

Why is it important for a business to budget? essay sample

[Business](#), [Company](#)



The main objective of any professional run organization is to be successful and healthy. Being successful and healthy is strictly linked to making a profit, adding value to the asset and reinvesting to grow in the future.

Therefore, an important management role is to achieve this objective by using a range of financial planning tools. Within these tools, the budgeting process is definitely the most effective and represents the crucial stage of the financial performance cycle. As stated by Professor Larry Walther, “ organizations carefully plan their financial affairs to achieve financial success. The key to achieving this success is to have an annual budget”.

Furthermore, he defines the “ budget” as “ a detailed financial statement that quantifies future expectations and actions relative to acquiring and using resources, a great tool to transform abstract visions into measurable goals. The bigger is an organization, the more detailed the budget must become”.

In one of his articles, Mr. Jed Heller (CEO of The Providence Group) defines “ the annual budget as a complete financial picture of the organization and contains the information needed to measure financial status at any time during the year. Based on past performances and goals for the current year, the budget captures projected expenses and anticipated revenues over a 12-month period. It covers every operational area of the organization”.

In order to cover the different areas/aspects of the organization, a variety of budgets can be used and the most common ones are the following:

- “ Operating Budget”, that is a “ budget that focuses on revenues, expenses, and profit to be made given those revenues and expenses”. The perfect example is given by the “ Statement of Profit and Loss” also known as “ Income Statement”, that “ summarize the revenues, costs, and expenses incurred during a specific period and the results of operations for the accounting period” (Definition from www.investopedia.com);
- “ Financial Budget”, that “ deals with expected assets, liabilities and stockholder’s equity” and it is perfectly represented by the “ Balance Sheet”, “ a financial report that lists an organisation’s assets (what it owns), liabilities (what it owes to others), the owner’s equity and the working capital. It represents the short-medium term financial health of the business”.(Definition from www.investinganswer.com);
- “ Capital Expenditure Budget”, or “ Capex”, that are “ funds used by a company to acquire or upgrade physical assets such as property or equipment. It is often used to undertake new projects and increase the scope of their operations. It can be considered as a reinvestment plan of the organization”. (Definition from www.investopedia.com);
- “ Cash Budget”, that is a “ budget that focuses on the expected cash inflows and outflows during a specific period”. It is perfectly represented by the “ Cash Flow Statement”, a “ statement that provides data regarding all cash inflows that an organization receives and outflows that an organization pays related to its ongoing operations and external investments”. It is a representation of the organization’s bank account.

In my opinion, within the context of a hospitality business, the agreement of a financial budget is highly valued and necessary because once agreed, it controls costs while it establishes measurement criteria regarding future performances. The concept is that the business will grow from year to year and the main aim will be to make a profit. Therefore, each annual budget will contain revenue goals, expenses amounts and profit expected and it will enable the organization to achieve improvements over the last budget.

Furthermore, agreeing and operating with a budget makes the organization's financial activities coherent among departments and gives managers a sense of direction when managing their daily operations. So it is important to agree on an operating budget so that everyone knows what to expect the business to generate in terms of profit over a given period. This gives the managers a guideline of expectations and also provides owners and shareholders with an expectation of return on their investment.

It is important that once agreed, the business is run within the limits of the budget because they are expected to achieve the budgeted revenue, spend within the budgeted expenses, which they will consider while running their department and making their daily decisions. The day to day activities must be in agreement with the budget as it represents the organization's strategy in numbers.

As explained by Osmond Vitez in his article " Why is it important for a business to budget?", the major benefit of operating with a budget is the " ability to control the expenses (how much money can be spent and on which

activities), to ensure that capital is not wasted or the company does not overpay for the resources used (i. e. labor cost and wastage of food).

In addition, operating with a budget gives the companies a tool for future growth as it ensures that they have the capital needed when deciding to expand their operations". With a Capital Expenditure budget, it is essential to agree because otherwise undertaken projects have no cost boundaries and it will be easy to overspend. A perfect example that shows how important it is to agree and operate within a Capital Expenditure budget would be the extensive renovation project that the hotel I work for is undergoing at the moment.

This project started in September 2016 and will continue all the way through March 2018 and a special budget has been originally set up for it. The Finance Department has been responsible for tracking the progress and controlling the expenses related to the renovation. Therefore, a report has been monthly prepared and sent to our Corporate Office based in Hong Kong. In this report, the actual amounts spent are compared with the budgeted ones, in order for them to check that the project is proceeding in agreement with the budget. The hotel was provided with the funds to renovate and it is one of the biggest management responsibilities that these funds are managed responsibly and the results expected are achieved.

In conclusion, operating with an agreed budget is vital, because it helps to plan and it represents a great control tool, that supports organizations in

achieving success (their financial goals) and avoiding failure due to insufficient resources to sustain their operations and pay the creditors.