“How’s business? Booming!” You may like the sound of that, but by only focusing on an ever-increasing number of sales you won’t have a full picture of your company. Estimating the revenue and expenses of your small business over a specific future period of time is a crucial step not only to maintain a sustainable operation, but also to be better prepared for the inevitable seasonal highs and lows.

A Small Business Budget Tells You The Whole Story

Let’s imagine that your annual sales for this year were $100,000, up from $75,000 on the previous year. A 33.33% increase in annual sales sounds great but you need to gather more details behind those numbers.

Here is an example:

2015		**2016**	
Gross Revenue	$75,000	Gross Revenue	$100,000
Total Expenses	$33,750	Total Expenses	$55,000
Net Profit	$41,250	Net Profit	$45,000

When accounting for the total expenses behind those sales, the impressive 33.33% increase in gross revenue is watered down to just a 9.09% increase in net profit before applicable taxes. One potential culprit behind this lower than expected profit margin could be an inefficient management of resources. In 2016, your total expenses were 55% of total sales, up from 45% in 2015.

From this simple scenario, you can draw several useful business management questions:

- How does a 33.33% increase in annual sales compare to the performance of your direct competitors? Your industry?
- Did you expect the additional 10% increase in costs as a percentage of sales to generate the extra $25,000?
- Was there an event, such as a layoff, supplier problem, or machine breakdown, that caused you to incur additional expenses?
- What are ways that you can cut down on expenses to meet additional customer demand?
- Would upgrading a piece of machinery allow you to drive down production costs? If so, would you be able to qualify for business financing for the new machine?
- If you profit margin continues to increase at an annual rate of 9.09%, could you

continue to cover your total expenses for the next 5 years? Think about details such as the terms of your rental agreement or labor needs throughout peak seasons.

This is why it’s important to have a business budget. It allows you to review your performance in a very objective manner, highlights business decisions that require your attention, and forces you to start thinking about the future of your business.

Now, let’s focus on how to create a budget, what are key items to include, and what are best practices.

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Creating a Budget for Your Small Business

Here are some key considerations when putting together the annual business budget for your operation.

Set Up an Easy-to-Access Spreadsheet
Since you’re going to access, update, and review your business budget many times throughout the year, you need to keep your spreadsheet accessible. This is an actionable document that you should refer to when negotiating terms with suppliers, discussing terms with your advertisers and evaluating options for small business financing.

Choose the option that makes most sense for your way of doing business but try to make it accessible on-the-go. Some options are storing an MS Excel file on your tablet, maintaining a Google Sheet on your Google Drive, or sharing a spreadsheet file on your company’s Dropbox account.

Break Down the Year Into Months
A budget is the expected future financial performance for a business. While annual totals are useful benchmarks to keep track of your performance, you’ll have more direct control over the month that you’re currently working on.

Compare Budgeted Against Actual Amounts
For every month, you'll budget an amount that you'll compare against the actual performance for that month. Big differences will raise red flags (or provide pleasant surprises!), empower you to act in a timely manner, and allow you to plan ahead for the rest of the year.

Keep Track of Operating Expenses
There are many reasons why it's important to separate business and personal finances. Proper budgeting forces you to reconcile your business income and expenses on a monthly basis, which is particularly useful when you do your own bookkeeping. Another benefit of keeping track of operating expenses regularly is that you'll have an easier time when you're preparing for your tax return.

Putting It All Together
We have put together a ready-for-use template on Excel here. Feel free to use this sample spreadsheet and adjust it to the unique needs of your small business. Using this business budget template, you should be able to answer all of the questions from our sample scenario and any other ones that you can come up with. For example, you'll be able to track the trajectory of your business and determine whether or not you're ready to hire your first employees.

FREE BUDGETING TEMPLATE >

Above all, having a budget allows you to keep better control of the lifeblood of any small business: monthly cash flow.

Monitoring Monthly Cash Flow

Starting line 32 from our business budget template, you'll find a tool to calculate your cash flow on a monthly basis. This portion of the template helps you determining if you need to apply for a line of credit or to tap into an existing one. Here's how to use it:

- Determine your net profit (or loss) for the month (line 30), add back the applicable depreciation expense for the month (line 31), and find out your **cash from operations** (line 32).
- To find out whether or not you'll need to get an advance from your line of credit or working capital account, take the dollar amount from cash operations (line 32) and add

to it the beginning balance of your cash account (line 33) and subtract from it any principal payment from your business debt (line 34). If the balance is positive on line 35, then you’re ok.
- If the balance of line 35 is negative, you’ll need to tap into your line of credit or apply for one to bridge a cash crunch.
- Use line 36 to annotate advances from your line of credit and line 37 to keep track of portions of the advance that you put back in excess of cash needs.
- Keep in mind that you could experience miscellaneous inflows (line 38) or outflows (line 39) of cash for several reasons, including purchases or sales of equipment and withdrawals from owners. Make sure that the ending cash flow balance (line 40) reflects all of these instances.
- The cash flow statement is calculated on a monthly basis, so you’ll see no details under the columns for annual totals.

Comparing your actual revenues and expenses against those budgeted ones helps you foresee any potential cash shortfalls. Keeping a business budget is good habit that will pay off during the small business loan application process with any financial institution. To evaluate the creditworthiness of your business, a potential lender very often requests financial statements, including balance sheets and cash flow statements. By getting into the habit of creating and maintaining a budget, you’ll be able to back up your claims and projections with historical data and put your business in a more positive light in the eyes of a potential lender.

More from the Resource Center:

- How Small Business Loans Can Help Seasonal Budgeting
- A Complete Guide to Working Capital Loans
- A Guide to Balance Sheets and Income Statements
- The Small Business Owner’s Guide to Equipment Financing