Sales Budget

A *budget* is simply a tool, a financial plan that an administrator uses to plan for profits by anticipating revenues and expenditures. The budgetary process and its offspring, the budget, are the very core of the planning-control structure of most large companies. At the end of each year, top management of most firms requires the organisation to prepare a plan for operations during the coming year. Such operational plans are developed by each operating unit like marketing, sales, production, finance, research, etc. according to the basic sales and profit targets for the year given them by top management. Each department head then develops a detailed plan of what the unit must do to achieve these goals and also the detailed estimated cost break-up for doing those things. The sales budgets are essentially based on the sales forecast. If the forecast is wrong, the resulting budgets will have to be revised often to reflect actual sales results.

Purposes of budgeting

The budget is very important for the successful operation of the sales force. It serves several purposes including planning, coordination, and evaluation, each of which is discussed below.

Planning

Companies formulate marketing and sales objectives. The budget determines how these objectives will be met. The budget is both a *plan of action* and a *standard of performance* for the various departments. Once the budget is established, the department can begin organizing to realize that plan. This is especially important to salespeople. It is through a detailed breakdown of the sales budget among products, territories, and customers that sales reps learn what management expects of them.

Coordination

Maintaining the desired relationship between expenditures and revenues is important in operating a business. The objective of a business is to buy revenues at a reasonable cost, and a budget establishes what this cost should be. If sales forecast is Rs. 5 crores, management can establish how much it can afford to pay for that revenue. If the company wants a profit of 10% on sales, then Rs. 4.5 crores can be paid to "buy" the Rs. 5 crores in revenue, a significant part of which would go to the production and administrative departments, and another portion would be available to operate the sales department. Thus the budget enables sales executives to coordinate expenses with sales and with the budgets of the other departments. The budget also restricts the sales executives from spending more than their share of the funds available for the purchase of revenues. Hence the budget helps to prevent expenses from getting out of control.

Evaluation

Any goal, once established, becomes a tool for evaluation of performance. If the organisation meets its goals, management can consider the performance successful. Hence the sales department budgets become tools to evaluate the department's performance. By meeting the sales and cost goals set forth in the budget, a sales manager is presenting strong evidence of his or her success as an executive. The manager who is unable to meet budgetary requirements is usually less well regarded.

Determination of Sales Budget

Two methods for determining budget levels are discussed below.

1) Budgeting by Percentage of Sales Method

Many business people plan and control their enterprises by percentages. Using this method, the manager multiplies the sales forecast by various percentages for each category of expense. The resultant product then becomes the dollar amount budgeted for each of the respective categories.

The percentages used for each category may be based on the manager's experience and/or feelings about what portion of the sales dollar can or must be spent 'on each business function to achieve 'the desired profit. The percentages might also be based on published industry averages for expense categories. These published averages should be used only as guidelines, which must be adjusted to reflect the unique aspects of the particular organisation. These percentages are then used in controlling sales and their costs. But the limitation of this method is that follows the direction of change in sales. For example, if sales are forecasted to decline, then the budget allocations for all expense categories will decrease as well. This may or may not be the optimal allocation to counter the sales decline. Additionally, the effectiveness of this method is dependent on the firm having accurate sales forecasts. Despite the limitations, the manager knows that if expenses are kept within their percentage budgets, final operations will come out as planned.

2) Budgeting by the Objective and Task Method

In the objective and task method, the manager starts with the sales objectives, which are specified in the sales forecast. Then the manager determines the task that must be accomplished in order to achieve the objectives and estimates the costs of performing those tasks. These costs will be reviewed in light of the company's overall profit objective. If the costs are too high, the manager may be asked to find a different way of achieving the objective or some adjustment may be made to the original objective. This iterative process continues until management is satisfied with both the objectives and the means of achieving them. Many firms use some variation of the objective and task method.

The American Marketing Association, a non-profit association of marketing professionals and academics, uses an objective and task method to develop its budget. Its budgeting process starts with forecasts of membership revenue and publication sales. Then the senior managers estimate the costs, of the programs designed to achieve the forecasted revenues. If the projected expenses exceed revenues, adjustments in costs, programs, and revenues are made until the budget is balanced.

Types of Sales Budget

Sales executives are responsible for formulating three basic budgets: the sales, selling-expense, and sales department administrative budgets.

1) The Sales Budget

The sales budget is the revenue or unit volume anticipated from sales of the firm's products. This is the key budget. It is the basis of all operating activities in the sales department and in the production and finance areas. The validity of the entire budgetary process depends on the accuracy of this one sales budget. If it is in error, all others will also be in error.

The sales budget is based on the sales forecast, which was discussed in the previous chapters but the sales budget calls for extreme detail. Every single product sold by the firm must be accounted for. It does little good to tell production planners that Rs.100,000 worth of small parts will be needed they must be told specifically what small parts will be sold, in what quantities, and when. Management estimates the sales of each product, and often makes separate forecasts for each class of customer and each territorial division. Budgets for territories and classes of customers usually are of interest only to sales executives. Other departments normally need only the sales budget for product divisions.

2) The Selling-Expense Budget

The selling-expense budget anticipates the various expenditures for personal-selling activities. These are the salaries, commissions, and expenses for the sales force. This is not a difficult budget to develop. If the salespeople are on a straight commission, the amount of the revenue allotted for compensation expense will be determined by the commission rate. Experience clearly indicates how much money must be set aside for expenses. If sales reps are paid a salary, the process merely requires compiling the amounts, taking into consideration any raises or promotions to be made during the coming period. Any plans for sales force expansion also should be anticipated in this budget.

The selling expense budget must be closely coordinated with the sales budget. Suppose the sales budget calls for the introduction of a new product line that requires considerable retraining of the sales force and the addition of a new service department. The expense budgets must reflect those needs. What will it cost to accomplish each line in the sales budget? That is essentially the question the sales manager must answer in preparing the selling-expense budgets that will accompany the sales budget.

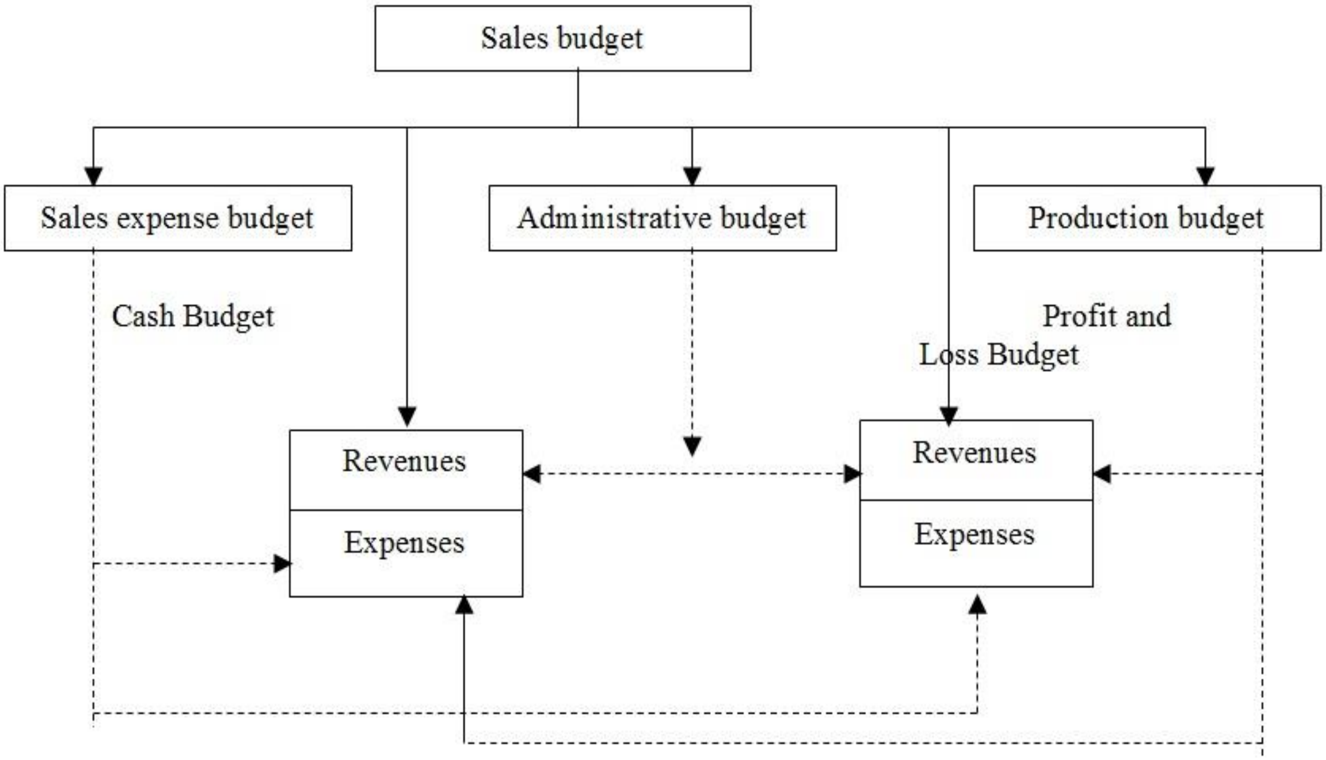
3) The Administrative Budget

In addition to having direct control over management of the sales force, the typical sales executive is also an office manager. Ordinarily the staff includes sales department secretaries and office workers; the total staff can be large. There may be several assistant sales managers, sales supervisors, and sales trainers under the sales manager. Budgetary provisions must be made for their salaries and their staffs. Management must also budget for such sales office operating expenses as supplies, rent, heat, power and light, office equipment, and general overhead. These costs constitute the administrative budget.

The budgeting process for the firm

Everything starts with the sales budget and from it, data flow in five directions. Following figure shows the flow of information from one budget to another.

Flow of information in budgeting process



The sales budget provides the basis for the various sales department budgets, such as advertising, selling expenses, and sales office expenses. Sales budget figures also flow directly to the production department. Here the total production budget is established, and from that the various materials and labour budgets are determined. The financial officer also uses anticipated sales figures from the sales budget to prepare the cash and the profit and loss budgets. The cash budget is a tool used to determine how many dollars will flow into and out of the firm each month. This budget is necessary because of the time lag between expenditure and receipt of funds. It is necessary to layout money for materials, labour, advertising, and selling expenses many months prior to selling the merchandise. Then, after sales of the goods, it may he several months before the firm receives cash. The financial officer must ensure that the firm has sufficient cash to enable it to finance the lag between the expenditure and receipt of funds.

The financial officer also uses the anticipated net sales figure as the beginning of the profit and loss budget. The budgets for sales department expenses, production, and general administrative expenses all flow into the profit and loss and cash budgets to determine the expected costs of operation. Thus all budgets are summarized in the profit and loss and cash budgets. Errors in the sales department budgets have a twofold effect on the financial plan. First, the revenues will not be correct. Second, expenses will be out of line because the sales budget determines the production and administrative expenses.

Budget periods

Budgets are commonly created for yearly, semi-annual, and quarterly periods. Some firms prepare budgets for all three periods; others prefer to operate on an annual basis, thereby reducing the amount of paperwork required.

The quarterly budget forces a reappraisal of the firm's position from times a year, thereby decreasing the likelihood that operations will get out of control. Many companies find a quarterly system advisable because that is roughly their operations conversion cycle.

Garment makers usually have four conversion cycles per year. That is, they put out four different lines of goods, one for each season, and find it convenient to budget for each selling season. The main advantage of a short planning period is that it is more likely to be accurate. The shorter the forecasting period, the less likelihood there is that the estimate will be disturbed by unforeseen developments. In deciding which period to use, a firm must balance the degree of control with the costs of compiling the budgets.

The budget-making procedure

The first step in the budgetary process is to translate the sales forecasts into the work that must be done to achieve the forecast. The firm may want to introduce a new type of product, since existing product is now obsolete. What does that mean in terms of the people needed (staff requirements)? What will it do to office expenses, field-selling costs, trade show commitments, and so on?

Each administrative unit must determine how much money it will need to meet the performance goals set for it. This is usually done by

(1) Surveying each of the activities the unit must perform

(2) Determining how many people will be required to accomplish the job

(3) Figuring what materials and supp1ies will be needed for them to do the job properly.

Many sales managers use the previous year's budget as a starting point. Then they take into account any changes in sales strategies and what those will cost to implement. They also get as much information as possible from their salespeople about changes in their territories, which may necessitate changes in the budgets. Once the sales department budgets are compiled into one major budget, it is forwarded to the financial executive, who disseminates the information to the other departments. The due dates on various budgets must be staggered if the budgeting program is to be a success. The sales department budget must be in the hands of the financial officer before final preparation of the production budget, since the production budget is completely dependent on the sales budget. Compiling all the budgets into the overall cash and profit and loss budgets can be done only after all other work on the plans of the organisation has been completed.

Every aspect of this process has become more efficient with the use of computers. With computer spreadsheets, it is possible to make changes in one part of the budget and see the impact of those changes on all other parts of the budget immediately. Sound planning procedures dictate that each administrative head sign off on all plans and budgets. That is, they agree that they will make it happen.

Managing with budgets

Once prepared and in operation, the budget becomes one of the manager's regularly used tools. The previous month's actual sales and expenses come back from the accounting department by the middle of the present month. All figures that are over budget are marked for attention. Some of the accounts that are over budget are understandable; the manager knows the reason and either accepts it or knows that the matter will be corrected ill the near future. If there are others, which are significantly over budget and the manager does not know why, he will investigate the overage and take corrective action if necessary.