Chapter 3: Budgeting for Front Office

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BUDGET:

A Budget is a detailed estimated plan of operations for a specific future period. It acts as a yardstick for the evaluation of the performance of the organization.

In simple terms, budget is the money that is available to a person or an organization and a plan of how it will be spent over a period of time.

Essentials of a Budget:

- It is prepared in advance and is based on a future plan of action
- It is based on objectives to be attained in future
- It is a statement expressed in monetary and/or physical units

Factors affecting budget planning:

The following are the factors affecting the front office budget planning:

1. Room Sales: This is one of the most critical key factors operating in hotels. When the sales budget is being prepared it is essential to examine patterns of occupancy to establish what level of room sales may realistically be expected ie. The forecasted numbers for the year ahead

2. Manpower: This factor can have an influence on the volume of hotel and restaurant sales. In some locations, labour shortages may, in fact, be a severe limiting factor and hence affect the budget

3. Level & variety of service: The level of service and the variety of services offered affects budget planning. Some hotels may offer more personalized service than others. Some hotels will have a wide choice of restaurants, bars, Spa, business centre, casinos etc.

4. Quality of management: Over longer periods, the quality of management will have a direct and powerful influence on the volume of sales generated.

5. Other factors:

- Political state of affairs
- Natural calamities

- Terrorist activities
- Climate conditions
- Events (sports, festival celebration, etc)
- Importance of the city (climate, industries- IT, BPO, Biotechnology)

Types of Budget:

Budgets are usually prepared for the next financial year. There are several types of budgets that are prepared by an organization.

Capital Expenditure Budget:

The Capital Expenditure (CapEx) budget provides guidance as to the amount of capital needed for buying capital assets. Capital assets are those with a lifespan of more than a year. Furniture, fixtures and equipment are examples of things that come under Capital Expenditure budget. Some of the common items of the Front Office included in the Capital Expenditure budget are Computers, chairs, EPABX and other telephone instruments, new software/PMS, billing machines, scanners, self service terminals etc.

Operating Budget:

Operating budget is a financial statement that is associated with the routine operations of a hotel. Operating expenditure is the cost that a hotel incurs in the process of generating revenue during its normal operation. It includes salary, wages and direct labour cost.

Fixed Budget:

Fixed budget is a budget that is prepared on the basis of standard or fixed level of activity. It does not change with the level of activity.

Flexible Budget:

Flexible budget is a budget prepared in a manner so as to give the budgeted cost for any level of activity. This is prepared keeping in mind the fixed and semi-variable costs that may change with the various levels of operations.

Master Budget:

Master budget, known as final budget, is the summary of all the budgets that are prepared in the organization. It incorporates all functional budgets that are approved and hence is a summary budget.

Sales Budget:

Sales budget is the forecast of the sales to be achieved in a budgeted period. The sales budget is generally prepared by the sales manager. The hotel may prepare the room sales budget, food and beverage sales budget and ancillary sales budget.

Administrative Overhead Budget:

Administrative overhead budget covers expenses of all the administrative offices and of management salaries. This budget is prepared by totaling the separate budgets for all the administrative departments.

Cash Budget:

Cash budget is the forecast of the cash position for a specific duration of time. It tells about the availability and requirement of working capital at different periods and forms an important part in the efficient working of the hotel. The cash budget is prepared by the Chief Accountant.

Budgeting Process: Defining goals, Preparing plans to analyze difference between planned and achieved goals, making necessary modifications

A budget is a management tool. It improves the process of control. The budgeting process starts before the beginning of a financial year.

- Defining goals: the goals set by a budget must be attainable. Many investors set unrealistic goals that demotivate the performing teams. While return on investment (ROI) is important, it should also be in sync with the market conditions. Goals should be measurable too. There should be wide participation in the budgeting process.

- Preparing plans to analyze difference between planned and achieved goals: Participation of the team gets their commitment to perform and achieve. All members must be informed of the approved budget. Regular budget reviews should be planned. Besides monthly meetings, budgets must be reviewed every quarter. The budget must be completed before the performing period.

- Making necessary modifications: Plans are influenced by unanticipated factors internally or externally. New sales tax can affect plans as much as an employee strike. Budgets have to be altered accordingly. Budgets must be flexible to permit revisions for unanticipated changes.

Budgetary Control:

Budgetary Control is defined as the establishment of budgets relating to the responsibilities of the executives to the requirement of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy or to provide a basis for its revision.

Budgetary Control has now become an essential tool of the management for controlling costs and maximizing profits. Budgetary Control involves:

- Establishment of budgets

- Continuous comparison of actual results with budgeted ones to attain the organization's objective
- Ascertaining the responsibility for failure in the achievement of budgeted targets
- Revision of budgets in the light of changed environment

Objectives of Budgetary Control:

1. To give a practical expression to the aims and objectives of the business
2. To provide a detailed plan of the Front Office Operation with respect to a particular period
3. To ensure better cooperation of various departments/sub-departments
4. To set 'benchmarks' (standards) against which the managerial performance is to be measured
5. To ensure an economical use of the resources of the business
6. Budgeting serves to clarify, measure efficiency and provide definite plans to all concerned

Advantages & Limitations:

Advantages of Budgeting/Budget Control:

1. Eliminates uncertainty:
   It provides a planned approach to every activity. This eliminates uncertainty
2. Result of team effort/various brains:
   Since it is a collective effort by the top management, it is made by several heads keeping in mind organization objectives
3. Optimum use of capital resources:
   It guides the hotel to use its capital resources in the most profitable manner
4. Easy availability of working capital:
   The cash receipts and expenses budget ensures that sufficient working capital is available for efficient functioning of the hotel
5. Effective coordination:
   Budgeting results in effective coordination between departments as goals of each department are interlinked with each other
6. Responsibility can be pinpointed:
   It pinpoints the person on whom the responsibility can be fixed.
7. Spotlight on deviation:
   Deviations can be seen and areas of improvement can be identified to take suitable corrective action
8. Serves as a guiding light:

Budgeting provides a benchmark for actual performance and shows the path to achieve the standards

9. Optimum utilization of man, machine and material:
   Budgeting distributes work and provides clarity on using resources – man, machine and material
10. Good incentives for employees:
   Meeting budgets can be a good incentive for employees who get rewards and recognition on achieving targeted budgets

<u>Disadvantages of Budgeting:</u>

1. Budgets are estimates hence can never be accurate. Inflation and rapidly changing business environment tend to distort budget data
2. Budget is simply a tool to efficient management not a substitute for it. Effective planning, implementation is crucial
3. Budgets cannot guide as to what action should be taken
4. Proper system of supervision and control is essential otherwise the budget will be ineffective
5. Budgeting can face the danger of inflexibility and everyone may think that without adherence to it, they will be called inefficient
6. Budgets may be misused by bosses to find faults in employees and restrict performance rather than improve it
7. The initiative and creativity of an employee may be hampered if budget is the only yardstick
8. Budgeting is a time consuming process and involves expenses
9. Budgeting goals may lead people to supersede organization goals
10. Success of budgeting depends on the motivation of people involved. It should be a gradual and cooperative exercise
11. Budgeting is just a pathway and does not guarantee successful implementation
12. Budgeting helps arrive at important management decisions however if used in isolation may lead to harmful consequences for the business

<u>Refining Budget Plans:</u>

The term ‘refining budget’ can also be called as amending the budget, or adjusting the budget or modifying the budget. As the term says, it means to change which may be increasing or decreasing the figures of the already made budget.

Budget is a forecast, a projection of figures for the future. It is based on certain assumptions. These assumptions are due to past figures or expected activities of future. Hence when it comes to the actual for that period, they may or may not match the projected figures.

Usually a budget is for a period of 1 year. It is always advisable to monitor the actual after regular intervals of time, say quarterly. The budget then can be refined.

For example, If we have budgeted 30 lakhs from Room Sales for the first quarter, we must review the first month room sales figure. If it is 13 lakhs, then maybe our initial budgeted figure was very conservative.

Another example, if we projected 5,000 foreign tourists in the first quarter of the financial year (April to June). However in March, there are lots of issues in the country such as terrorist attacks, unstable government or an outbreak of an epidemic, then we must refine or modify our targeted figures from April to June to maybe 3,000 or lesser depending on the gravity of the situation.

Re-forecasting or refining the budget plans is normally suggested when actual operating results are significantly different from the original budget. This is possible only when the actual figures are reviewed from time to time. Records must be maintained about the refining of the budget along with explanations and reasons. This data is important. Such records are also necessary for answering questions which arise during budget review meetings.

The person making the budget or refining the budget must have a strong and reliable MIS (Management Information System) along with data from Government and other agencies.