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1.
What is a budget and how do I use one?

The Basics

Often times, a business fails because they run out of cash and cannot honor their obligations. A key way this can be avoided is by planning and monitoring what money is expected to come into and go out of your business. This planning and monitoring is called budgeting. A budget is your best estimate of what will happen in your business, usually presented in the same format as your financial statements. If you think of your business as going on a trip, your budget is a detailed map of the route you have chosen for the next few kilometers. It's a description of what you think will happen in the short term, using numbers instead of words.

The real value of a budget is to create a process and tool for you (the owner). A budget gives you a structured way to think about what the next year will bring for your business, and to set yourself and your team specific targets to measure your performance. Another benefit of your budget is that it can help you make sure you know how much money is necessary for the things you need and are important to your business. Following a budget can also help you work your way out of debt, or help keep you from going into debt.

Your budget will not only help you identify where your business is going, but will also help to identify the potential obstacles and determine what resources you will need to be successful.

Because there are many different perspectives on a business, each budget will be a little different. Every budget should contain:

1. Monthly estimates of profit or loss.
2. Monthly estimates of cash on-hand (including big purchases like equipment, inventory, etc.).
3. A clear, concise description of the assumptions you have made within the budget – so that you and your team are all aware of what needs to happen to achieve the budget.
4. An easy way to compare your budget to your financial statements, often by translating your budget into the same accounting categories used in your financial statements.

A budget does not have to be perfect – focus on building a tool that will help you in achieving your business' goals.

Tell Me More

Successful businesses plan for the future. Your budget is the core of your plan, so you need to invest enough time and energy into the process to give yourself the highest chance of success.

You will get more benefit from going through the budgeting process yourself. Do not rely only on accountants or bookkeepers to create a budget for your business. You know your business better than anyone even if you are not very comfortable with all the accounting terms and numbers involved. Challenge yourself to create a budget that you can use and develop over time to help your business grow.

A budget is a tool. It should be refined and improved over time. There is no "right" way to build a budget, just use the way that works best for you and your business. The worksheets will help guide you on how to set up a budget.

How do I use a budget?

Step 1: Decide when you will prepare your budget each year, and set aside enough time to prepare it. Many follow the calendar year and create a budget from January through December or it can be made based on the Persian calendar from Hammal through Hoot. If your business is seasonal, you may plan to begin and end your budget when it suits your business best. Plan to have your budget completed at least one month before the beginning of the budget period, so that it can be communicated to your team and included in your reporting.

Step 2: Use the performance of your business in the past to learn more about the patterns of your business. Depending on your business, some key questions to ask may be: How long does it usually take to acquire new customers? How long does it take to produce your product? How long does it take to get paid by customers?

Step 3: If you have not created a budget before, build yourself a template customized to your business to use every period. Keep it simple to start, because you can always add detail later. Too much detail can keep you from seeing what's really happening inside your business. If you already have a template, identify what has been working in the past period and what changes can be made going forward. There are several budgeting templates available in the Toolks section of the Dastyar website that you can use to create your own budget.

Step 4: Decide what your target for sales will be at the end of your next budgeting period. See the question, how do I project sales?

Step 5: Plan the expenses you will need to achieve that level of sales by asking how and what will you need to accomplish that sales goal. How long will it take to achieve that goal? For example, how much does it cost you to make your products available for the end customer. It may include the cost of the shop you rent, the advertisement cost, salaries you pay, etc.

Step 6: Make sure that your plan (budget) helps you make progress towards the ultimate goal of your business – generating profits and cash flow. Are you profitable, or will you be losing less money as the year goes on? If not, you may need to revisit your budget to see if there are ways to reduce expenses. Do you have enough cash during the year to survive, or will you need to seek funding from outside of your business? Remember that cash flow is not the same as profit. It is possible for a profitable business to run out of cash on hand. Budgets can help you understand the expenses that taking away from your profit. Budgets can also help your predict when your company will be taking in or paying out actual cash.

Step 7: Compare the monthly performance of your business to what you had budgeted to determine if you are off course and identify what areas of your business may need attention. You can update and adjust your budget for the rest of the period accordingly.

During each budget period, repeat the steps and evaluate the information you are assuming when creating your budget with the information that is actually happening within your business. With gradual refinement, your budget will evolve over time to become more and more valuable and useful in making your business successful. The budgeting process is your best guess of the money coming into and going out of your business. Be sure not to become discouraged if what you assumed and what is actually happening does not match up. Learn why then revise your budget appropriately.

Glossary Terms from this Section

Bookkeepers - People who set up and work on all the records for keeping track of daily financial activities.

Budget - An estimate of income and expenses for a set period of time.

Cash Flow - The total amount of money coming in and out of a business.

Debt - Money borrowed from one party by another, often a loan from a bank.

Expenses - Money paid out of the business to pay for an item or service.

Fixed Costs - Money spent that does not change depending on the number of products you sell.

Profit - Any positive amount of money left over after subtracting expenses from revenue (income).

Variable Costs - Money spent to make and sell your products and goes up together with each product sold.

For More Information Related to this Topic See

- How do I create a budget? 10. *Budgeting*
- What happens if I go over my budget or my budget was wrong? 10. *Budgeting*
- What do I do if my budget says I will not be profitable? *10. Budgeting*
- Do I have to create my budget myself? *10. Budgeting*
- Who should I show my budget to and why? *10. Budgeting*
- What is a cash flow statement? *12. Financial Management*

Additional Tools Available

Budgeting Process Checklist

Cash Flow Budget Worksheet

Revenue Projection Worksheet

2.
How is my budget different from my financial statements?

The Basics

Your budget looks forward, estimating what will happen in the future. Your financial statements describe what has already happened in the past. The budget sets your goals, and the financial statements measure your progress towards those goals. For instance, when Strikers, a bowling club in Kabul, plans to open a branch in Mazar-e-Sharif next year, it develops a budget and allocates the funding needed to expand. Once the expansion takes place next year, the money used in the purchase, associated expenses, and money received from the new location affects the financial statements of Strikers at the end of next year.

There are three very important financial statements that you should look at each month: the Income Statement (also known as a Profit and Loss statement or P&L statement) which gives a summary of how your business earns and uses money, the Balance Sheet which shows what your business owns and owes to others, and the Cash Flow Statement which shows how cash enters and leaves your business. There are other statements that you might use as your business grows, but these statements are the three most commonly used documents.

While they do not have to be in exactly the same format, it is important to have an easy way to compare your budget and your financial statements so you can measure your performance and take action. The format and your understanding of your budget and financial statements will advance over time. They do not need to be perfect but both of these tools need to provide you with information useful to your business. As your business grows, you will discover where having more details in your budget and your financial statements would help you understand what is happening and make better decisions. For example, Ellaha starts a clothing company where she focuses on ladies' garment, but as the business grows, she adds more lines of business such as horizontal and vertical curtains, handicrafts etc. Her earlier budget was very simple, listing only types of women's clothing like skirts, dresses, shirts, and coats. As her business grows, the budget format changes accordingly because she needs to add more categories of cost and revenue. Ellaha's new budget includes lines for various types of curtains, different kinds of housewares, and a range of handicraft items.

Revenues	**Hamal**	**Sawr**	**Jawza**
Skirts	15,000	20,000	20,000
Dresses	25,000	35,000	35,000
Shirts	10,000	10,000	15,000
Coats	18,000	18,000	20,000
Total Revenues	68,000	93,000	90,000
Cost of Goods Sold			
Skirts	7,500	10,000	10,000
Dresses	12,500	17,500	17,500
Shirts	5,000	5,000	7,500
Coats	9,000	9,000	10,000
Total Cost of Goods Sold	34,000	41,500	45,000

Revenues	Saratan	Asad	Sunbula
Skirts	15,000	20,000	20,000
Dresses	25,000	35,000	35,000
Shirts	10,000	10,000	15,000
Coats	18,000	18,000	20,000
Total Clothing	**68,000**	**93,000**	**90,000**
Vertical Blinds	20,000	20,000	30,000
Horizontal Blinds	20,000	20,000	30,000
Table cloths	12,000	14,000	15,000
Decorative napkins	5,000	7,000	7,000
Total Housewares	**57,000**	**61,000**	**82,000**
Wooden Toys	5,000	5,000	5,000
Carved Bowls	8,000	8,000	8,000
Decorative Plaques	8,000	10,000	12,000
Total Handicrafts	**21,000**	**23,000**	**25,000**
Total Revenues	**146,000**	**177,000**	**197,000**
Cost of Goods Sold			
Skirts	7,500	10,000	10,000
Dresses	12,500	17,500	17,500
Shirts	5,000	5,000	7,500
Coats	9,000	9,000	10,000
Total Clothing	**34,000**	**41,500**	**45,000**
Vertical Blinds	10,000	10,000	15,000
Horizontal Blinds	12,000	12,000	18,000
Table cloths	6,000	7,000	7,500
Decorative napkins	2,500	3,500	3,500
Total Housewares	**30,500**	**32,500**	**44,000**
Wooden Toys	2,500	2,500	2,500
Carved Bowls	6,000	6,000	6,000
Decorative Plaques	4,000	5,000	6,000
Total Handicrafts	**12,500**	**13,500**	**14,500**
Total Cost of Goods Sold	**77,000**	**87,500**	**103,500**

Tell Me More

Running a business requires that you be good at setting goals and measuring your progress – whether in developing your products, selling, producing and delivering them or managing your finances. Your budget and financial statements are extremely useful tools, so you need to consult them often.

In addition to their value to you as the owners, both your budget and your financial statements are used to estimate the potential and performance of your business by others.

- Budgets (as well as longer-term financial projections) are almost always requested by any outside investor early in the process. Lenders and equity investors use your budget as a way to understand what your specific plans are for the business and how those plans will increase the value of your business and their investment.

- Financial statements are used by various tax authorities to ensure that you are correctly reporting your business performance, as well as by outside investors and partners to determine if you are making the right decisions to grow your business. For example, the Medium Taxpayers' Office at the Ministry of Finance evaluates the financial reports of medium enterprises to make sure the companies report the right amount of revenue and costs are reported.

When your performance does not match your budget, we say that you have a budget variance. A budget variance tells you when you have missed your planned goals. Variances can be positive or negative – but in both cases, they give you important information about your business.

A negative budget variance can be:

- Not selling as much as you expected in a given period (either in number of units or money received)
- Spending more than expected for a particular business expense

An example of this is when Ellaha could not sell the number of curtains she thought. She expected to sell 250 sets of curtains in the year, but for various reasons, such as a new competitor entering the market, she only sold 170 sets. She also had a negative budget variance because the cost of production per curtain increased by 12% due to the increase in the cost of raw materials she imported from Pakistan.

A positive budget variance can be:

- Selling more than you expected in a given period (either in number of units or money received)
- Spending less than expected for a particular business expense

An example of this is when Ellaha decides to produce the curtains in-house using labor hours of her employees, and decides uses local raw materials that help her not need to spend money paying custom duty of imports.

Budget variances should be reported in units (if applicable), dollars/AFN and percentage. This enables you to identify the areas that deserve your attention first. Do not chase down a 200 AFN variance before looking at a 200,000 AFN one. Just knowing where you have gotten off course is not enough. You need to use the variances to identify where the biggest issues are, so that you can work on those first. You need to know what works and what does not work in your business in order to improve.

One of the easiest ways to find out is by asking yourself why the variance occurred. Do not be content with "we did not hit our target" or "we just need to work harder" as an answer. Dig deeper into the exact chain of events that led to the variance, so you can see where your assumptions are not lining up with reality. In Ellaha's case, she had assumed the cost of raw materials would remain constant. But when she looked the numbers, she realized the negative variance was partly the result of a 12% increase in costs of raw materials from Pakistan. Due to this, when planning for the next year, she will explore additional sources of raw materials to avoid an increase of product costs in the future.

How to Identify Budget Variances

Step 1: Create your budget with enough detail to allow you to track your assumptions. Include both dollars and units for sales and variable costs. Variable costs (such as raw material used for production, wages, etc.) change depending on the number of products or services you sell while fixed costs (such as rent, machinery, etc.) stay the same no matter the amount sold. These costs are easier to predict for the future.

Step 2: Integrate the various areas of your budget into your financial reporting system so that variance analysis is easier and more organized. This ensures that both help to inform the other and you can get a more accurate picture of your financials.

Step 3: Set aside 2-4 hours at the beginning of each month to review the past month's performance versus your budget. The sooner you understand what's working and what is not, the quicker you can make improvements.

Step 4: Rank the variances you have identified by how far off the actual amount is from the budget and then by dollar amount.

Step 5: For each variance (starting with the largest), ask "What happened?" and "Why?". Identify the specific budget assumption that was made and then describe what you did differently from your plan. Record your answers and identify one step you can take in the coming month to improve that specific line item.

Step 6: Repeat for each significant variance.

Step 7: Remember that the goal of this exercise is NOT to get discouraged by any negative variances, but to find ways to improve. If you find yourself becoming negative during this process, it's time to take a break and come back to it later. Budgeting is not a perfect science and there is not only one correct way. The key is for your budget to provide you with information useful to your business.

One technique is called a Rolling Forecast (RF). It highlights the impact of the variance over the course of the year, and it helps identify the gap to the overall organizational goals. For example, if Coca Cola company managers see their sales increasing by 20% for January from the projected budget, the RF should encourage the team to achieve 20% higher than the annual target for upcoming months of the year and next year accordingly.

Glossary Terms from this Section

Balance Sheet - A financial document that shows how much you have in your business and how much you owe at a given time.

Cash Flow Statement - A financial document showing the money that is flowing into your business and the money flowing out of your business.

Financial Statements - Formal records of the financial activities of a business that includes a balance sheet, income statement, and cash flow statement.

Fixed Costs - Money spent that does not change depending on the number of products you sell.

Income Statement - A financial document showing the difference in revenue (income) and expenses.

Variable Costs - Money spent to make and sell your products and goes up together with each product sold.
Variance – The difference between a target and actual performance.

For More Information Related to this Topic See

- What are financial statements and why do I need to use them? *12. Financial Management*
- What are Income Statements (Profit and Loss Statements) and how do I use them? *12. Financial Management*
- What is a cash flow statement? *12. Financial Management*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*

Additional Tools Available

Monthly Budget Review Worksheet

3.
How do I create a budget?

The Basics

Your budget is a tool for you to use in thinking about the future of your business. Your budget needs to be designed to fit the needs of your business and a tool that you will actually use. An operating budget is a combination of expenses that you know, expected costs in the future, and income you expect to receive over a given time period of your budget, usually the next one year.

Your budget should be as detailed as you need it to be in order to understand what other resources you will need, or to understand why you did not achieve your forecasts. Whatever you create, be sure that you know how you will use it and why each element is important information for you.

Tell Me More

The elements needed to build your operating budget can be broken down into specific areas of activities. Most entrepreneurs are focused on action, so it can be easier to think about the activities you currently do as you are building your budget. See the following questions to ask yourself that will help guide you on identifying where you spend your money and how this can inform the structure of your budget.

What are the costs of attracting prospective customers and making them aware of your business?
These are your marketing costs associated with the activities you can do to attract prospective customers. For example: create some flyers, provide free samples, or do online advertising. It's crucial to know which activities you will be trying so you can allocate your budget and analyze which ones work best.

What are the costs of convincing those prospects to become customers?
Once those prospects come into your shop or contact your business, there are sales costs associated with getting that customer to actually buy your product. These costs could be administrative costs, selling costs such as sales team salaries, etc. For example, Foot on Street (FOS) is a project by Roshan Telecom that encouraged students to sell Roshan SIM cards in universities. The students get a commission on the SIM sales, and Roshan adds to its subscriber base. The sales commissions count as selling costs.

What are the costs to produce and deliver your product, provide your service, pay your suppliers and employees?
These production costs include costs relating to the manufacturing or creation of goods or services such as raw materials, labor, manufacturing supplies, and general overhead.

How will you manage your contractual obligations and get paid?
General and administrative costs relate to the day to day operations of your business. They relate to the operation of your business rather than to the expenses directly related to production your products or services. These costs can include building rent, consultant fees, insurance, supplies, subscriptions, and utilities.

How will you identify and create new products or services?
Product development costs include the expenses related to the entire process of researching, designing, creating, marketing, and selling new products.

Once you have determined the estimated costs of these activities, you should set up your budget in a way that makes sense to you, and will correspond into accounting terms so that it is easy to compare your performance (financial statements) to your goals (budget).

Each category of activities roughly corresponds to an accounting category.

1. Attracting prospective customers = Marketing Costs
2. Converting prospects into customers = Sales Costs
3. Producing and delivering your product or service, paying vendors and employees = Production Costs (also called variable costs)
4. Managing your business, your contractual obligations, getting paid = General and Administrative Costs
5. Identifying and creating new products /services = Product Development Costs

Creating Your Operating Budget:
Step 1 –List the activities you will need to perform in each of the 5 key elements of your business. The operating budget tool will help you set up your operating budget.

Step 2 – Estimate how much time and money each activity will need, and the likely results (how many prospects, customers, products, etc.). For example, Fahima and her husband own a store selling construction materials. They know their business has a decline in sales during winter (seasonality) and require a warehouse to store their goods not sold during the first three seasons of the year. They plan accordingly with a sales plan in place to lease a warehouse or offer the stock at a discount during winter. Whichever option is chosen, the necessary costs are included in the operating budget in advance.

Step 3 – Translate your budgeted activities into "accounting" language so they are consistent with your financial statements. You may want to get your accountant or bookkeeper to help with the details of your template and to help set up reporting.

Step 4 - Choose a format for your budget, and enter your sales and expense projections into that format. Setting up sections for each element of your business (Marketing, Sales, Production, General and Administrative, Product Development) can make data entry and reporting easier.

Step 5 – Once your data is all entered, look at the profit and loss results of your budget. Ask yourself if this plan achieves your goals. When are you profitable? Also, consider how realistic the plan is and how confident you are that you can achieve it.

Step 6 – Rework your budget as needed until you believe that you have the most realistic and achievable plan for your business for the budget period. The budgeting process is designed to help you think about your business so you should expect to work through several versions of your budget before deciding on your final budget for the year.

As the owner, it's your responsibility to plan for your success and to take action when things are not going according to the plan. Build yourself a budget that helps you understand and analyze your business so that you make decisions based on data instead of guessing or turning over responsibility to an accountant.

Here is an example of how a budget might look. In the Tools section of this Toolkit, you will find a template with the steps to create your own Operating budget.

Revenues	Assumptions	January	February	March
Produce (fruits & vegetables)		7,565	7,815	8,065
Dry goods (cereals & grains)		7,650	7,650	7,650
Meat / Dairy		19,250	19,250	19,250
Add more rows as needed				
Total Revenues		**34,465**	**34,715**	**34,965**
Cost of Goods Sold / Cost of Sales				
Produce (fruits & vegetables)		1,845	1,908	1,970
Dry goods (cereals & grains)		1,913	1,913	1,913
Meat / Dairy		6,000	6,000	6,000
Add more rows as needed				
Total Cost of Goods Sold / Total Cost of Sales		9,758	9,820	9,883
Sales & Marketing Costs				
Trade shows / Conferences	3 per year		10,000	
Local markets / fairs	"Includes free samples 1 per month"	1,250	1,250	1,250
Radio advertising	1 ad per week	2,000	2,000	2,000
Salespeople	1 person part-time	4,167	4,167	4,167
Total Sales & Marketing Costs		7,417	17,417	7,417
Administrative Costs				
Rent (store + storage)	Lease through 12/2019	3,000	3,000	3,000
Utilities		1,500	1,500	1,500
Insurance	Paid in July			
Accounting / legal	Bookkeeping + annual review	3,750	1,250	1,250
Shop employees	1 cashier + 1 inventory manager	7,500	7,500	7,500
Fees / licenses / taxes	Paid in March			5,000
Total Administrative Costs		**15,750**	**13,250**	**18,250**
NET PROFIT / LOSS		(1540.83)	(-5771.67)	(-584.17)

Glossary Terms from this Section

Expenses - Money paid out of the business to pay for an item or service.

Profit - The amount that you make after you subtract your costs.

Vendors - People or organizations that provide products or services used to operate a business.

For More Information Related to this Topic See

- What is a budget and how do I use one? *10. Budgeting*
- What format should I use for my budget? *10. Budgeting*
- For how long should I create a budget? *10. Budgeting*
- Do I have to create my budget myself? *10. Budgeting*

Additional Tools Available

Budgeting Process Checklist

Cash Flow Budget Worksheet

Operating Budget Worksheet

4.
How do I know how much cash I will need in the future and make sure I can pay my costs?

The Basics

Your operating budget is very useful for understanding the operations of your business but it has one major flaw: it assumes that everything will be paid as soon as it happens. Since this is almost never the case in the real world, you need to forecast not only your profits, but also your cash. Often times, a business fails because they run out of cash and cannot honor their obligations. A key way this can be avoided is by planning and monitoring what money is expected to come into and go out of your business.

Your business may collect cash from customers as soon as they pay (for example, if you have a retail establishment like a store or restaurant), but some suppliers require you to make deposits when you place orders, or allow you to pay for your purchases over time.

Budgeting your cash for the coming year is a useful exercise as it helps you set a specific target for your cash balance each month. Make a plan with a monthly goal to help you identify any problems early as it's essential to know if you are running out of cash as soon as possible.

It is not enough to manage sales and expenses - you have to manage your cash, especially in small and growing businesses. This is because in order to grow, you will need to invest more cash in things like raw materials, equipment, salaries, marketing, etc. before you are able to grow sales. Some entrepreneurs make the mistake of spending the cash in the first few months of the year and struggle to pay their expenses throughout the year. Another common mistake is to spend more when you have more cash available. You should look forward and plan for future months, even if you receive more cash now. For example, Naheed and her father produce and sell carpets as a family business. Earlier in the year, they received an order from the United Kingdom to sell 15 pieces of different carpets within three months for an exhibition in London. They were happy and managed to ship the consignment in time. After receiving the payment, her father wanted to spend the money on decoration of their main store in Kabul. Naheed resisted. She knew that selling carpets take time. She explained to her father that in the upcoming 6-9 months, they should instead look ahead at the need to pay carpet weavers and designers. They may not have as much money from sales during the last part of the year.

Tell Me More

One of the main reasons for developing budgets is to understand what you need in the future. Without enough cash, your business will struggle. Developing a cash budget also helps you measure your performance, and tells you if you need to invest more time and energy into a certain aspect of your business. If you do not collect payment from your customers' invoices, you cannot pay your own bills. Your cash flow budget can help you see the impact of a change in collections, so that you can decide if you can let that customer wait another week to pay or not. Continuing in the example of Naheed, she should make sure to have enough cash on hand to pay the carpet weavers and suppliers of raw material in order to maintain good business relationships.

By calculating your expected ending cash balance, and comparing it to what you have in the bank, your cash flow budget gives you a quick and easy way to verify how close you are to your plan each month.

Building Your Cash Budget:
A cash budget is an estimation of your cash inflow and outflow of your business. Your budget will be compared to your actual performance, so it's best to use a format that is the same for both documents. The cash flow budget tool will help guide you in making a cash budget.

Step 1 – Enter your beginning cash balance– How much money you will have in the bank at the beginning of your next budget period? The start of each subsequent month will be the same as the ending balance from the previous month.

Step 2 – Identify the cash you receive or use from your operations.

a. Include a line for your net profit from your previous month's operating budget. It will be either a positive or negative amount.
b. Calculate your working capital's (capital used in your day-to-day business) impact on cash by listing out the following, each on a separate line:

- List the total amount that people owe you (accounts receivable) for this month. Show that cash coming in as a positive number. You can never receive more cash than the total of what you are owed, so this line should never be greater than your total accounts receivable.
- List the total amount that you owe people (accounts payable) for this month? Show that cash going out as a negative number. You should never pay more than what you owe, so this line should never be greater than your total accounts payable.
- List the amount of cash expected from selling your products from your inventory. This will be a positive number.
- List any amount you plan to invest in additional raw materials or other inventory. Show that cash going out as a negative number. For example, if you need to purchase a large quantity of raw materials for 200,000 AFN this month, include that 200,000 AFN as a negative number in your "inventory" line item.
- After you have included all of the elements of working capital, create a subtotal line for their impact on your cash balance by adding all the positive and negative amounts together.

Step 3 – Identify the cash you will receive or use from investments.

a. List the amount you expect to invest in the purchase of new equipment, vehicles, or new location. This will be a negative number. Also include any deposits or payments that you need to make before receiving the equipment. For example, Naheed will have to consider the investment she will have to make for the acquisition of the new frames needed to produce the more carpets.
b. List the amount you expect to gain from selling your existing equipment you no longer need or from other investments? Fees, commissions, or payment plans will reduce the cash you receive. This will be a positive number.
c. Create a subtotal line for the impact of investments on your cash balance by adding all the positive and negative amounts together.

Step 4 - Identify any cash related to funding your business.

a. Will you take out any loans for your business? Include the cash you will receive from the loans as a positive number. Fees, commissions, or payment plans will reduce the cash you receive.
b. Will you have to make any loan payments? If you have outstanding loans, include the repayment of that loan as a negative number. Include only the principal portion you are paying back as the interest will be reflected on your income statement.
c. Will you add money yourself or ask other investors to add money? Show amounts for each investor that will be contributed into the business as a positive number. Include any fees (legal, escrow, etc.) that will reduce the amount of cash you receive.
d. Will you make distributions to yourself or other investors? Show amounts for each investor you plan to give distributions, or payments, as a negative number. Tracking by investor is critical and may have to report those payments for tax purposes.

e. Create a subtotal line for the impact of funding on your cash balance by adding all the positive and negative amounts together.

Step 5 – Calculate your ending balance by adding together:

a. Your opening cash balance
b. The net impact of operations
c. The net impact of investments
d. The net impact of funding

Step 6 – Review your monthly ending cash balances. When will your cash balances be the smallest during the year? How much additional cash will you need to put into your business before you make a profit and have positive cash flow?

Step 7 – If you do not have a positive cash amount according to your budget, think about possible sources of capital you could talk to in order to get the money you need. One of the quickest ways to get a positive cash flow is to reduce your expenses. Review your expenses to see if there is any way to achieve similar results without investing as much. Another way is to ask your customer to pay you in advance or collect money owed to you sooner.

Step 8 – If you determine that you will need additional money, research and pursue other sources of funding such as loans, investors, grants, etc.

You can find the Cash Flow Budget Tool in the Tools section of the Dastyar website. Below is an example of a cash flow created using the tool.

	Assumptions	January	February	March	April	May	June
Beginning Cash Balance		100,000	94,824	79,711	69,936	65,371	60,850
Net Profit / Loss from operations		(7,626)	(14,938)	(9,751)	(4,541)	(4,499)	(14,441)
Changes to Working Capital							
Increase in what customers owe you (cash out)	This month's sales (if on credit)	(250)	(500)	(600)	(700)	(800)	(900)
Decrease in what customers owe you (cash in)	Last month's sales (if paid in 30 days)	200	250	500	600	700	800
Increase in what you borrowed from vendors (cash in)	This month's purchases (if on credit)	7,500	7,575	7,651	7,727	7,805	7,883
Decrease in what you borrowed from vendors (cash out)	Last month's purchases (if paid in 30 days)	(5,000)	(7,500)	(7,575)	(7,651)	(7,727)	(7,805)
Increase in Inventory (cash out)		-					
Decrease in Inventory (cash in)		-					
Total Changes to Working Capital		2,450	(175)	(24)	(23)	(23)	(22)

Total Cash Flow from Operations		(5,176)	(15,113)	(9,775)	(4,564)	(4,522)	(14,463)
Cash Flow from Investments							
Investment Purchases (cash out)		-	-	-	-	-	(10,000)
Refrigeration equipment for store	Vendor requires 1,000 at order, 1,500 at equipment delivery						(10,000)
Add more as needed							
Investment Sales (cash in)		-	-	-	-	-	-
Add more as needed							
Add more as needed							
Total Cash Flow from Investments		-	-	-	-	-	(10,000)
Cash Flow from Financing							
Incoming Loans (cash in)	Borrowing from family						
Loan Repayments (cash out)	Repayments of family loan (excluding interest)						
Incoming Equity Investments (cash in)							
Payments to Investors (cash out)							
Total Cash Flow from Financing		-	-	-	-	-	-
Total Changes to Cash		(5,176)	(15,113)	(9,775)	(4,564)	(4,522)	(24,463)
Ending Cash Balance		94,824	79,711	69,936	65,371	60,850	36,387

Glossary Terms from this Section

Distribution - Money given to the owner as a repayment for the money the owner invested in the business or share of the profits.

Invoices - A list of thing or services provided and the amount of money to be paid.

Profit - The amount that you make after you subtract your costs.

For More Information Related to this Topic See

- How do I estimate what my sales will be in a year? *10. Budgeting*
- How do I estimate what things will cost in the future? *10. Budgeting*
- What is a cash flow statement? *12. Financial Management*
- What is profit and how do I determine mine? *12. Financial Management*

Additional Tools Available

Costs Projection Worksheet

Revenue Projection Worksheet

5.
What format should I use for my budget?

The Basics

The best budget format is the one you develop yourself that best fits your business and its needs. Unless you are in a heavily regulated industry or looking for significant institutional investment, your budget will not need to follow any specific requirements. There are some standard best practices for what should be included in a budget and to ensure you have included all the important elements into your budget. For example, Farida and Yasmin are two business owners. Farida is a doctor and runs a clinic. Yasmin owns a pharmacy chain. The nature of the two businesses are similar but the budget format for the two will be very different. Farida's business is focused on the number of patients who visit her clinic where the medical services are recorded as revenue. Rent of the venue and doctors' salaries are major costs. For Yasmin, her budget includes the quantity of medicine sold in each store as her revenue and pharmaceutical drugs are the costs.

Consider these points when designing the format of your budget:

- Understand the level of detail your budget will need to better monitor your businesses performance. Newer businesses tend to have less detail available. You want to create a budget that takes a close look at your spending.
- Think through what worked in the past year, and what needs to change. Identify the activities that you will do differently first, and add them to your budget template if needed.
- You want a format that you can share as needed to help family members, team members and/or investors understand what to expect from your business in the coming year.
- If you notice a major error in your thinking during the year, do not be afraid to re-estimate your current budget.
- Track your performance of what actually happened in both money coming in and money going out of your business. Compare this with what you budgeted each month. You can change next year's budget format to be more closely aligned with the actual numbers, if needed. It is best to stay aware of what is happening in your business so you can be more accurate when estimating.

Tell Me More

The main reason for creating a budget is to track the performance of your business and ensure you can easily compare your budget with your actual spending. To develop a process for building and reviewing your budget, the following areas should be included to help you build your own budget template for your first year. As your business grows, you may choose to add, remove, or alter any of the areas. Review each area every year to ensure your budget remains a tool that helps you understand and plan your business.

Align your budget with your financial statements so they are comparable. When comparing your budget versus actuals, show enough detail so you can see where you may need to look at making changes. You can build your budget on paper, in spreadsheets such as Microsoft Excel, or perhaps within an accounting system (if it has this ability). The advantages and disadvantages of each method are:

- **Paper:** Very simple to create, but difficult to protect, share and maintain. Paper makes performance measurement very time consuming, which can decrease the likelihood that you do it.
- **Electronic Spreadsheets:** Very flexible, lets you decide exactly what categories to include and how you set things up. Spreadsheets can be challenging if you do not have experience in them. There is also the possibility for errors in calculations since you create them yourself.
- **Online Accounting System:** Not all systems offer this capability, but if they do, it can be useful to have a budget format and calculations set up. The disadvantage is that you have no flexibility in setting it up and most ac-

counting systems will use your chart of accounts as a basis for budgeting. This means that you will have to create your assumptions and examine your activities outside of your "official" budget. This may decrease the likelihood that you actually use it.

When creating a template on paper or in a spreadsheet such as Excel, include the following:

- Separate your assumptions from your actual numbers. Color-coding (displaying information by using different colors) the cells or highlighting the assumption data works well. You can also place your assumptions on a separate sheet.
- In Excel, to avoid errors copy and paste formulas instead of recreating or retyping them each time.
- Your template helps you understand how the numbers relate to each other. For example, you can include calculations on your average sales per customer or per unit, your gross margin as a percentage of sales, and other expenses as a percentage of sales.
- You can find several budgeting templates in the Tools section of the Dastyar website. A sample operating budget can be found here.

Building your template requires making assumption areas. Using paper, each set of assumptions can be separate pieces of paper. Using Excel, make multiple worksheets as described below. The included tools will help guide you.

- **Create your assumptions worksheet including:**

1. Your sales forecasts
2. Your categories of activities
3. A list of major purchases if you have not included them in your activity list (new equipment, improvements on your retail space, etc.)
4. You may also track your current and future employees and their salaries and benefits costs.

- **Create your "output" worksheet in a similar format to your financial statements:**

1. Calculate your sales forecast per month (units sold * sales price). Create a total for all sales (also called revenues) below the detail of your sales.
2. Based on your budget for units in each month, calculate your Variable Costs per month (units sold * variable cost per unit). To find your variable cost per unit, divide the sum of your variable costs by the number of units you produced. Use the same level of detail (individual products or product groups) as you did for your sales forecast.
3. Calculate your Gross Margin. (Sales – Variable Costs)
4. Calculate the fixed costs you have for each month (rent, utilities, salaries, etc.). If you have payments that occur infrequently, be sure to include them when they are due.
5. Calculate Net Profit. (Gross Margin – Fixed Costs)

After you have created the data for your budget, you should create a written explanation of your business and your assumptions with each "official" version so you know that you can explain your thinking (and what you expected to happen) when you created it. Write down the following:

- Your business goals (quarterly and annual)
- Your assumptions about sales
- Your assumptions about variable expenses (gross margin)
- Your assumptions about fixed costs

	Assumptions	January
Changes to Working Capital		
Increase in what customers owe Sahar (cash out)	Five equipment sales on credit	(25,000)
Decrease in what customers owe Sahar (cash in)	Last month's sales of 3 pieces of equipment	15,000
Increase in what Sahar borrowed from vendors (cash in)	This month's purchases of 7 pieces	52,500
Decrease in what Sahar borrowed from vendors (cash out)	Last month's purchases of 3 pieces	(22,500)
Total Changes to Working Capital		**20,000**

- At what point will you be profitable or break-even point
- Anticipated cash needs

For example, Nadia predicts an increase of customers for her beauty salon in the 2nd and 3rd quarters of next year because that is the wedding season. This information should be written down and kept to justify her assumption of the increased customers in quarters 2 and 3.

Here is how Nadia's sales estimates and assumptions look:
Once you have built your template, be sure to protect it by always making a copy to work with. Overwriting your template can create lots of extra work for you, so you want to protect it as much as possible.

Not only is it critical to protect your template, it's also essential to clearly mark and protect each of your official budgets. One of the easiest ways to do this is by using naming conventions such as "Budget 2017 Working Copy" or "Budget 2017 FINAL version" to identify each version. It's not critical to keep all of your working copies once you have set your budget for the year, as long as you have both the data file and your written assumptions file. If you are using electronic files, it's best to create a separate folder for each official budget you create, so that you can go back to them if needed.

The Tools section of the Dastyar website has several budgeting templates that you can use to create your own budget, It also has a sample budget so that you can see how this process works with an example.

Glossary Terms from this Section

Break-Even Point - The point where your revenues surpass your costs and you begin to make a profit. It's also the point where any new price or new volume generates the same level of profit as was achieved at the original price or original volume.

Financial Statements - Formal records of the financial activities of a business that includes a balance sheet, income statement, and cash flow statement.

Fixed Costs - Money spent that does not change depending on the number of products you sell.

Margin - The difference between the price you sell something for and the cost of that item.

Profit - The amount that you make after you subtract your costs.

Variable Costs - Money spent to make and sell your products and goes up together with each product sold.

For More Information Related to this Topic See

- What is a budget and how do I use one? *10. Budgeting*
- How do I create a budget? *10. Budgeting*
- For how long should I create a budget? *10. Budgeting*
- Do I have to create my budget myself? *10. Budgeting*
- What are financial statements and why do I need to use them? *12. Financial Management*

Additional Tools Available

Cash Flow Budget Worksheet

Operating Budget Worksheet

6.
How do I estimate what my sales will be in a year?

The Basics

Thriving businesses need revenues, so estimating (also called forecasting) what your sales will be in the coming year is a critical element of your budget.

But setting uninformed (and likely unachievable) sales goals will not help your business, and it will not help you understand what is working and what is not working. Aside from asking for money from friends and family, to grow your business, you will likely be speaking to lenders or other types of investors who will require you to justify your sales goals. To achieve sales growth, you need to set your goals, but also ensure that you have got a realistic plan for achieving them.

In order to accurately forecast your sales, you will also need to understand as much as possible about your existing customers by looking at how much each customer buys, which types of products they buy, and how often they purchase. For example, Najiba and her brother have a grocery shop in a residential area and while making the sales estimates for the next year, they consider their current average number of customers each day and their purchase patterns, such as what items are being purchased the most. They have 35 customers each day and the best-selling items are sugar, oil, sweets, and milk. They then use this information in their sales forecast for next year. Include your assumptions in your future forecasts and test whether or not your estimates are reasonable and what your sales might look like if they are better or worse than you expected.

Forecasting your future sales includes three steps:

1. Set monthly sales targets to determine your expected annual sales.
2. Compare how your annual sales amount fits into your own goals.
3. Confirm that you can achieve those monthly sales by thinking through various scenarios to test whether or not your estimate is reasonable.

Tell Me More

The goal of setting your monthly targets first is to help you think through exactly what you will have to do to achieve it each month, so that you can decide if your plan is reasonable. Expecting to double sales from one month to the next is unrealistic, so looking at each month's growth can help your forecast be more accurate.

As you are developing your monthly sales targets, you want to be able to change your assumptions easily. The easiest way to do that is by identifying areas of your sales you want to track, and set up your sales budget accordingly. The goal of having a budget is to enable you to set goals and measure your performance.

Track the area of sales that make the most sense for your business by analyzing your existing customer data. You need to understand when your customers buy, what they buy, and how much (on average) they buy from you. Calculating the number of customers, average spent per customer per month (or year), as well as the frequency of purchases (how many times per month, quarter or year) by the same customer are important first steps for creating your sales budget.

Using what you already know helps you develop reasonable goals, and easily measure your improvement over time. For example, if you run a retail store, and your average sale per customer is 2,500 AFN and customers usually buy once per month, you will also want to track how often a customer buys from you to see if you can increase the number of purchases. If you sell physical products, you may track the number of units of each

product type that you sell and your sales price, as well as the frequency of customer purchases. Set up your sales budget so that you can use the areas of sales tracked to make assumptions.
Once you have the framework of your budget, enter the data for each month's sales and look at your annual totals. This will help you get perspective on how reasonable your budget is, and whether you are confident in your ability to achieve it.

After confirming your sales projections are reasonable, ensure that you can deliver all of those products or services. Think through your current sales, production and delivery process, to ensure that you can scale your business as planned. Imagine you had twice as many customers – could you provide them with what they purchased in the same manner as you do today? Would you need additional sales people, cashiers, or perhaps a bigger storefront? Could you obtain enough raw materials, and produce a higher quantity of goods to meet demand? And could you deliver your solution to customers in the same way (and at the same price) as you do today? It's essential to think through your sales budgeting process, as it does no good to sell something you cannot deliver to your customers. Najiba and her brother are well aware of their capital needs to increase their sales. They experienced a shortage of grocery items just before Eid last season, but they have learned the lesson and now plan their budget accordingly.

Glossary Terms from this Section

Revenue - Money coming into the business usually from the sale of goods or services.

For More Information Related to this Topic See

- What is revenue and how do I know mine? *12. Financial Management*
- How do I estimate what things will cost in the future? *10. Budgeting*
- What happens if I go over my budget or my budget was wrong? *10. Budgeting*
- How do I account for borrowings (accounts payable) or accounts receivable in my budget? *10. Budgeting*
- How do I create a sales strategy? *7. Sales and Customer Service*
- How do I track my sales and what can I learn from tracking sales? *7. Sales and Customer Service*

Additional Tools Available

Revenue Projection Worksheet

7.
How do I estimate what things will cost in the future?

The Basics

The goal of every business is to make enough money to earn a profit. Profit is when the money coming into your business is greater than the money being spent by your business. To understand if you will make a profit in the future, you need to estimate (also called forecast) what it will cost to run your business and how will your sales grow. Understanding what it costs to run your business gives you options if your costs start increasing in a particular area of your business. For example, running a business in rural areas such as the districts of Kandahar, Helmand or Badakhshan may have higher costs because proper infrastructure such as electricity, roads, and water are more lacking there. If a business plans to expand into these regions, it should consider the incremental costs of working with poor quality infrastructure.

Some costs seem to stay relatively the same but everything is subject to a general rise in prices known as inflation. Depending on the economic situation in your region, you may see a high inflation (rapidly rising prices) which may be difficult to pass on directly to your customers.

To best estimate the future costs of your business, you must understand and learn from your past and current cost. Variable costs (such as raw material used for production, wages, etc.) change depending on the number of products or services you sell while fixed costs (such as rent, machinery, etc.) stay the same no matter the amount sold. These costs are easier to predict for the future. A key aspect of estimating what things will cost in the future is by analyzing the current and past market prices to identify trends in what things will cost. Some costs such as labor tend to rise while other costs such as technology tend to decrease over time.

Tell Me More

Estimating your costs for the future is important to knowing how much you must sell to make a profit during the year. Knowing where you spend your money and how much is helpful in identifying and estimating what your costs will be in the future. There are two types of costs, variable costs and fixed costs.

Variable costs relate directly to the number of products or service you sell. If you sell 100 products one week, your costs will be higher than if you sold 50 products. Variable costs include raw materials, shipping costs (to get the raw materials to your production facility), and labor (if your workers are paid for each unit produced). To estimate your future variable costs, you can look back at what your costs were in the past and if you plan to produce and sell the same amount of products as before, you can use the past data to estimate your future variable costs. Be sure to take into account that inflation (general increase in prices) and the market costs of raw materials or finished goods may also rise and fall in the future which can impact your costs. Research how fast costs have been rising in the past to help you estimate what they may be in the future.

Fixed costs remain constant regardless of how many units you sell. Examples of fixed costs are rent, utilities, insurance, taxes, and employee salaries. These costs are the same whether you sell 100 products this month, or 50. The best way to estimate these costs is to simply look at what you have paid for in the past and usually only change slightly due to inflation. These future costs can be impacted by negotiating lower costs from your suppliers, or finding other ways to cut your costs.

For instance, Nooria has a tailoring company with 22 tailors, producing 100 Gand Afghani (Embroidery) per quarter. She predicts a 20% increase in the first six months of next year and needs to estimate her costs as well. Her fixed costs such as rent of the building and staff salary remain the same, while the variable costs of fabric and accessories used for making the clothes will increase for the same period.

Cost of Products (Cost of Sales)	This Year	Next Year
Embroidery	100,000	120,000
TOTAL REVENUES	**100,000**	**120,000**
Variable Costs		
Fabric	20,000	24,000
Thread	5000	6000
Accessories	7,500	9000
Total Variable Costs	**32,500**	**39,000**
Fixed Costs		
Rent (store + storage)	30,000	3,0000
Utilities	15,000	15,000
Shop Employees (1 cashier + 1 inventory manager)	5,000	500
Total Fixed Costs	**50,000**	**50,000**
Net profit/Loss	**(17,500)**	**(31,000)**

An important category in estimating your future costs is how much you plan to spend on getting and retaining customers. This is typically done by marketing and advertisement but can also be any activity that costs money related to getting customers. Costs for networking, business development activities, and traveling for business should also be considered. To estimate these costs, look back at what they cost you in the past and evaluate how effective those methods were. Based on your sales goals for the future, you can apply those costs and any other assumptions to what it may cost for those activities in the future. For each activity, estimate how much investment (time and money) will be needed, and what results that activity will achieve for you (how many prospects, customers, units sold, etc.).

Once you have estimates in each area, test your level of confidence. If you are not confident in your expense estimates, you can also add a "contingency" line item to your budget that is a percentage of some or all of your costs into your budget. This helps you see what would happen if prices were more or less than expected without the need to re-forecast every line item. If you are having trouble estimating which way prices will go, include a best and worst case scenario for your costs.

Estimating your future costs is not always easy and requires knowing your business; how much money will come in and how much money is going out. With practice and dedicated time to the process, you can more accurately budget your costs and better understand the amount of profit of your business.

Glossary Terms from this Section

Expense - Money paid out of the business to pay for an item or service.

Fixed Costs - Money spent that does not change depending on the number of products you sell.

Inflation - The general increase in prices and fall in the purchasing value of money.

Profit - The amount that you make after you subtract your costs.

Variable Costs - Money spent to make and sell your products and goes up together with each product sold.

For More Information Related to this Topic See

- What is the difference between operating costs and capital investment? *12. Financial Management*
- What are fixed and variable costs? *12. Financial Management*
- How can I manage my costs and expenses? *12. Financial Management*
- How do I estimate what my sales will be in a year? *10. Budgeting*
- What happens if I go over my budget or my budget was wrong? *10. Budgeting*
- How do I account for borrowings (accounts payable) or accounts receivable in my budget? *10. Budgeting*

Additional Tools Available

Costs Projection Worksheet

8.
Where do I show big purchases (raw materials in bulk, equipment) in my budget?

The Basics

Major purchases such as bulk raw materials, equipment, vehicles, and buildings are accounted for in your cash budget. When investing a large amount into your business, the timing of the purchase can have a significant impact on the amount of cash you have and can affect your ability to stay in business.

Accounting for large purchases in your cash budget is important to show as the difference between the money that you are owed (accounts receivable) and the money that you owe (accounts payable) as well as any timing differences between when you pay your bills and when your customers pay you. Factors like this may leave you with little or no cash to pay your bills.

When you are planning your big purchases, include these deposits / partial payments in your budget to ensure that you have enough cash available at the time that these payments are due.

Tell Me More

Many vendors of equipment (or large quantities of raw materials, etc.) will require a deposit at the time of your order and perhaps additional payments before the delivery – especially in the case of custom-built equipment. When you are planning your purchase, include these deposits / partial payments in your budget to ensure that you have enough cash available at the time that these payments are due.

As you are planning your cash, if you see that you do not have enough cash saved to make the required payments, here are a few options for finding the cash you need:

- One option is to negotiate some type of financing for the large purchase, whether directly with the vendor, or with a third party such as a bank or micro-lender. In both cases, it is essential that you include the loan you will obtain for the major purchase in your cash budget, since the repayments will be an additional drain on your cash.

- If you are unable or choose not to finance your purchase, it may make sense for you to set aside some of the needed cash before the month of your purchase to ensure that you can acquire the needed materials or equipment. You can include this "savings" account on your cash flow budget as an investment, so that you can set yourself monthly goals and measure your performance against that goal before you place a large order for your purchase.

When thinking about major purchases and cash, it is essential to have a plan that will get you from the date of your order to being able to use the purchase as quickly as possible. This means knowing how much cash you will need and having a plan to ensure the cash for major purchases is available to you when needed.

Working capital is a general term that covers the difference between the money that you are owed (accounts receivable) and the money that you owe to others (accounts payable) as well as any timing differences between when you pay your bills and when your customers pay you. Inventory can also play an important role in your working capital if you produce your own products.

Customer collections have a big impact on your cash, so it's essential to have a method in place for making sure you invoice customers as soon as their purchase has been delivered, and getting paid as soon as your customer invoices come due.

Holding significant inventory amounts of raw materials, semi-finished or finished goods can also create a huge cash need – especially if you have already paid for those goods, so that they are no longer counted in what you owe (your accounts payable). It is critical to understand the real value of your inventory, and to manage your inventory in a way that converts inventory into cash as quickly as possible. Rather than keeping your inventory for a long period with the hope of selling at a high price, it may be worth trying to sell your inventory at a lower price and avoid the cost of storing your inventory.

For example, Mezhgan and her two sisters produce fruit concentrate and packaged juice through processing seasonal fresh fruits in Mazar-e-Sharif. They usually have to purchase large amounts of fresh fruit from farmers and process the fruit at their facility. While they do not keep the fresh fruit in their inventory for long so as not to perish, Mezhgan usually stocks packed juice for long periods. Last year, she did an analysis and realized the cost of storing the juice was adding to her costs per item by around 9%. She decided to distribute the juice as quickly as possible with a slight reduction in price to avoid the additional storage costs. Instead, she focused on keeping the juice concentrate in stock for longer as its buyers were willing to pay higher prices for the quality concentrate.

Investments mean any asset that you expect to have a life of more than one year. This can be an asset that you purchase, such as production equipment, in which case your budget will show an outflow of cash (either in one payment or multiple payments, depending on your agreement with the vendors of your equipment).

When making a major purchase, such as a vehicle, buildings or production equipment, you may be required to make several payments before you can even begin using that equipment to improve your profit margin. It's essential to understand not only the total cost of your purchase, but the payment schedule that you will have to use. Include each payment in the appropriate month of your cash budget to be certain you have that amount of cash available at the right time.

With an investment that generates cash for you, such as a loan you have made to someone else, or the sale of your existing equipment, forecast the payments that you will receive in each month. For example, when selling an old vehicle, will you receive that money all at once, or will the buyer make payments over time? The impact on your cash situation is very different depending on the answer, so you need to be as detailed as possible in your forecast.

Glossary Terms from this Section

Invoices - A list of thing or services provided and the amount of money to be paid.

Profit Margin - The amount you make after you take your total amount of money in sales and subtract your total costs.

Vendors - People or organizations that provide products or services used to operate a business.

For More Information Related to this Topic See

- How can I manage my costs and expenses? *12. Financial Management*
- How do I plan for spending money for my business? *12. Financial Management*
- How do I know how much cash I will need in the future and make sure I pay my costs? 10. *Budgeting*
- What happens if I go over my budget or my budget was wrong? *10. Budgeting*
- How do I account for borrowings (accounts payable) or accounts receivable in my budget? *10. Budgeting*

Additional Tools Available

Cash Flow Budget Worksheet

9.
What happens if I go over my budget or my budget was wrong?

The Basics

Missing your budget will not cause your business to fail but you want to try your best to understand why you went over or under what you budgeted and take action to keep it from happening again. The past cannot be changed but you can learn from what happened and make better decisions moving forward.

Do not panic because you missed your budget but instead focus on finding out why you missed your budget. Make sure you gather all the data needed to analyze why and what caused the unexpected difference in your budget so you can make plans to correct it. For example, Nadia considered a 20% increase in sales of Grand Afghani (embroidery) during quarter 2 and 3 of the year. In quarter 2 she notices that the increase did not happened and led to her missing her budget for the whole year. Rather than panicking, she needs to find out what had changed and why that made her miss her budget. Is it the style of the clothes she makes? Or a different trend of clothes has come to the market that she is not aware of? Could it be marketing problem? Or perhaps her partner changed the plans without letting her know. She needs to find out the underlying reasons and next time plan her budget more accurately to take these reasons into consideration.

Often three reasons are the cause of missed budgets:

- There was not a clear written agreement of what was supposed to happen and how much it would cost.
- The agreement was not respected in some way. (For example, you did not send the invoice or your customer did not pay.)
- Something that was not planned happened, or someone besides yourself made a decision without understanding the significance.

Once you identify where the wrong assumption was made, or how your actual spending differed from your budget, revise your budget appropriately with your more accurate assumptions. Take action quickly and be sure to review your budget frequently (at least monthly) to find and correct any further variations. Your budget will never be perfect but you always want to continually improve and become more accurate in estimations.

In Nadia's case, she reviewed her sales for the second quarter and discovered that she had planned for high sales of clothing that was lighter weight for spring. But this year the winter was unusually cold and long so no one was buying the spring clothing that she had manufactured large quantities of. By understanding this, Nadia was able to adjust her third quarter advertising budget to promote the light weight clothing once the weather grew warmer. The advertising helped her grow her third quarter sales enough to make up for what she lost in the second quarter.

Tell Me More

Do not let missing your target budget disrupt your progress. Gather the data needed to understand where your budget and actual costs varied. Focus on the biggest discrepancies on each area of your budget. Missing your target in one area by a small amount is less important than missing your budget by a much larger amount in another area. For example, maybe you spent just a little bit more on advertising this month than expected but you also thought you would have sold many more products. The key area to focus on is why you did not sell as many products as you had thought. Did you under or over estimate how much you thought you would sell this month? Was the advertising not effective? As you learn more about your business, you can adjust these figures to ensure that you are focusing your time and attention on the right things when you evaluate your performance.

Be sure to focus on the details of each area to understand what happened and ask "why?" There are many possible sources of a problem, and you may not find an explanation that provides all of the answer, but you need to identify something that you can do to improve. If you cannot understand what happened and why there was a difference, get the help of others to assist you such as an accountant, mentor, or other business owner.

Develop a fix to the issue and take action. Once you have identified what is not working, change your assumption or design an experiment that you think will improve the situation. This could be as simple as increasing your sales price, or as complex as revising your production process. Each of those may take a very different level of time, energy, and financial investment to make happen but will help your business in the future.

Decide what progress would look like for you in the coming month, document it and communicate it to your team. Make sure that your definition of progress is something that can be measured (like reduced waste in the production process, lower utility usage or higher sales prices).

If you discover that something major has changed (or was missed in your original budget), reforecast for the remainder of the year and not just the month. Determine if you will need additional funding or other changes to cover the difference missed in your budget. The key is to quickly find where and why you missed your budget and implement a change that fixes the issue.

Glossary Terms from this Section

Advertising - Communication used to convince your target audience to buy a product or service.

Invoices - A list of thing or services provided and the amount of money to be paid.

For More Information Related to this Topic See

- What is break even and why do I need to know? *12. Financial Management*
- How do I know how much cash I will need in the future and make sure I pay my costs? *10. Budgeting*
- How do I estimate what my sales will be in a year? *10. Budgeting*
- How do I estimate what things will cost in the future? *10. Budgeting*
- What do I do if my budget says I will not be profitable? *10. Budgeting*

Additional Tools Available

Monthly Budget Review Worksheet

10.

Why don’t I have enough cash in the bank? My budget said I should be making money.

The Basics

Your budget is only an estimate. What matters is what you actually did (as shown in your financial statements). Not having enough cash is a big problem for your business. Identify and resolve this problem right away. Do not ignore it and hope it will go away.

Pay attention to your cash balance at the same time that you review your monthly financials. Even if you are close to your planned profit / loss number, you also want to verify that your cash balance is close to what you expected. If your cash balance is not close, analyze your income statement to find out how they differ and why it has occurred. Make sure you gather all the data needed to analyze why and what caused the unexpected difference in your budget so you can make plans to correct it.

Some common reasons for having less cash than you thought are that you did not sell enough or spent too much money on running your business. Or perhaps you did not get a loan you expected or payments to lenders were different than you had originally thought. Other reasons could be that you are not getting paid on time by your customers, you bought equipment not planned for or cost more than expected. For example, when you run a retail store, you may not sell enough to be able to pay to your suppliers. Or you might pay your suppliers too quickly and extend too much credit to your buyers. To help ensure you have the cash needed at the right time, be sure to make an agreement with your suppliers to pay them over a longer period of time and collect money from your customers as quickly as possible.

Tell Me More

Lower profits are not the only thing that can drain your bank account. Anytime you see that your cash balance is very different from what you estimated, be sure to find out why right away. Gather enough data to identify your problem, find out why, and then take the appropriate action.

If you have less cash than you expected, it is often due to one of these reasons:

- You did not sell enough OR spent too much money on running your business.
- You are not getting paid on time by your customers or you are paying your vendors early.
- You bought equipment or other long-term assets that you did not plan for, that cost more than you thought, or you did not sell equipment or other long-term assets for as much as you had planned.
- You did not get the loan/investment you expected or your payments to lenders/investors are different than you thought.
- There was something that happened out of the normal, or that you have no control over, such as an explosion near your office that caused damages, or costs occurred that you had not budgeted for.

If you have issues with your customers paying you, contact those customers and remind them of their obligation and arrange payment. You can change your contracts to include a deposit for first-time customers, or periodic payments during a project instead of at completion.

Negotiate better terms with your suppliers. Consider ways that work better for you with your large vendors, such as monthly billing (instead of individual invoices), early payment discounts or bulk purchasing. For example, in a retail store, it is a good idea to negotiate to pay your suppliers at the end of each month, as opposed to the end of each week which is common in Afghanistan.

If you have issues with your investments, it's critical to communicate the problem to your vendor (if you are purchasing equipment) or your buyer (if you are selling equipment). Do not hope that things get better on their own – get the problem you have identified out in the open and work with the other party to find a solution.

If your cash issues are related to funding, it's also critical to communicate the problem right away. If a lender or an investor has not made the required payment, inform them right away in writing. Politely but firmly request that they fulfill their obligations and ask them to confirm when you will receive your funds.

Likewise, if you are unable to make a required payment to someone you owe money to, reach out to that person or organization in writing and let them know what is happening. Use the information you discovered to help them understand why the cash shortfall has happened, and what you are doing to correct it. Show them a plan for getting back on track with your payments, and you increase your chances of preserving a good relationship.

Glossary Terms from this Section

Assets - Anything of value that your business owns.

Financial Statements - Formal records of the financial activities of a business that includes a balance sheet, income statement, and cash flow statement.

Income Statement - A financial document showing the difference in revenue (income) and expenses.

Invoices - A list of thing or services provided and the amount of money to be paid.

Profit - The amount that you make after you subtract your costs.

Vendors - People or organizations that provide products or services used to operate a business.

For More Information Related to this Topic See

- What are financial statements and why do I need to use them? 12. *Financial Management*
- How is my budget different from my financial statements? *10. Budgeting*
- How do I know how much cash I will need in the future and make sure I pay my costs? *10. Budgeting*
- How do I estimate what my sales will be in a year? *10. Budgeting*
- How do I estimate what things will cost in the future? *10. Budgeting*
- What do I do if my budget says I need cash? *10. Budgeting*

11.
For how long should I create a budget

The Basics

Your budget helps to guide and measure your business, which means that you need more detail in the short term, but not as much later on.

Since the budgeting process is detailed and requires you to think about your business in a different way, it's not efficient to create budgets more often than once a year. Most reporting requirements happen based on a year-long period (usually a calendar year). It is recommended to create a detailed budget plan for the coming year.

It's important to have a good idea of what your business will look like in future years, especially if you are not gaining a profit, or you want to obtain additional funding. Lenders and investors want to see that you have thought through a longer period of time before giving you their money. You should want the same assurances if you are investing your own, or your family's money.

Tell Me More

Most businesses have a detailed monthly budget for the coming year, with a higher-level plan for the next 2 to 4 years. These two plans do not need to be separate but can be part of the same process and even part of the same spreadsheet or paper document. Simply add additional columns to your worksheet which allows you to project future months with ease.

The future is unpredictable so there is never a right answer but a few other issues may influence how long you need to look into the future:

- What are your reporting requirements? Do you need to report annually (or more often) for taxes, business licenses, or other industry standards? If you need to report on a specific period (quarterly, semi-annually, etc.) be sure to include that level of detail in your budget.
- How long do you want to own your business? Are you planning to sell it within a few years, or do you want to keep it a few decades? The closer you are to selling, the more information you will want about the value of your business. This means you will want more detailed predictions to show what your business will look like at the time of sale.
- Are you considering putting more money into your business? If so, you will want to see when you can recover that money, so you will want to be sure to build a budget that allows you to see at least three years into the future.

To create a longer-term budget, develop your detailed 12 month budget. Then, simply add columns for the future periods – either projecting by month (easiest if you are using spreadsheet software such as excel), or quarterly / semi-annually if you are using paper.

The budget is a tool for you to understand and plan your business not only for the coming year, but also for the longer term. Perfection is not the goal. The key is having a tool you will use and that provides you with information you can use to make informed decisions.

Glossary Terms from this Section

Investors - An individual or company who gives money with the expectation of financial return.

Profit - The amount that you make after you subtract your costs.

For More Information Related to this Topic See

- What is a budget and how do I use one? *10. Budgeting*
- How do I create a budget? *10. Budgeting*
- Do I have to create my budget myself? *10. Budgeting*

12.
What do I do if my budget says I will not be profitable?

The Basics

Becoming profitable as a new business can take time and does not often happen right away. The goal of a business is to make money, so you need to be confident that your business will become profitable relatively quickly. Not making a profit means that you must invest money into your business to pay for expenses until you start making money. The longer it takes, the more you will have to invest so getting profitable is priority. The budget for a financial year can be unprofitable, but make sure the Business Plan, which is usually made for a longer period, clearly indicates your business becoming profitable in the foreseeable future.

New businesses often take between 18-24 months to start making a profit. If your long-term budget does not show you becoming profitable within that time period, you may need to rethink your business model. If your budget indicates you will not be profitable, consider these key points:

- Review your assumptions to see if they need to be refined. Are your estimates too conservative or too aggressive?
- Determine why you are not profitable in this budget year. Do you have too few customers? Are you selling at a price that is more than it costs to make your product? Are you hiring too quickly and have high labor costs? Decide if shifting your priorities would help you become profitable sooner.
- Make sure you can commit what is needed. Do you believe in this business enough to continue to invest your time, energy and money while it becomes profitable?

Tell Me More

Finding out that you will not be profitable can be upsetting, especially if you have already been in business for a while. Do not get discouraged but take the time needed to understand what your budget is telling you about your business.

A budget is only as good as its assumptions. Before drawing any conclusions, take a look at your assumptions and see how realistic they are. One way to do this is to take your existing budget and create an aggressive example and a disaster example of different scenarios. Review if either of these two scenarios gives you any ideas for getting closer to becoming profitable. In her business, Hosna had predicted that last year she would sell 250 computers. Near the end of the year she realized she was not even close to her goal. She had only sold 50 items and only two months remained until the end of the year. She was very upset, but realized she was over optimistic about her expectation of sales. She did not make a profit last year, but for the next year she reduced her fixed costs drastically and focused on increasing sales through promotions and advertisement. She adjusted her assumptions of her sales and expenses. She reached the break-even point of selling just enough computers to cover her costs within the next six months. Since making those changes, she has now begun to make a profit.

Here is what Hosna's budgeted and actual sales looked like for last year and this year:

		Last Year			This Year	
Revenues	**Assumptions**	**Budget**	**Actual**	**Assumptions**	**Budget**	**Actual**
Computers (Sell for 500 AF)	will sell 250	125000	25000	budgeted sales of 250, actual sales of 325	125000	162500
Total Revenues		**125000**	**25000**		**125000**	**162500**
Cost of Goods Sold / Cost of Sales						
Computers (Cost 200 AF)		50000	50000		50000	65000
Total Cost of Goods Sold / Total Cost of Sales		**50000**	**50000**		**50000**	**65000**
Sales & Marketing Costs						
Promotions		1000	500		4000	4000
Advertising		2000	1000		7500	7500
Total Sales & Marketing Costs		**3000**	**1500**		**11500**	**11500**
Administrative Costs						
Rent (store + storage)		3000	3000		3000	3000
Utilities		1500	1500		1500	1500
Shop employees		7500	7500		7500	7500
Total Administrative Costs		**12000**	**12000**		**12000**	**12000**
NET PROFIT / LOSS		**60000.00**	**-38500.00**		**51500.00**	**74000.00**

Explore ways that you could modify what you are already doing (or planning to do) to get better results. If it takes you 6 weeks to get a new customer now, think about what you would need to do in order to shorten that time period. Is it possible to get more business from your existing customers? Or if you raised your prices by 10%? It may take some creativity and rethinking to approach aspects of your business in a different way. Are you too conservative on sales? Could you sell more units or raise prices? Are you too conservative on costs? Do things really cost that much or could you negotiate a better price? Are you hiring too early? Not delegating enough responsibility to your employees? Hiring people without the skills you need?

The key is to think about what's possible for you and your business, not to create more work. Set aside some time to brainstorming what changes you can make to your business. Once you are confident that you have got good assumptions, and that you are doing everything you can to improve your processes, you need to ask yourself whether this business model can ever become profitable.

Customers need to pay more for your product or service than it costs you to deliver it, for your business to make a profit. Find a way to either have people pay more or provide the same product or service at a lower cost.

If you determine that your business model cannot achieve profitability, it's better to stop investing time, money, and energy into that model right away.

If you believe that you can achieve profitability with the way you are currently doing business, but it will not happen in the coming year, you will need to be very clear about the total investment (money and time) that you can afford to make in this business. Set yourself clear goals to show that you are approaching profitability, and be sure you are always moving in the right direction. For example, Halima's bakery initially offered a few types of coffee and cookies. It had high fixed costs. She realized that her bakery would not be profitable with just coffee and cookies so she added variety of cakes, tea, snacks, and juices to the menu. She researched and realized she could add a number of complimentary products to the menu without increasing her fixed costs. Halima had to adjust the way she does business to become more profitable. By doing so, the fixed cost remains the same, while a small variable cost of additional products increased its sales. Compared to the budget she had developed for the year, her bakery became much more profitable. She adjusted her budget numbers and assumptions accordingly in the future.

Glossary Terms from this Section

Advertising - Communication used to convince your target audience to buy a product or service.

Break-Even Point - The point where your revenues surpass your costs and you begin to make a profit. It's also the point where any new price or new volume generates the same level of profit as was achieved at the original price or original volume.

Fixed Costs - Money spent that does not change depending on the number of products you sell.

Profit - The amount that you make after you subtract your costs.

Promotion - A short term action designed to change a consumer's purchasing behavior, such as a sale or discount coupon.

Variable Costs - Money spent to make and sell your products and goes up together with each product sold.

For More Information Related to this Topic See

- What is profit and how do I determine mine? *12. Financial Management*
- What is break even and why do I need to know? *12. Financial Management*
- How do I know how much cash I will need in the future and make sure I pay my costs? *10. Budgeting*
- How do I estimate what my sales will be in a year? *10. Budgeting*
- What happens if I go over my budget or my budget was wrong? *10. Budgeting*
- What do I do if my budget says I need cash? *10. Budgeting*

13.
What do I do if my budget says I need cash?

The Basics

As a business owner, your goal is to build a profitable business but having profits does not always mean you have cash in the bank. It is possible to be profitable, but not have enough cash to pay your expenses. Having both an operating and a cash budget is important in planning for your business to make sure your business is profitable and has enough cash.

As your business grows and becomes profitable at some point in the future, you need to know how much cash you will need to keep your business going until that time comes. To answer this, you will need to understand:

- Exactly how much cash you will need until you become profitable?
- What you will use that cash for?
- Where is the source of cash that will keep your business running until it can support itself?

Once you know your business needs cash, how much you need, and how it will be used, do not ignore the issue or wait too long. Develop a plan and be proactive about finding the funding you need to help your business survive.

Tell Me More

Realizing you need more cash to pay your expenses is a good first step. Next you need to understand how much cash you need and when do you need it. It's best to be as clear and specific as possible. Often business owners approach investors or lenders without knowing exactly how much and when they need the money.

Fauzia and her husband run a dried fruit business in Kandahar. They are often short on cash and struggle to pay for their expense. One day, her husband suggested they borrow 50,000 AFN for a year and all their cash constraints would be resolved. Fauzia and her husband visited the local bank. After review of their application and financial statements, the lender offered only 25,000 AFN as an overdraft loan. This is where they could borrow the amount of money as needed up to a certain amount (25,000 AFN) instead of a large fixed amount they may not fully use. The lender's suggestion was based on a number of factors:

- Their business needed just enough to pay suppliers in months of where they had low sales.
- There was high demand of dried fruits for special occasions such as the Eid holidays. The loan would allow Fauzia and her husband to pay interest only when they used the loan (as opposed to keeping the full amount of the bank loan in their account even when they did not need it).
- Fauzia and her husband had done a random estimation of the amount they thought they needed to borrow. The banker calculated the business needed no more than 25,000 AFN to keep the business running. The remaining 25,000 AFN would be extra money and may be an unnecessary expense they would need to pay interest on.

It is important to accurately estimate how much cash you will need in the future, when you will need it, and how exactly it will be used.

If a family member approached you asking to borrow money but did not know how much, when they needed it, or when they could pay it back, you might be hesitant to lend them any money. But if they came to you with a clear plan and knew they needed to borrow 5,000 this month and another 5,000 in 6 months, and start paying you back in 3 months after that, you may feel more confident to lend them the money.

To understand how much cash you need, examine your cash budget. Add up each month where your cash flow is negative. This will be the total amount of cash you will need. You may not need all of that cash right away. Examine which months you will need the most cash so you can plan to raise that amount when needed.

Secondly, understand for what and where you will use the cash. The following are typical areas the cash could be used:

- **Working capital** – this means that you need cash to cover the costs of holding inventory or to cover the differences between your accounts receivable and your accounts payable. This type of need for cash is usually ongoing in a business, and can be a large amount in companies that produce their own goods or hold large inventories.

- **Capital investment** – this means you need cash to purchase equipment or cover other large investments in your business (machinery, etc.). This type of cash need is punctual, and should easily show that the investment of money will bring major benefits to the company in the future. For example, purchasing an automated packing machine makes sense only if it can pack goods more quickly, with less breakage, in a more professional way that current packing methods do not.

- **Customer acquisition or product development** – this means that you need cash to market or sell your business, or to develop new products. This type of cash need should be at a specific time. Some ongoing marketing needs are always to be expected but once you have achieved a solid customer base, your sales price should be high enough to allow your ongoing marketing expenses to be covered.

- **Debt repayment** – this means you need cash to repay existing debt. This type of cash need can be a warning, since it indicates that you are already unable to meet your obligations. Again, if you have a solid customer base, you should be able to repay your debt from the revenues of your business.

Lastly, you can find another source of cash to cover the amount you are missing. If you discover that your biggest cash need is for working capital, consider modifying your customer payment terms (such as asking for deposits, or giving a discount for early payment to big customers). This could reduce your cash need by bringing in cash to your business sooner than you anticipated. You can also negotiate better terms with your vendors (allowing you to pay later, for example), or by bartering with certain vendors instead of paying them in cash.

If you discover that your biggest cash need is for capital investment, such as purchasing equipment, consider asking your equipment supplier for a loan. Banks and other lenders may be more attracted to financing equipment purchases because they can take a lien and have the option to repossess the property in the event you do not repay them.

If you discover that your biggest cash need is for costs to gain customers or product development, consider focusing on "soft" costs like marketing, sales, or product development. Be very clear about what those investments will do to help move your business forward. Look for ways to reduce your costs such as contracting labor instead of hiring full employees. These costs can be hard in finding funding as they are often difficult to connect directly to a desired result.

If you discover that your biggest cash need is for debt repayment, consider whether your business can support adding any debt going forward. Develop a clear plan for how to change your operations to allow you to repay any new debt borrowed to refinance your existing debt. Be sure to ask yourself why you currently cannot make these debt payments now. What is happening in your business that kept you from meeting those obligations, and how will you change so you can meet future obligations?

Another way to address your lack of cash is to better manage the cash you already have. This can include:

- Check frequently to ensure your sales are on track to match your expenses. Do not wait until you are already behind.
- Set aside an amount of money that you do not touch until you reach a certain milestone (a certain amount of customers, a certain number of sales revenue, etc.).
- Set aside a portion of your initial investment for emergency situations such as a time when cash is limited.

Glossary Terms from this Section

Accounts Payable - Money owed by a company to its creditors.

Accounts Receivable - Money expected from your customers.

Cash Flow - The total amount of money coming in and out of a business.

Debt - Money borrowed from one party by another. Often a loan from a bank.

Profit - The amount that you make after you subtract your costs.

Revenue - Money coming into the business usually from the sale of goods or services.

For More Information Related to this Topic See

- What is capital and why do I need it? *3. Access to Finance*
- What is profit and how do I determine mine? *12. Financial Management*
- How do I know how much cash I will need in the future and make sure I pay my costs? *10. Budgeting*
- How do I estimate what my sales will be in a year? *10. Budgeting*
- Why don't I have enough cash in the bank? My budget said I should be making money? *10. Budgeting*
- How do I account for borrowings (accounts payable) or accounts receivable in my budget? *10. Budgeting*

14.

How do I account for borrowings (accounts payable) or accounts receivable in my budget?

The Basics

Your budget is a tool for you to use in thinking about the future of your business. Your budget needs to be designed to fit the needs of your business and a tool that you will actually use. It is important to keep track of the money that you are owed (accounts receivable) and the money that you owe (accounts payable). Knowing the amount of cash owed to you and the amount of cash you owe to others is vital to making sure you have enough cash each month to run your business. For example, Sahar is an experienced trader of medical equipment in Afghanistan. She supplies equipment to many distributors and end users. She has to keep track of the medical equipment that she has given to a distributor who has agreed to pay in three months. She also needs to account for the money she owes to the suppliers of the equipment in China and Pakistan. Sahar will create invoices to send to her distributor for the equipment she has sent to them. Her suppliers also creates invoices that they send to Sahar for the equipment that she purchases on credit from them. Invoices are a list of things or services provided and the amount of money to be paid.

Invoices are an important tool to help keep track of money that is owed to you. They are used to record sales transactions and sent as a bill to the purchaser of your product or service. Invoices given to customers agree to pay you at a later time. Invoices can be received from suppliers or vendors for products or services that you need now but agree to pay at a later date.

Estimate how much money you are expecting to receive and pay out each month and keep the totals up to date. Every week, you should know what is due to you, what is due to others, and how much is still outstanding on both. Monitoring these two areas closely is one way to help ensure you have enough cash coming in and out of your business.

	Assumptions	January
Changes to Working Capital		
Increase in what customers owe Sahar (cash out)	Five equipment sales on credit	(25,000)
Decrease in what customers owe Sahar (cash in)	Last month's sales of 3 pieces of equipment	15,000
Increase in what Sahar borrowed from vendors (cash in)	This month's purchases of 7 pieces	52,500
Decrease in what Sahar borrowed from vendors (cash out)	Last month's purchases of 3 pieces	(22,500)
Total Changes to Working Capital		**20,000**

You can use the cash Flow Budget Worksheet in the Tools section of the Dastyar website to track your incoming and outgoing cash like Sahar does. You may also want to keep a list of the individual invoices you send out and receive.

Tell Me More

Customer collections have a big impact on your cash, so it’s essential to have a method in place for making sure you invoice customers as soon as their purchase has been delivered, and getting paid as soon as your customer invoices come due.

It is common to include more details in your budget for significant amounts of money that you are owed by your customers and money that you owe your vendors or expenses. Be sure to have a system in place to track what you owe and what is owed to you. Invoices can be used to record sales transactions and sent as a bill to the purchaser of a product or service. Invoices include the date, names and addresses of both the customer and supplier, a description of the items purchased with prices, and terms of when the amount needs to be paid back (usually 30-45 days). This creates a record of both what invoices you need to pay as well as invoices you sent out to customers who need to pay you.

It's important to keep up to date totals on both accounts payable and accounts receivable. Every week, you should know what is due to you, what is due to others, and how much is still outstanding. By looking at the due dates of the invoices, you can estimate how much money is expected to be received and paid out each month. Include this amount in your budget under accounts payable and account receivable.

Working capital is a general term that covers the difference between accounts receivable and accounts payable as well as any timing differences between when you pay your bills and when your customers pay you.

Make sure to keep 2-3 months of cash on hand to be able to pay what is owed to others. One way to soften the impact of accounts receivable changing from month to month is to estimate a certain percentage of your customers will never pay you back. Start out with a larger estimated percentage and as you gain experience, you can adjust this amount in future forecasts.

Any asset that you expect to have a life of more than one year is considered an investment. This can be an asset that you purchase, such as production equipment, in which case your budget will show an outflow of cash (either in one payment or multiple payments, depending on your agreement with the vendors of your equipment).

When making a major purchase, such as a vehicle, buildings or production equipment, you may be required to make several payments before you can even begin using that equipment. If you put down a deposit and already have the equipment, you will include the monthly payments still owed to the supplier in your accounts payable total.

If your business makes a loan to anyone (including YOU as the owner), you need to budget for its repayment. Include the expected repayment of the money you loaned out in accounts receivables.

When taking out a loan from banks, investors, or micro lenders, factor in your repayment amount each month into your accounts payable. As you received a large sum of money from the loan, the principle amount, and any fees associated with the loan will need to be paid back over the course of the loan terms you agreed.

Glossary Terms from this Section

Invoices - A list of things or services provided and the amount of money to be paid.

For More Information Related to this Topic See

- What is capital and why do I need it? *3. Access to Finance*
- Why do I need a balance sheet and how do I create one? *12. Financial Management*
- How do I know how much cash I will need in the future and make sure I pay my costs? *10. Budgeting*
- How do I estimate what things will cost in the future? *10. Budgeting*

15.
Do I have to create my budget myself?

The Basics

You are the person who best knows your business and can make the most informed decisions. You do not have to create your budget yourself but you do need to take responsibility for the process and the assumptions you make.

Being a successful business owner means recognizing your strengths and weaknesses, so do not feel obligated to do everything yourself. It is acceptable to get help as long as you remember that you are the one who needs to be confident in the realism of the budget you have created and your ability to achieve the results you have projected.

Many business owners oversee but delegate the task of creating a budget to an accountant, financial team, or even a family or friend who can assist with helping create a budget. The final responsibility always lies with the business owner.

Tell Me More

Being a business owner means learning lots of new things – but it does not mean you need to be an expert in everything. As you are creating your budget, there will be areas where you need help, so do not be afraid to ask for expert advice on certain parts of the process. However, you must take responsibility for the process and for the results of your budget, so this is not something you can delegate to your accountant and ignore.

Step 1: Build a process that makes sense for you and that you can implement yourself. Do not get so focused on making a "perfect" process that you do not actually use the tool you create. Your budget process needs to:

- Make sense to you, so that you could easily explain it to someone new joining your team (a new accountant, investor, lender or team member).
- Help you link your business activities to your planned sales and expenses. Lumping last year's expenses together and increasing it by a set percentage is not useful.
- Help you track your thinking at a given point in time. You do not just need the numbers, you also need a document that explains WHY the numbers are what they are.
- Help you draw conclusions about what is working and what is not. Include your assumptions about the return on expenses. If you plan to spend more on online advertising, how many customers should that investment get you? Even though it may not show up directly linked in your spreadsheet file, you should clearly indicate that in your documentation.

Step 2: Decide where and how you will keep your budget (on paper, on a software spreadsheet, in your accounting system, etc.). Make sure you can get all the data you need to compare it to your actual performance.

As you build your budget, you may need help from your accountant, or other experts. It is fine to use their expertise, but do not abandon your responsibility for both your budgeting tool and the process.

Step 3: Make your assumptions for the coming year. You are not expected to know everything and do it all alone, but as the owner, are responsible for keeping your business going. This means that you need to develop all of the assumptions for your budget yourself early on, even if you have help developing the format and the formulas.

One of the primary goals of the budgeting process is for you to take the time to think about what is working and what is not in your business, and to make a plan to do certain things differently in the coming year to ensure that your business makes a profit. So dedicate the time needed to understand your business needs, and commit to making the budget process a useful exercise for you, instead of something to get over with as quickly as possible.

As your business grows and you delegate responsibilities to others within your business, you can ask for their input for the upcoming year and include that information in your budget. However, you will still be fully responsible for making sure that you understand the profitability and cash needs of your business.

Glossary Terms from this Section

Advertising - Communication used to convince your target audience to buy a product or service.

Investors - An individual or company who gives money with the expectation of financial return.

Lender - A person or organization who offers others an amount of money to use for a fee.

Profit - The amount that you make after you subtract your costs.

For More Information Related to this Topic See

- How do I create a budget? *10. Budgeting*
- What format should I use for my budget? *10. Budgeting*
- For how long should I create a budget? *10. Budgeting*
- Who should I show my budget to and why? *10. Budgeting*

16.
Who should I show my budget to and why?

The Basics

Your budget is an internal tool, designed to help you plan the coming year, set goals and measure progress. It should give you a good idea of where you'd like to be, but it is not something that you cannot change over time.

Because it deals with the future, your budget is by definition an estimate. It's not something that you want other people to rely on as perfectly accurate information. For that reason, it is not usually a good idea to share your budget with anyone. However, there are a few exceptions:

- Your accountant or bookkeeper should see your budget format to ensure that they will be able to provide you with your accounting data in a way that makes it easy for you to compare the two.
- Your family and advisors should see your budget when it is close to final, so they can provide insights about your business and point out anything you may have missed.
- Your team should receive an overview of your budget, with the details of their goals included. For example, your sales team should see the annual and monthly sales goals, as well as the mix of products you are expecting them to sell. If they have a marketing or travel allowance, they should also be informed to those amounts.
- Your sponsor or financer should be shown your budget and business plan. This will help them understand your business, where it is going, and become confident of the future growth or understanding of why it may be declining and what can be done to turn it around. They also help support justification for further investments in your business.

If you share your budget with someone who is part of your business, you should also share your actual performance with them. Depending on their role, you may share more infrequently, but it is important to have good feedback on your performance as well as your goals.

Tell Me More

Sharing your budget internally (with accountants, family, advisors, or other team members) needs to be done in a way that preserves its confidentiality. Never share the entire budget file or an electronic copy that could be modified with anyone. If you choose to share selected data, it's best to summarize it in a different presentation, instead of simply copying and pasting the original document. Ensure that any internal person you share the budget knows it should be kept confidential, and understands that sharing it outside the company could cause their employment to end.

While a budget is usually for internal use, there may be times when you choose to share your projections outside of the company. Be careful of when, how, and with whom you share it.

If you decide to ask for outside money, your lender or partner will ask for your "projections" or your budget. Investors and bankers are usually very interested in your budget and financial projections. They want to understand what you think will happen in your business before deciding whether to give you a loan or provide investment to you.

When you decide to share your budget, keep these points in mind:

- As a starting point, include more general information presented in graphs and charts to make it more easily understandable at first glance. For example, presenting your sales targets and gross margin as a chart instead of a list of numbers will not only avoid giving away too much specifics, but will also be a more effective presentation.
- Be sure that your budget numbers align with the rest of your business plan or presentation to those investors. It looks bad to show conflicting numbers to an investor.
- When sharing any numbers with outside parties, be certain that you understand those numbers and how they support the request for investment you are asking.
- Use your most realistic case scenario when presenting to investors, and simply discuss the best and worst cases if asked. Do not provide any level of detail about your best and worst case assumptions, since those are not a basis for investment.
- In general, do not provide your full budget (electric spreadsheet) to anyone external. This is why having a separate page of assumptions (both numbers and text) can be very helpful. If you are pushed to share your projections, you can share those two documents instead of the full calculation worksheet.

Glossary Terms from this Section

Business Plan - A written document that describes how a business plans to reach their goals.

Investors - An individual or company who gives money with the expectation of financial return.

Lender - A person or organization who offers others an amount of money to use for a fee.

Margin - The difference between the price you sell something for and the cost of that item.

For More Information Related to this Topic See

- What format should I use for my budget? *10. Budgeting*
- Do I have to create my budget myself? *10. Budgeting*
- How do I find mentors, coaches, and advisors? *1. Startup and Planning*
- What are the kinds of investors and how do they work? *3. Access to Finance*

Tools