



Improve Business Performance with Flexible Budgets

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Have you ever gotten midway through a vacation to discover you've already blown through most of the money you saved for the trip? You probably didn't pack up your bags and go home. Instead, you may have taken a look at your trip budget, compared it against what you had actually spent and made some adjustments in your personal finances to enjoy the rest of the journey.

Owners of small businesses can run into the same problem. By keeping an eye on monthly changes between budgeted costs and what is actually spent, adjustments can be made to improve the situation. Budgets can help determine how well a business is performing by comparing expected costs with actual costs. It is important, however, that you adjust your budget to reflect actual sales so that you will be comparing apples to apples. This is called flexible budgeting and it can illuminate changes you can make that may improve the performance of your business.

For example, let's say the owner of a gift basket business is having a hard time figuring out how to make more money on her high-end baskets. She planned to sell 1,000 baskets last month but only 900 were sold. Midway through the month when she saw sales were lagging a bit, she reduced her price to try to boost sales. She didn't think the reduction in price would hurt too badly because she was also able to reduce some of her costs by making fewer baskets. So why did her revenue turn up shorter than expected? To find the answer, she must adjust her budget to the actual sales volume of 900 baskets before comparing it to her actual costs.

Budget and Actual Results Adjusted for Volume

	Budget	Budget Adjusted for Volume	Actual	Adjusted Variance
Volume	1000	900	900	
Revenue	\$ 40,000	\$ 36,000	\$ 35,100	\$ (900)
Variable Costs	\$ 24,000	\$ 21,600	\$ 22,950	\$ 1,350
Contribution Margin	\$ 16,000	\$ 14,400	\$ 12,150	\$ (2,250)
Total Fixed Costs	\$ 10,000	\$ 10,000	\$ 10,000	\$ -
Income	\$ 6,000	\$ 4,400	\$ 2,150	\$ (2,250)

She already has a budget that indicates expected volume, revenue, variable costs, contribution margin, fixed costs and income. Using this as a starting point, she should add a second column in which she will write her revised budget calculations that now assume sales volume of 900 baskets. A third column should be added containing the actual revenue, variable costs, contribution margin, fixed costs and income. A fourth column should indicate the difference between revised budget numbers and actual costs for each of the six line items.

Only then can she see that the drop in volume was probably a contributing factor to the fall in revenue but likely not the only influence. In other words, only after she has removed the effect of changes in volume can she look at the effect of changes in selling price and the cost of putting together the baskets. Variances may reveal that variable costs were higher than budgeted. If this is the case, she should focus on not only increasing sales but also on finding a way to reduce the cost of her product. Possible strategies may be to find new vendors for the various elements of her baskets or buy more of the components in bulk, which might help reduce costs. Whatever she chooses to do, she now has better information in hand to manage her business and make it more successful.

By stacking up your small business' performance against budgets that adjust for levels of sales, you can harness the power of cost analysis and get more out of your business. If you would like to learn more about this kind of budgeting, there are a number of Web sites that provide in-depth explanations and templates. A Google search of flexible budgets will turn up quite a few. Business advisors at a Small Business Development Center near you can also answer questions free of charge and work with you on your small business budgeting needs. To find the center nearest you, go to www.nmsbdc.org. If you discover capital may be part of your solution, you can apply for a small business loan at nonprofit lender ACCION New Mexico's Web site www.accionnm.org.

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