

Figure 12.9 Before Starting a Business



support his wife and two children on a disposable income of \$3500 a month because his wife also has a job. Dan's business goal is to purchase a building for his business to avoid paying rent. He believes this will be a good investment for the business because it is an asset that has value. His goal is to save at least \$1000 each month toward a down payment. Meeting that goal each month will allow Dan to buy a building in three or four years.

Preparing a Business Budget

The steps in preparing a business budget are very similar to those of preparing a personal budget. The first step is to calculate the amount of income expected. In a business budget, this is the total revenue.

The second step is calculating expenses. Fixed and variable expenses also occur in a business budget. Examples of fixed expenses for a business include rent, salaries for full-time employees, and property insurance. Variable expenses include wages for part-time workers, cost of goods sold, utilities, advertising, and bank charges.

The third step is calculating the amount left. This step is very different from a personal budget. Remember, in a personal budget, the goal is to not have any income left over. In contrast, business budgets are supposed to have income left over because that is the business's profit. Business budgets are created to restrict expenses to only what is necessary and to make certain that expenses do not sky rocket. The goal of a business budget is to ensure that as much profit as possible is made.

The final step in the budgeting process is to review your budget. This step allows managers to compare actual spending with expected spending. If the business is spending more than it earns, managers need to adjust expenses or increase income through increased sales, higher prices, advertising, or new product lines.

Figure 12.10 is an example of a budget for a small business. Dan Sierra runs a small catering company. A budget is very important to him because he must control costs to make sure he can make enough money to support his family.

Now Dan needs to create a budget for November. This will be a busier month because he has five major holiday parties to

Figure 12.10 Sierra's Catering Company Budget for October

Monthly Budget		
Revenue		\$ 25 000
Cost of Goods Sold		<u>7 000</u>
Gross Income		18 000
<u>Expenses</u>		
Salaries	6 000	
Wages	2 000	
Rent	1 500	
Telephone	100	
Utilities	500	
Insurance	800	
Delivery Truck	600	
Advertising	700	
Interest and Bank Charges	500	
Supplies	500	
Equipment	300	
Total Expenses		<u>13 500</u>
Net Income		<u><u>4 500</u></u>

cater. This will increase his revenue. However, he anticipates having greater expenses such as food, employees, and supplies. His new budget can be found in Figure 12.11.

Figure 12.11 Sierra's Catering Company Budget for November

Monthly Budget		
Revenue		\$ 40 000
Cost of Goods Sold		<u>14 000</u>
Gross Income		26 000
<u>Expenses</u>		
Salaries	6 000	
Wages	6 000	
Rent	1 500	
Telephone	100	
Utilities	600	
Insurance	800	
Delivery Truck	600	
Advertising	700	
Interest and Bank Charges	500	
Supplies	800	
Equipment	300	
Total Expenses		<u>17 900</u>
Net Income		<u><u>8 100</u></u>

Review Questions

18. List and define the three types of business income.
19. Explain how a business that produces bicycles can spend its income.
20. What is the difference between a personal budget and a business budget?
21. State the steps in establishing a business budget.
22. Explain the difference between fixed and variable expenses. Provide some examples of fixed and variable expenses in a business budget.
23. Describe the purpose of start-up and operating budgets.
24. In November, Dan Sierra's Catering Company runs into a major problem. The truck breaks down and needs \$4000 in repairs. How can the company deal with this problem?

CHAPTER REVIEW

Knowledge

1. Explain why the dollar's purchasing power changes.
2. How would you adapt Figure 12.6 to suit your needs?
3. What factors might you consider when deciding where to shop?
4. State the advantages to buying goods on sale. State the disadvantages.
5. Explain the actions you can take if you find that your personal monthly expenses are consistently greater than your monthly income.

Thinking

6. Explain why teenagers with jobs may have more discretionary income than their parents.
7. Do you think that a businessperson who sells good quality products or services wants well-informed customers? Explain your answer.
8. What customs or habits influence your purchasing decisions?
9. Many consumer purchases are the result of a desire to be in fashion or to follow a fad. What items have you purchased recently for these reasons? Were these wise choices? Why or why not?
10. Can impulse buying ever be justified? Explain your answer.
11. State two short-term and two long-term savings goals you have.

Communication

12. Interview an elderly relative or neighbour. Ask them how much each of the following cost when they were young.
a) bread b) movie
c) soda pop d) bicycle
e) house
Create a chart of your findings and insert the current prices of these products. Which price has changed the most? Why do you think it has changed so much?
13. Write a memo to a company suggesting ways the company can improve its profits. You can include suggestions about reducing costs, increasing sales, new advertising strategies, and new products or services. Word it carefully and politely.

Application

14. Think of three products that you would like to purchase in the next year. Using the Internet or telephone, comparison shop for the products at three different stores. Find out the price and delivery costs at each store. Put your findings in a chart.
15. Create a personal budget for a person living in your city. His or her salary is \$35 000. Using a newspaper or the Internet, find an actual apartment. Include method of transportation, food, utilities, savings, furniture, entertainment and anything else you think is important. Use a spreadsheet if possible.
16. Make a list of all the operating expenses a small ice-cream shop might need. Create a monthly budget for the shop. Use a spreadsheet. Revise your budget to account for a flood that occurs one night when no one is in attendance.

Team Activity

Team Goal: Prepare a start-up budget

Team Assignment: Calculate the Components for an Effective Budget

- Teams could use the team activity from Chapter 7 as part of their research.
- Assume that your audience consists of 150 potential consumers.
- Gather as many accurate costs of products used in production, as you can.
- The team that produces the most realistic budget for the event wins the competition.

Portfolio

Obtain annual reports from at least two of the companies within the industry you are profiling (or use annual reports you have obtained in the past).

- Illustrate with examples how the companies earn their income. Be sure to include the difference between gross income and net income.
- What do the businesses spend money on? Demonstrate the difference between fixed and variable expenses. Discuss what factors a purchasing agent or other buyer might consider when making one or more of these purchasing decisions.
- Use a PowerPoint or other visual presentation to enhance your work.

Reflect on Your Learning

Assess your earning and spending habits based on the information learned in this chapter. What wise income decisions have you made recently? What poor income decisions have you made? What habits should you change?

What characteristics or skills do you possess that would help you plan and follow a budget? Consider your personality, talents, and any skills you have acquired through school, work, volunteering, and so on. What could you do in your everyday life that would help you improve your planning and budgeting skills?

INTERNATIONAL PROFILE

Wal-Mart

The story of Wal-Mart began in the late 1940s when Sam Walton opened a store in Bentonville, Arkansas, named Walton's Five and Dime. Although, in many respects, the management of this particular variety store was similar to others, there was one critical difference in the style of Walton's management that set his store

apart from his competitors. Specifically, though Sam Walton was careful to always strive to achieve the best possible deals from his suppliers—which in itself is not an unusual characteristic in a store manager—the strategy leading to Walton's success was that, instead of pocketing the resulting extra money, he would pass those savings on to his customers. Walton realized that, by foregoing the small savings, he could reap huge profits by increasing the sheer volume of the goods that he sold. Indeed, this aspect of Sam Walton's style of management formed the foundation of a business that would eventually earn Walton the title of wealthiest man in the United States in the 1980s.

The incredible success of Walton's first store (which was a franchise of the Ben Franklin variety store chain) led him to create his own business, which took the form of the first Wal-Mart store that opened in

Rogers, Arkansas, in 1962. By 2006, Wal-Mart's employees numbered 1.8 million worldwide, with close to 6500 stores and wholesale clubs stretching across 15 countries. Named the "most admired retailer" by *Fortune* magazine in both 2003 and 2004, Wal-Mart also set a new record in the fiscal year ending January, 2006, by generating over US\$312.4 billion

in revenue, where the company's net income in fiscal 2005 was US\$11.2 billion.

But Wal-Mart has not been successful in every nation. For example, in July, 2006, Wal-Mart announced that it would be retreating from the German market due to significant losses that it had experienced since entering the country in 1998. Indeed, the estimate of the



A mother and child leave Wal-Mart after picking up some goods.

costs incurred by Wal-Mart, during its attempt to gain a foothold in Germany, is in the hundreds of millions of dollars; Wal-Mart is also expected to lose an additional billion during its withdrawal from Germany alone.

Explanations of why Wal-Mart was unable to capture the German market have mainly focused on the criticism that Wal-Mart's American-style management practices are simply incompatible with many German customs. For instance, Wal-Mart initially offered the service of grocery bagging for their customers, before the company realized that Germans did not want their groceries to be handled by strangers. Additionally, when Wal-Mart

clerks were ordered to smile at shoppers, many of the male German customers interpreted such behaviour as being sexually suggestive.

Although Wal-Mart may have closed up shop in Germany, the company's ability to conduct business elsewhere has not been adversely affected. Specifically, as the largest grocery retailer in the United States, in the summer of 2006, Wal-Mart started the process of selling more organic foods in an attempt to attract more urban and upscale customers. Such action on the part of Wal-Mart is expected to drastically change the production of organic foods. Some organic food advocates claim that this will contribute positively to

increasing both the amount of organically-farmed land and, in turn, the availability of organic food. However, others say that Wal-Mart's participation in the organic food market will ultimately be both a detriment to the organic farmers, and lower the standards for organic food production.

Whether or not Wal-Mart's style of business is unanimously accepted or credited favourably worldwide, the bottom line is that, as a business, Wal-Mart has flourished. And, as the world's largest retailer, Wal-Mart has shown that it is their bottom line that counts.

QUESTIONS

1. Discuss a Wal-Mart business strategy that both sets the company apart from its competitors and contributes to Wal-Mart's success.
2. Pretend that you are a business consultant. In a hypothetical scenario, if Wal-Mart had yet to open any stores in Germany but was planning to do so in the next year, what kind of advice would you offer them?