
11

Budgets and forecasting

Financial planning encompasses a wide range of topics, from credit control to investment decisions. However, they all require accurate predictions of the level of business to be achieved in the future, whether expressed in terms of cash received, payments made or the necessity for largescale loans to fund a refurbishment or new acquisition. The process for predicting these levels of business is known as *forecasting*.

We will consider several different types of forecast, dependent on the timescale involved and on the specific information required. The term *budget* defined here is a formalized forecast for a specific time period (usually one year), whereas the usual industry definition of a forecast for most departments is of a less detailed prediction, for a timespan of anything from a day to ten years. In revenue management, forecasting refers to the detailed prediction of rooms sold and average rate, by market segment.

Budgets

Budgets are formal plans for the level of business or trading to be achieved. They are usually detailed, and are generally prepared for the next full financial year, by month. Some organizations use rolling budgets that are updated each month for the year ahead. Budgets are not just financial plans but encompass all aspects of the operation, including staffing levels, marketing plans and new equipment.

Why prepare budgets?

A budget guides our steps for the year. It consists not only of financial information, but also of the actions required of us in order to achieve monetary targets. A budget is not just numbers, but also contains various reports and charts. For instance, a completed budget may include a marketing plan and a staff organization chart, neither of which reports may include any numbers at all.

The finalized budget is used as a measure of performance – we can compare how well we are performing with how well we expect to perform. Managers are responsible for the financial results of their areas, and often pay increases and promotion will depend on this. With these types of incentives, managers

need relevant information in order to take decisions on a daily basis, and to be able to communicate effectively with their staff.

At a higher level, companies must budget accurately in order to be able to maintain the confidence of owners and other stakeholders, to borrow money from financial institutions and to plan their overall company strategies for the future.

Types of budget

There are different sections of a *master budget* which, when combined, will form a full financial plan for the forthcoming year. These are:

- ◆ *Operating budget.* A plan for the revenue and expenditure to be achieved during the period. This forms the largest section of the master budget, and involves decision making by all members of the unit's management team. The format of the operations budget closely resembles a profit and loss statement.
- ◆ *Cash budget.* A plan of the movement of cash in and out of the business, this is derived from the information in the operating budget. This is usually completed by the property financial managers.
- ◆ *Capital budget.* A plan for the expenditure required in terms of fixed assets, such as furniture and equipment, and refurbishment projects needed to achieve the levels of revenue detailed in the operating budget.

The operating budget forms the budgeted profit and loss statement whilst the cash and capital budgets form the budgeted balance sheet. However, the main emphasis here is on routine (medium-term) annual budget preparation.

The budgeting process

The budget team

We can compare the budget team to a sports team – hockey or football, for instance. There is a manager, a coach, a team of players with a captain, a rule book and even a pitch. There is also a governing body which makes the final decisions as to results, with a referee to adjudicate at a lower level.

- ◆ *The manager.* The manager of the budget is usually the general manager of the property, whether it is a hotel, restaurant or visitor attraction. This person is ultimately responsible for the content of the budget, and for actually achieving the results predicted.
- ◆ *The coach.* The financial controller of the property will act as the coach. This person needs to be fully conversant with all the rules required of the game and to act as a mediator between the players and the manager.

- ◆ *The captain and players.* There may well be several captains with several teams of players within the operation. In a large hotel, for instance, there will be a separate group for each discipline (department), such as room, food & beverage, administration, etc. all with different sections of the budget to complete, but all dependent on each other. Smaller businesses may only have one budget team, and the manager may also act in a captain's capacity. The hotel or restaurant is, of course, *the pitch*.
- ◆ *The rule book.* This is the budget manual (normally accessible online), which specifies the information is to be detailed in the budget and may also include other criteria to be used (see below). Where the property is part of a large organization, this will usually be prepared by the corporate office, which actually decides the rules. The corporate office will also supply a pre-designed spreadsheet package that enables all properties to calculate and present their budgets in the same manner.
- ◆ *The governing body.* In whatever form, the entrepreneur, owner(s) or corporate office represents the governing body. In all cases, the property (whether it be a single restaurant or a multinational hotel corporation) will be ultimately responsible to the owners, who will decide what return on investment is required from the business. This will result in the formation of many of the rules or criteria necessary. There may well be a *referee* in the guise of a regional controller or operations manager.

Preliminary processes

Before the commencement of the budgeting process, and before many of the departmental managers become involved, we need to obtain certain information. This may well be supplied by a head office, which will make preliminary decisions as to future events.

Market trends

This is probably the most important aspect of the budgeting process. Accurate and detailed predictions of demand for the product and services are essential if an effective and achievable budget is to be prepared. We should determine:

- ◆ Competition for the product (other hotels, a new restaurant locally).
- ◆ The broad pricing strategy that should be adopted for the type of clientele to be attracted.
- ◆ New products or facilities that can be offered (leisure facilities, for instance).
- ◆ Inflation factors.
- ◆ Foreign exchange rates (influence the level of overseas tourist activity).
- ◆ The weather (influences local trade).
- ◆ International political activity, and potential for risk .