Chapter Review 52

Budgets, Forecasts and Business Plans

Objectives...

1 evaluate the purpose of budgeting in organizations
2 discuss the process for developing budgets
3 describe the key contents of a typical business plan
4 apply investment appraisal techniques such as NPV and IRR

Key Terms

budget	statements of desired performance expressed in financial terms; typically a financial plan to manage the spending and saving of money
business plan	a document that summarizes how an entrepreneur will organize a firm to exploit an opportunity, along with the economic implications of exploiting that opportunity
Capital budgeting	the process of analyzing and selecting various proposals for capital expenditures
Net Present Value (NPV)	An investment appraisal technique that determines the amount of money an investment is worth, taking into account its cost, earnings, and the time value of money

30. In this chapter we explored financial planning and control mechanisms and techniques for allocating financial resources. Budgets are statements of desired performance, expressed in financial terms. They indicate how much should be spent, by which departments, when, and for what purpose. All budgets should be prepared against the backcloth of wider organisational plans. Budgets are used to anticipate future costs and revenues, prioritise and control spending, and ensure that expenses do not exceed available funds and revenues. A generic Budget development process was presented. Next we noted that businesses need to know they have enough cash available to fund their immediate operating expenses such as wages/ salaries, rent, telephone charges etc. The most usual way of keeping track of the cash position is to prepare a cash flow forecast. This is essentially a budget which sets out the estimated receipts and payments of the business on a month-by-month basis over a period of one financial year.

31. Investment decisions are important for all organisations; the purpose of investment is to increase value and ultimately cause cash to flow into the organisation. Once business objectives/ goals have been set in the strategy-making process, investment opportunities and needs can be identified. Data is then assembled about costs and benefits associated with the investment opportunities (CBA Cost Benefit Analysis). It is rarely possible to fund all investment opportunities, or in some cases some opportunities may seek to tackle the same problem. It is therefore necessary to choose the projects within which to invest. Numerous quantitative approaches for evaluating investments are available such as, net present value (NPV), internal rate of return (IRR), payback period and pay-off tables. The main goal of such techniques and investment appraisal is to assess the profit (increase in wealth) for a given period.

32. Budgets and forecasts are examples of business plans. However, the expression 'Business Plan' has particular meaning for small and medium-sized enterprises and here the main interested parties are (a) owners and (b) lenders and investors. The business plan is a written document that summarizes how an entrepreneur will organise a firm to exploit an opportunity, along with the economic implications of exploiting that opportunity.