

Principles and Concepts of Finance

BMSW5012

Budgeting Principles and Approaches

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Introduction:

- Overview of Budgeting in Financial Management:

One of the important components of financial management is budgeting. It plans your income and expenses for how much money businesses can run normally based on that. A budget is a financial roadmap that a company uses to come up with the right ways of spending money. It helps managers to control costs and avoid unnecessary expense and action to where money is coming in or going out. A business can work out a budget that gives it a target to follow financially for the future growth and unexpected financial challenges.

- Importance of Budgeting for Businesses:

Regardless of the size of a business, budget is its lifeblood. The main benefit is it helps in making an informed decision about what to invest, which are expenses, and saving. A budget is well planned in a way that a company does not spend more than it earns and this lessens its financial risk. Besides, it is also helpful for businesses to allocate resources to different departments. This helps companies to keep the track of their progress as well as financial success. Without a budget, the management of cash flow becomes more difficult and may create financial difficulties for the business. Simply put, budgeting offers stability, makes the business more economical, as well as fuelling long term business growth.

Blue Thread Ltd owns ten stores which sell high quality clothing. Good, they have an overdraft of £25,000 at the start of June of the business. The company has been requested to pay this overdraft by the end of November. For this, the company must spend carefully to the extent of next six months. Having done this, the company has developed financial plans that it needs to review to identify if it could adequately manage cash flow (Srbinoska et al., 2023).

- Structure of the Report:

There are several sections to this report. The second is to explain budgeting in the financial management and its necessity for businesses. It then presents the calculations for stock budget, cash budget and profit and loss statement. The report then goes to analyse the financial problems that Blue Thread Ltd can encounter and then suggests some answers. Also, the report discusses the requirements for smooth budgeting and human behaviour on budgeting. At last, it analyses traditional budgeting methods and offers recommendations for the company.

Budget Preparation:

Stock Budget:

Month	Opening Stock	Purchases	Cost of Goods Sold (COGS)	Closing Stock
June	143	150	130	163
July	163	180	156	187
Aug	187	190	136.5	240.5
Sept	240.5	160	143	257.5
Oct	257.5	200	149.5	308
Nov	308	210	162.5	355.5

*COGS is 65% of Sales

Cash Budget:

Month	Beginning Cash Balance	Cash Inflows (Sales Receipts)	Cash Outflows	Ending Cash Balance
June	-48.62	194.18	191.98	-46.42
July	-46.42	233.16	221.32	-34.58
Aug	-34.58	204.93	253.82	-83.47
Sept	-83.47	214.62	196.6	-65.45
Oct	-65.45	224.32	234.39	-75.52
Nov	-75.52	243.75	246	-77.77

*After 3% CC fee

Profit & Loss Statement:

Particulars	Amount (£000)
Revenue	
Sales Revenue	1,350.00
Less: Cost of Goods Sold (COGS)	
Opening Stock (June 1)	143
Add: Purchases	1,090.00
Less: Closing Stock (November 30)	-355.5
Total Cost of Goods Sold (COGS)	877.5
Gross Profit	472.5

Less: Operating Expenses	
Administration Expenses	153
Selling Expenses	43
Taxation	15
Interest	6
Store Refurbishment	36
Loan Repayments	24
Total Operating Expenses	277
Net Profit	195.5

Analysis of Budgeting Issues:

- Identification of Financial Challenges in Blue Thread Ltd:

There are many financial challenges facing Blue Thread Ltd which may negatively affect its business operations. One big problem is its over drafting to the tune of £25,000, where it asked the bank in the end of November to clear. This forces the company to handle its finances with great care. A second issue is the fact that the high stock levels require a lot of cash, leaving a firm cash strapped. However, the company might not be able to pay for the other expenses if it has too many shares. Moreover, the company has very high operating expenses, including administration, selling expenses and repayment of a loan. This makes it very difficult to cover necessary payments as available cash has been reduced. As 30 percent of customers pay using the card, there is also a 3 percent fee from that, so the company also must deal with credit card fees (Libby and Lindsay, 2019). It also reduces the amount of real cash receipts from sales. And unexpected such as store restitutions, contribute to financial burden. If not managed properly, these issues are likely to get very expensive.

- Analysis of Cash Flow Constraints:

Blue Thread Ltd has a major concern regarding cash flow. Sales are a source of income to the company, but a part of the amount earned through these sales goes off to pay credit card fees. It has large monthly cash outflows, such as stock purchases, operating costs, and loan repayments, at same time. Some cash is always tied into inventory with the company having to stock to maintain a minimum stock level of £40,000. Taxation payments and store refurbishments also consume cash that would currently be available (Østergren and Stensaker, 2011). Therefore, company's account will usually turn negative at the end of each month. But if this keeps going, it may not be able to pay its suppliers, its employees, and so on. To improve cash flow, the company must be more effective in managing its stock, minimize unnecessary expenses and look for ways to get cash inflows.

- Impact of Credit Card Charges on Profitability:

The costs of credit card payment are through Blue Thread Ltd, which gives customers the option of paying using credit cards. Thereby, about 30 % of customers pay for goods with a credit card and the company needs to pay for the 3% fee on these payments. In other words, the company receives £97 for every £100 of credit card sales. This means that it eventually

diminishes the total cash taken from sales. A lower company's earnings can be thought of because of these fees can, since sales revenue is a key source of income.

These charges make a difference in the profit calculations. If the company generates £1,350,000 in sales over six months, and that accounts for 30% of the sales amount, then £405,000 is affected by the 3% fee. An example of the loss taken here is £12,150 from credit card fees alone. This straightaway cut off from the gross profit and leaves the company low in the pocket, unable or hardly able to cover costs. The company may not notice these charges immediately; however, with time, these charges will cut down on overall profitability (Becker et al., 2016). Blue Thread Ltd can also offer small discounts or incentives to customers to use cash or debit cards to address this issue. The second solution is to slightly increase the price to pay for transaction fees without affecting sales instead.

- Potential Liquidity Risks and Solutions:

The meaning of liquidity (under this side of the pass/fail barrier) is the company's ability to pay its bills on time. Since the cash balance of Blue Thread Ltd. has generally negative value at the end of each month, the company will likely be subject to liquidity risk. This is because cash is held back in stock and there are big expenses such as store refurbishments, tax payments and loan repayments which take cash. The company may have problems paying its suppliers, employees and other necessary costs if the company does not have enough liquid cash on hand.

Management Actions for Improvement:

- Strategies to Mitigate Cash Flow Issues:

A business can run into serious problems due to cash flow issues. For Blue Thread Ltd to improve cash flow, they should bring in more cash inflow and decrease the cash outflow. Another way to achieve this is by motivating customers to pay sooner. Instead of giving small discounts for customers who pay immediately and using the credit card, which is charged, the company can offer discounts. The second and opposite strategy is to negotiate better payment terms with suppliers. In this case, the company can pay its suppliers late and keep cash in shorter while collecting cash from customers faster (Hope and Fraser, 2018).

At the same time, Blue Thread Ltd should also maintain expenses by cutting unneeded expenses. In this case, the company may defer store refurbishments until its finances improve. Administrative and selling costs can also be reduced. The other option is to borrow short term financing (e.g. small business loan or credit line) to cover the urgent cash over a short period of time. Unfortunately, owing to this, borrowing money is not an option; since you will pay a cost of interest. Pricing strategies of the company should be also reviewed to make sure that they are earning enough profit from each sale.

- Inventory Management Techniques:

A good cash flow is vital for proper inventory management. To avoid overstocking, Blue Thread Ltd should buy stocks it requires only. Storing too much inventory forces you to place cash you would have otherwise spent elsewhere. Just in time (JIT) inventory management is one very effective way of controlling the stock. It reduces surplus stock and thus saves money (Libby and Lindsay, 2019).

The company should also assess the sales trends and try to determine the ones that sell quickly and those that do not. Fast moving products should be stocked on a regular basis, while slow moving products should be ordered in smaller quantities.

- Sales strategies to boost a revenue stream:

For Blue Thread Ltd to further its revenue, sales must be improved. The easiest way to do this is by luring more customers through promotions and discounts. Special deals with some products will encourage more people to buy. Moreover, the company can also create a customer

loyalty program by rewarding repeat customers with discounts or other rewards for regular shopping.

There are also added strategies of expansion like the expansion of online sales. Reason being that today most customers prefer to shop online and for any business that want to sell and generate revenue, you can choose to have a website or sell on one's social media platforms. As for the company, they can even provide home delivery or click-and-collect services so that the customers are able to purchase without giving it a second thought (Henttu-Aho and Järvinen, 2013).

- Reduction of Unnecessary Expenses:

A profitable business is founded on reducing unnecessary expenses. A way to do this is to reduce expected inventory purchases. It binds up cash that must now be held tied up as stocks if you buy too much. The only thing that the company should order is what it needs based on sales trends (Becker et al., 2016).

Cost savings can also be made by cutting utility and office costs. The company can cut waste, turn off unused equipment, use energy-saving lights etc. Saving money through negotiating better deals with suppliers, is another way to do this. The company can afford to spend its capital on social media and email marketing, which are cheaper than other kinds of marketing.

Organizational Conditions for Effective Budgeting:

- Key Principles for Successful Budgeting:

Business budgets help in proper planning with the finances. Realism is one of the important principles of budgeting. Based on real numbers, not mere guesses, the budget should be. The financial problems usually arises when a company overestimates income or underestimates expenses. Another key principle is clarity. The budget must be clear and easy to understand and everyone in the company must be able to know how much money is at disposal of the company and how it must be used (Otley, 2018).

Another important factor is flexibility. The budget can be sensitive to some unexpected expenses or shifts in the market. A good budget gives opportunity to tweak it when necessary. What is also essential is to track and monitor. Regular comparison of actual spending with the budget will help businesses identify early if there is a problem with their spending. In the case of higher expenses than expected, then, things can be altered before they are too late. Lastly, goal-setting is crucial. It should be aligned with the company's economic goals like increasing profit or reducing cost or enlarge the scope of operations. Following these principles makes budgeting a very effective financial success tool.

- Role of Financial Discipline in Business:

Financial discipline is keeping yourself under control with the money and make smart financial decisions. This also helps a business to be able to avoid unnecessary spending and concentrate on those things that are important. Spending control is one very key thing to control your money. Indeed, businesses should only spend on things that are necessary and must avoid wasteful expenses (Ubayachandra et al., 2021).

Timely payments is another important factor. It helps maintain good relationships with suppliers, employees and lenders and it will help avoiding penalties. It also consists of saving and reinvestment. In other words, businesses should not spend all their profits in the present, but should set apart some for future growth. Record-keeping is another key aspect. Keeping records of the financials is helpful when people start to track income and expenses to make it easier when planning to the future. Financial discipline gives a business to remain stable and to grow steadily.

- Importance of Flexibility in Budgeting Approaches:

So, budgeting is important for controlling business finances, but a budget should not be too strict. A great budget pays for change. Businesses fight uncertain situations – changes in market conditions or supplier increases of the price and unexpected expenses. Too rigid budget could hamper the company to adjust and make appropriate financial decisions.

It is because a flexible budget allows a business to change spending plans whenever is needed. For example, if the sales are less than expected, the company can cut down the expenses to avoid problems in the finances. If, however, sales go up, the company can add to marketing or lengthen operations. Thus, a flexible budget is also an opportunity to promote new opportunity. If a business catches a chance of growth, it ought to hustle the budget as required and put it in that chance of growth itself (Oyadomari et al., 2018).

Flexibility another benefits from better risk management. Any business cannot foresee the future accurately, so having a forecast budget so that you could vary it over architectural choices makes it easier to cope with the risks. With regular updating and review of the budget to proceed or address any challenges, business regulation and planning remain to be financially sound and effective.

- The Impact of Budgeting Culture on Financial Performance:

What the process of a company budgeting tells can make a company succeed or unable to. In this, strong budgeting culture is the fact that all the employees are aware of the value of budgeting, all employees follow financial plans responsibly. Budgeting when employees are given a part of the budget each begins to use company resources responsibly. This is better enabling better cost control and efficiency.

Such culture also sets clear financial goals. When everyone puts effort towards the same financial targets, it works towards the overall performance. Setting your budgets properly will help you avoid unnecessary expenses, and if you determine them wisely you will invest on profitable areas so that the business will grow further (Ssebulime, 2019).

Human Behavioural Considerations in Budgeting:

- Behavioural Biases in Budgeting:

Most of the times, people decide with their hearts (or unless they are the only that is right) without facts. behavioural biases can have an impact on planning finances in budgeting. Overconfidence is one of the most common biases that managers may have and typically believe that their predictions are always right. This can cause unachievable budgets. Another such bias is confirmation bias which involves only seeking information that supports one's opinions and ignoring the rest of the facts. This is also a problem of resisting to change. For instance, some employees can use old budgeting methods although it is not effective (Libby and Lindsay, 2019). And these biases can result in bad decisions in terms of budgeting, which can ultimately result in a loss of money.

- Employee Motivation and Budget Participation:

Employees feel more responsible as well as moved to finish up the objectives of the finances, when they involve in the spending. A budget that is created without taking the workers into consideration may lead to employees being ignored and disengaged. But when they themselves work, employees of the company know more about the company's financial situation and work harder to remain within budget. Employees take better care when spending and are more cost controlled because they feel a sense of ownership (Lau et al., 2018).

- Communication and Transparency in Budgeting:

Effective communication and transparency lead a business to achieve a successful budget. Therefore, employees should be aware of how the budget is formed and the reasons for some financial decisions being made. If the employees feel their budgeting information is hidden or made confused, then the bonding may not be created. Transparency in the budget sharing allows trust to flow and teamwork to kick in leading to better financial management (Susiyanti et al., 2024).

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