number of separate departments that exist

Fixed Budgets

As the term suggests this remain unchanged over a period of time, and are not related to the level of sales. Example of such budgets is advertising, rents and rates, administration budgets.

Flexible Budgets

These budgets predetermined costs with respective possible volume of sales, called the cost of sales budget. The budget of college or school canteens, motels, and seasonal hotels would all be flexible budgets.

It is important to keep in mind however, that any particular budget does not fall only in to a single category or type. For instance, a labor cost budget is an operating budget but may also be a departmental budget and flexible or fixed according to the policy and needs of an establishment.

Operating Budgets

There are a number of operating budget prepared in the catering industry such as sales, labor and overhead cost budgets, maintenance budgets, capital and cash budgets and so on, a few of which are being briefly discussed.

Sales Budget

The sales budget is the most important one in terms of budgetary control. This is because the other budgets are work on the assumption of what is expected to be solved, in the sales revenue that can be generated there by. It is also the most difficult to prepare, because there are the number of uncontrollable external factors that influence the level of sales. If budgeted sales are forecasted wrongly all other cost budgets will also be inaccurate. The cash budget too, which is affected, by the sales volume will also be out of proportion and unrealistic. The preparation of the sales budget therefore is based on the following factors:

- Past Performance: This is analyzed with respective actual sales figures achieved in previous periods, the sales mix, seasonal trends, and fluctuations and so on.
- Current Trends: Present state of sales menu mix, likes and dislikes of customers, changes in living and eating habits etc.
- Limiting Factors: Identification of factors which are limiting sales in a certain area.
- Other information: This includes state of competition, employment, location, climate and weather changes, political situation, Government policies and their effects on future turn over.

✓ The percentage turn over in restaurants sales was continuous falling in spite of a slight increase in the sales revenue. When analyzed the limiting factor was found to be the dining space of the restaurant.

- ✓ There was a gradual increase in bar sales, but because of the identified space limitation the increase for the year ahead cannot be very much greater.
- ✓ Sundry sales too are expected to increase as above but not too dramatically.

At the end of each 4 – weekly period the actual sales would be compared with the budgeted figure to ensure that targets are being achieved. In case of variances, corrective action would be taken in time to achieve the annual estimates. For instance if restaurant sales actually achieved are less than the monthly targets a price revision may be the answer since the turn over cannot be increased due to space being the limiting factor.

The budget is then forwarded by the divisional manager to the budget committee for scrutiny and comments. The sales budget must indicate the department to which it refers the budget period, description of items with sales in unit analyzed for type of sale with monetary value of units, the sub totals for each class of products sold and signatures indicating authorization for the department. Provision for comments at each level must be made for guiding the budget committee in case of suggested revisions.

Stock Budget

This is intimately connected with the sales budget because the buying of raw materials and estimating stocks need to be coordinated with sales. Other factor involved is capital commitment to stocks and storage space for them. Stock budgets are usually prepared at selling prices especially in larger organizations, but depends on the items of sale. It is however necessary , to keep abreast with any reduction in selling prices offered to customers due to an urgency to clear stock of perishable items are seasonal price variations. The selling prices once fixed it should however, not be reduced without the authority of the purchase department. The amount by which the prices of books are reduced is called the mark- down.

Maintaining stocks at selling prices provides greater control over sales, but for control over buying the cost figures need to be used. This can be done by the application of cumulative mark-up rate for each type of stock used. The cumulative mark-up is calculated by reference to opening stocks and purchases to date at cost and selling prices.

It may be noted that original opening stock plus purchase does not go on indefinitely. At the end of say six months calculations are made with the opening stock cost, the selling price begin the figures at the close of the previous six months. All percentages however, are calculated on the selling price. Other factors associated with stock budget which also affect the sales budget are wastage or surplus stock rate of stock turnover and age of stock.

Wastage or surplus stock

The stock wastage or surplus where reasonable is usually written off during physical stock verification, but where wastage figures are large , they need investigation as it may be due to faulty records or pilferage. Discrepancies between the stock book figure and actual physical stock may be due to a number of other reasons such as:

- ✓ Items received and added to stock but invoiced not received. In such cases the purchase entry in the stock and purchase entry in the stock book must be increased for the amount of outstanding invoice.
- ✓ Items may be in stock on a sales-on-return basis. These should be excluded from the stock check with the book figures.
- ✓ Items on customer’s approval should be entered in stock till a sale is made.

All sales are deducted from stock lists while purchases are added.

Stock turnover

A fast turnover is important to prevent wastage and block funds in stock. The rate of stock turnover is calculated by dividing selling price by the average stock during the period also at selling price. The rate will depend on the type of stock item. Sometimes the value of stocks may reduce because the item becomes obsolete, or deteriorates quickly as in the case of perishable items. Control over buying stock can be calculated by preparing the stock budget.

The statements are prepared from the sales and stock budgets. Control over buying possible by adjusting the period figures. Where actual stock is greater than budgeted, the figures are reduced , similarly if sales increase more than budgeted figures the stocks and therefore purchasing allowance is increased and vice versa.

Staff or Labor Budget

This would provide estimates of number of staff at each level in a department; their salaries; payments to ad- hoc or casual labor and for overtime work; proposed changes in staffing and the rates of pay. This budget would also include the cost of staff meals and other employee benefits offered by the organization. The staff cost budget would be closely related to the budgeted volume of sales, as the degree of increase in sales determines whether existing staff can handle the workload or additional inputs are necessitated.

It is important to consider a department- wise analysis of staffing before adding on additional staff costs in the budget. This is all the more necessary in catering, where job rotation is the norm because of periods of peaks and through in production and service activities.

Other Budgets

A number of other budgets for costs and expenses are prepared to get an overall estimate from each department from their requirements of capital investments, overhead, maintenance, advertising and office expenses. These estimates help to organization to prepare capital, cash as and when required. The latter is essential for the uninterrupted performance of the organization.

Cash Budget

As already indicated this budget is prepared from the various operating and capital budgets, that is those concerned with the assets and capital funds of the enterprise. The cash budget gives estimates of cash receivable as from sales and other sources and cash payable over the budget period, which is obtained through the operating expense budgets and estimates of fixed assets planned.

The data has been taken from the capital and operating budgets of organization. Since all states are against cash, they represent the month's cash inflow for the month. Where a time lag of 2 months exists between purchases and payments the purchase amounts have been taken for February in April and so on. The same treatment has been accorded to the overhead costs where one month time lag for payments has been taken into account.

The cash budget helps to determine if the future cash deposition is satisfactory or not, and plan capital expenditure while ensuring optimum use of cash resources to build up the assets of the establishment.

Assuming that all sales are cash sales; the organization's interest received on investment in Rs 1500 in july, 2002 and the time between purchases and payments to supplies is 2 months and for payment of overheads the time lag is one month. In addition new equipment costing Rs 15,000 will be purchased in May, 2002 and paid for in June. The bank balance on 18th April , 2002 is Rs 20,000.

Master Budgets

These include the budgeted or estimated profit and loss account and the balance sheet. The former shows the sales and expenses and the budgeted net profit.

The budgeted balance sheets are compiled from the balance sheet of the previous year period and includes the acquisition of new assets, amount of depreciation on equipment are set through budgets and thus production and service activities can be planned according to set goals for the period in question.

Preparation of Budget.

For formulating budgets it is important to involve managers of all departments who are in the best position to set the targets of the organization and their departments. These personnel constitute what is called a budget committee, which decides how the overall system of budgeting will fit into the structure of the organization. In the process authority and responsibilities of each manager are defined and the different budgets are then prepared for each department keeping the goals and policies of the establishment in mind expressing the targets in terms of turnover, profit margins, operating ratios and costs.

The budget proposal are then scrutinized by the committee which thoroughly analyzes past income, expenditure and fluctuations that may have occurred from time to time, along with the current states of the organization.

The analysis may bring out areas of the enterprise which have been more profitable than others, degree of unemployment, competition, staff turnover and the like. While the committee sets the budget period it must also lay down the time period for interview of results also referred to as the control period, when actual results obtained are compared with the budgeted figure. For Catering establishments it is usually one calendar year. For smaller establishments budget preparation is not the practice, but for larger establishments the operating budgets are reviewed every week, or month to ensure that they are progressing towards establishment goals satisfactorily. Where there is deviation from target, corrective action is taken so as to achieve targets by the end of the year.

The first step in preparation of a budget is to forecast the volume of sales as accurately as possible. This will determine the level of variable and semi fixed costs, as well as the cash position of the enterprises.

Forecasting

Good forecasting makes the difference between happy customers bringing in huge profits on the one hand and dissatisfied customers resulting in unwanted inventory on the other hand.

Simple data lead to the most effective forecast. If forecasting for short periods such as a week the following information is required.

- The balance sales target for the year, obtained by subtracting the cumulative sales achieved from the annual target. The balance target is an indication of how more effort is required to draw customers in the next week. If performance has slipped this week it is time to push harder in the next week and so on.
- The sales of the previous 2-3 years at the same time of the year.
- And the current sales for the last few weeks.

The last few years, sales indicates the long term market trend , whereas the last few weeks sales help to predict short term targets. Forecasted figures may be adjusted up or down using a multiplier to account for seasonal variations in demand.

When forecasting it is important to keep in mind that certain factory may limit volume of sales. These are referred to as limiting factors and commonly operate in the hotel and food service industry.

Factors influencing forecasting

Accommodation: In residential establishment like hotels, motels, hostels , old age homes etc once the available accommodation id fully occupied the number of customers gets more or less static. The only way to increase sales revenue in these situations is increase prices.

Seating capacity:

The seating capacity in restaurant, coffee shop, and cafeteria is usually fixed beyond which it may be difficult to increase sales volumes except by adopting strategies to increase customer turnover per seat, or increase the prices on the menu.

Capital:

If capital available is not enough for expansion, renovation or increasing choices on menus to meet demand it can become a limiting factor.

Staff:

A shortage of staff affects production and service and can block quantity and quality of food and services offered.

Management:

If leadership is inappropriate and managers do not lead by example, love and trust , it can hinder production and service affecting quality production , demand and sales revenue.

Policy:

Management policies retracting production over certain limits through high staff turnover, low stock levels and so on, can all be causative factors in forecasting demand.

Customer Demand:

Customers are dynamic and do not demand products or services at easily predictable levels. Variations appear from meal to meal, day and so on. The demand for eating out though increasing the tastes and choices has shifted to fast services, to which establishment must adjust continuously. Sometimes the limiting factors may be high prices, fixed, potential demand or competition.

Many more limiting factors may operate in the internal and external environment of an establishment which need to be identified and efforts directed to deal with the problems they generate. Some factors however, are not possible to counteract fully, and therefore forecasts can never be absolutely accurate, but only provide a starting point for setting targets.

In catering the biggest problem is predicting what customers want and when. The only way to predict true demand for products and services is to use technology to record data accurately, concerning customers is the reason for the existence of organization, the profit being only the reward, all efforts have to be directed towards providing customer satisfaction.

Preparing Budgets

Budgets are usually prepared annually in advance for the following year. The methods of preparation of a few types of budgets have been indicated through examples to enable an understanding of the difficulties that may arise in planning estimates or targets in monetary terms.

Summary:

To summaries let us remember that we studied on three cost components namely the fixed cost, the semi fixed cost and the variable cost. Based on subjective point of view budgets are classified into capital or operating budget, based on comprehensiveness they are classified as master and departmental budgets and based on level of sales they are classified as fixed and flexible budget. Students, Since budgeting is a futuristic goal of action , careful planning and execution under a controlled environment will make any food service successful. Thank you for listening. Have a fantastic day.