## BUDGETING

## INTRODUCTION

The most important long-term planning function performed by front office managers is budgeting front office operations. The hotel’s annual operation budget is a profit plan which addresses all revenue sources & expense items. Annual budgets are commonly divided into monthly plans, which, in turn, are divided into weekly (& sometimes) daily plans. These budget plans become standard against which management can evaluate the actual results of operations.

The budget planning process requires the closely coordinated efforts of all management personnel. While the front office manager is responsible for room revenue forecasts, the accounting division will be counted on to supply department managers with statistical information essential to the budget preparation process. The accounting division is also responsible for coordinating the budget plans of individual department managers into a comprehensive hotel operations budget for top management’s review. The hotel general manager & controller typically review departmental budget plans & prepare a budget report for approval by the property’s owners. If the budget is not satisfactory, elements requiring change are returned to the appropriate division managers for review & revision.

The primary responsibility of the front office manager in budget planning is forecasting rooms’ revenue & estimating related expenses. Rooms’ revenue is forecasted with input from the reservations manager; expenses are estimated with input from all department managers in the rooms division.

The hotels annual operation budget is a profit plans that addresses all revenue sources & expense items. Budgets are important tools for managing cash flow, controlling costs, and making effective management decisions. The ability to accurately predict future profits requires a firm understanding of operating costs.

**Types of Budget**

Budgets are of various types and based on the purpose for which they are prepared, these may be classified as follows:

1. Production Budget
2. Production Cost Budget
3. Purchase Budget

647.94/MS/AUG 2020

NO: [9] / IIIrd YR BHM

1. Production Overhead Budget
2. Capital Expenditure Budget
3. Cash / Revenue Budget
4. Sales Budget
5. Selling and Distribution Cost Budget
6. Labour Budget
7. Labour Related and labour taxes budget
8. Materials Budget

**Production Budget:**

Production budget is the forecast of the total output of the whole organization broken down into estimated of outputs of each type of product with a scheduling of operation to be performed and a forecast of the closing finished stock. It may be defined as an estimate of quantity of goods to be produced to meet the sales forecast.

**Production Cost Budget**

It details the estimated cost of carrying out production plans as per the production budget. It breaks up the cost of each product into 3 main elements – material, labour and overhead.

**Purchase Budget**

Purchase budget shows the purchase to be made during the budget period. In some cases, a purchase budget may deal with the purchase of raw materials only while in other cases, it may incorporate the purchase of all direct and indirect material as also fixed assets and services like electricity, gas etc.

**Production Overhead Budget**

It contains the forecast of all production overheads to be incurred during the budget period. It deals with production overheads in three parts – fixed, variable and semi variable

**Capital Expenditure Budget**

It points to the plans concerning addition, improvement and replacement of all fixed assets during the budget period. But the time frame of this budget may not be restricted to just one year as in the case of other budgets.

**Cash Budget**

This budget gives estimated cash receipts and estimated cash disbursement during the budget period and shows the cash position arising from it. Its purpose is to ensure that the concern never feels any shortage of cash, In case any shortage is expected, suitable steps may be taken to augment the cash reserves. In case there is surplus, arrangements may be made to make suitable investments or loans.

**Sales Budget**

This means projection of the minimum volume of sales required to produce necessary operating profit in respect of a trading period and thus enable an assessment of the sales performance of the business at the end of the period. A sales budget shows what product will be sold, in what quantities and at what prices.

**Selling and Distribution Cost Budget**

This budget forecasts the cost of selling and distributing products during the budget period. It is based on sales budget in that sales estimated point to the cost to be incurred in selling and distribution. This budget is jointly prepared by the sales manager, the advertising manager and distribution manager.

**Labour Cost Budget**

Labour costs are budgeted in relation to the budgeted volume of sales. Labour budget gives the estimate of labour requirements to meet the production needs during the budgeted period. The budget includes both direct and indirect labour requirements in most cases.

**Labour Related and Labour Taxes Budget**

Having fixed the payroll cost for the budget, the payroll taxes rate, employees compensation rates etc. can be easily fixed to arrive at the budgeted figure in terms for rupees for taxes on payroll, and employees public relations.

**Materials Budget**

Materials budget deals with the requirement and procurement of direct materials. Indirect material are dealt with under the overhead budget.

**Making of Front Office Budget**

Front Office is one of the major revenue producing departments of a hotel and is responsible for guest satisfaction. Approximately 70% or even more of revenue is generated from this department, so it becomes all the more necessary that more than any other department a more conscious budgeting / budgetary control is exercised on this department. Front Office department of a large hotel has various sections such as Reservations, Lobby, Bell desk, telephones etc. The Department Master Budget of Front Office, which includes budgets for each section such as Reservation, Lobby and Bell Desk individually.

Reservation section will give its budgeted figures of reservation for a specific period of time (number of bookings). This budget will also include the cost of reservation system, ie. Cost to be incurred on various equipment and stationary used in the system, for eg. Reservation rack, their replacement, new purchase, maintenance etc. Also the cost incurred on stationary like reservation slip, Shannon slip etc. Similarly if it is on computer system, then the cost incurred on maintenance and repair of computer hardware or if a new machine needs to be procured. Further the reservation budget may include the budgeted figure of labour which will consist of

* the requirement of staff
* labour cost and labour related cost for that period

The budget for the reservations section will be prepared by the reservations manager with input from his staff.

On similar lines, sub section budget shall be prepared by other sections of Front Office, such as Lobby and Bell Desk. Many hotels combine the bell desk budget with the lobby budget. These budgets are also made on the lines of fixed or static budget, sales budget and operating expense budget and labour and labour related expense budget etc. The lobby budget is usually prepared by Lobby manager, who is assisted by the Bell Captain

Finally on the basis of the sub section budgets, the Front Office Manager prepares a Front Office department budget for the hotel. Normally the Front Office budget is prepared on a quarterly basis. While preparing the budget, guidance is taken from past figures and information. The marketing and sales department of the hotel also helps in preparing the final budget as they can also forecast the future business. The budget has to be given to the department for implementation once it is approved by the Front Office Manager, then by the General manager, The Financial Controller and then by the Board of Directors.

Heads under Front Office Budget:

Fixed Cost : Racks, tables, Computers, front office equipment etc.

Operational Cost : Printing and Stationary, Travel agents commission, salaries and wages, Transportation, Telephone calls, overheads.

Once the budget has been given for implementation, any deviations must be observed, recorded and notified. From time to time the refining of the budget must also be done.

***Forecasting Room Revenue***

Historical financial information often serves as the source on which front office managers build rooms revenue forecasts. One method involves an analysis of room revenue from past periods. This means the Reservation Manager will supply to the Front Office Manager figures of room revenue for, say, three previous years and the pattern in the increase of revenue and also the increase in terms of percentage.

 Another approach to forecasting room revenue bases the revenue projection on past room sales and average daily room rate

Forecasted Room Revenue = Rooms Available X Occupancy % X Average Daily Rate

A more detailed approach would consider the variety of different rates corresponding to room types, guest profiles, days of the week and seasonality of business and several other factors affecting room revenue.

##### Example I

#### Rooms’ revenue summary for the Star Dust Hotel

|  |
| --- |
|  Year Rooms revenue Increase over Rs. Prior year % |
|  2008 Rs. 10,00,000 -- ---- |
|  2009 Rs. 11,00,000 100000 10%  |
|  2010 Rs. 12,10,000 110000 10% |
|  2011 Rs. 13,31,000 121000 10% |

Example shows yearly increase in net rooms revenue for the Star dust hotel, for years 2008 –2011, the amount of room revenue increased from 10,00,000 to 13,31,000 reflecting a 10% yearly increase. If future conditions appear to be similar to those of the past, the room revenue for 2012 would be budgeted at 14,64,100 at 10% increase over the 2011 amount.

Preparing an accurate budget requires the ability to forecast sales with a reasonable amount of certainty, several different methods are used to predict future sales, but some techniques are more accurate than others. The easiest technique is averaging- calculating the average monthly sales in the past.

**Sales averages**

Past financial information is called historical data. The more recent the historical data used, the more accurate the average. In most cases, sales figures from more than three years in the past often are not reliable for predicting future sales. To calculate an average, add the amounts and divide the sum by the number of amounts.

Room revenue can be projected on the basis of past room sale and ARR. Suppose a hotel has 100 rooms and average occupancy of the hotel for the year 2001 is 80%. Therefore, the number of rooms sold over a period of the year 2001 shall be 80/100\*100\*365 = 29,200 rooms and suppose the total room revenue for the year 2001 is Rs 11,68,00,000. Then the ARR shall be 1168,00,000/29,200 = 4000. Further, we see that the occupancy % increased by 3% in the year 2001 to 2002 and from 80% it became 83% in 2002.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| YEAR | TOTAL NO OF ROOMS IN HOTEL | OCCUPANCY% | NO OF ROOMS SOLD DURING THE YEAR  | TOATAL REVENUE FOR THE YEAR | ARR |
| 2001 | 100 | 80 | 29,200 | Rs 11,68,00,000 | Rs 4000/- |
| 2002 | 100 | 83 | 30,295 | Rs 15,40,00,000 | Rs5,008/- approx |
| 2003 | 100 | 86 | 31,390 | Rs 17,80,00,000 | Rs5676/-approx |
| 2004 | 100 | 89 | 32,485 | Rs 22,00,00,000 | Rs6751/- approx |

Also that every year it is increasing by 3%, (i.e.) the occupancy percentage for 2003 becomes 86%, and for the year 2003-2004 the occupancy percentage becomes 89%. Further, from the figures, we find that it means that a total number of 30,295 rooms and the room revenue is Rs 15, 40, 00,000/- and hence the ARR is Rs 5,008 approximately for the year 2001-2002 and for the year 2002-2003 these figures are, total number of rooms 32,585, total room revenue Rs 22,00,00,000 and ARR of Rs 6,751.

 From the above figures, we note that while the occupancy percentage is increasing at a constant rate of 3% every year , the ARR is increasing from Rs 400/- to Rs 5,008/- , i.e. 125.2% and further to Rs 5,676 from Rs 5,008, which means 101.1%, and further from Rs 5,676 to Rs 6,751, which means 119.6% increase and further shall increase to Rs 7,784, which means an increase of 115.3 (average of the previous increases) in ARR . Now , based on the above assumption of 3% increase in room occupancy percentage, which means 92% for the year 2004-2005, the total room revenue, can be forecasted as Rs 24,60,00,000 appx., the number of rooms sold will be 33,580 and ARR shall be approximately Rs 7,329.

**Projecting Expenses**

Most expenses for front office operations are direct expenses in that they vary in direct proportion to room revenue. Historical data can be used to calculate the approximate percentage of room revenue that each expense item may represent. These % figures can then be applied to the total amount of forecasted room revenue, resulting in rupee estimate for each expense category for the budget year. Typical rooms division expenses are payroll and related expense, guest room laundry, guest room supplies, stationary, travel agents commission, reservation expense and other expenses.

One key element in budget preparation is the estimating/projecting expenses. Since expenses are categorized both in relation to operated departments (direct/indirect) and how they react to changes in volume (fixed and variable), the forecasting of expenses is similar to the approach used in forecasting revenue. However, before department heads are able to estimate expenses, they must be provided with information regarding the following:

Expected cost increases for supplies and other expenses

Labor cost increases, including the cost of benefits and payroll taxes.

Expenses are of two types: **fixed expenses and variable expenses**. A fixed expense remains constant and is not dependent on sales and these include charges such as depreciation, insurance expense, property taxes, rent expense, and similar expenses. A variable expense fluctuates as sales rise or decline. Expenses such as stationery charges, room amenities expense that varies as per the occupancy of the establishment are termed as variable expenses.

**Factors affecting Budget Planning**

The following are the elements, which affects the front office budget planning.

* **Accommodation:** This is one of the most critical key factors operating in hotels. When all the rooms are sold, it is impossible to increase the volume of room sales except through an increase in room rates. 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 during the forthcoming budget year. Where there is a high degree of room sales instability, evidenced by pronounced swings in occupancy rates, it is desirable to examine the possibility of shifting demand from peak to off-peak periods.
* **Shortage of labour:** This particular key factor is potentially powerful, but there is no evidence that it exerts much influence on the volume of hotel and restaurant sales. In some locations, labour shortages may, in fact, be a severe limiting factor.
* **Consumer demand:** Consumer demand is often found to be a potent key factor. Its operation may be due to several reasons.
* The price level of the establishment may be too high, and this may result in a low ARR or low occupancy or both**.**
* **Quality of management:** The management and its operation however do not have a bearing over short period. Over longer periods, the quality of management will have a direct and powerful influence on the volume of sales generated.
* **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)

**Refining Budget**

The term ‘refining budget’ can also be called as amending the budget, or adjusting the budget or modifying the budget. This means ‘to change’ which may be increasing or decreasing the figures of the already prepared forecasted figures. Budget is a forecast for future based on certain assumptions. Whatever base was taken for these assumptions may occur or may not occur at all or may occur partly or more than the expectations, and hence the actual figures may be more or less than the projected figures. Budget should be monitored at regular intervals and variances ( may be plus or minus) have to be studied and analysed immediately and corrective action taken. Reforecasting is normally suggested when actual operating results begin to change significantly from the original budget. Refining budget is a very important activity and it protects the establishment from suffering a loss. If we are not able to meet the targeted revenue, then the expenditure part also needs to be scaled down proportionately, failing which money may be wasted unnecessarily. The refining of budget is done by the same person who initially prepared the budget, but he must be furnished with facts and figures, data and information through the Management Information System (MIS).

**Budgetary Control**

It is the financial control through budgets, which means fixing responsibility for budgeted results to the managers concerned. It is a control technique because it provides a standard for evaluation of actual performance. Hence budgetary control means the responsibilities we assign to managers, usually expressed in terms of items such as sales targets, profit margins and cost ceilings. Budgetary control is the process of finding out what is being done and comparing actual results with the corresponding budget data in order to approve accomplishments or to remedy differences by either adjusting the budget estimates or correcting the causes of differences.

Another aspect of budgetary control is perpetual comparison of budgeted figures to actually achieved figures of the business for that specific period for which the budget was prepared. Variances are ascertained. Where there is a system of budgetary control in operation, current operating results are viewed frequently, weekly, monthly or quarterly. Budgetary control has been 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 provide a basis for its revision.

**Objectives of Budgetary Control**

The objectives of budgetary control may be summarized as follows:

* To give a practical expression to the aims and objectives of the business
* To provide a detailed plan of the Front Office Operations with respect to a particular trading period
* To ensure better cooperation of various departments / sub departments.
* To set ‘benchmarks’ against which the managerial performance is to be measured
* To ensure an economical use of the resources of the business
* Budgeting serves to clarify the programme, measure efficiency, and provide definite plans to all concerned
* Essentials of Sound Budget
* To be effective, a budgetary control system should be based on the following guidelines:
* Define clearly the responsibilities and authorities for preparation and administration of budget
* Sound organizational capabilities
* An accurate and adequate system of measuring and recording performance. The budget making must receive a total support of top management.
* Timely and regular system of reporting of current events should be developed to keep responsible people informed of actual results for timely correction. There must be an effective accounting and costing system.
* Clearly defined policies should be established for all phases of the firm.
* Free and frank communication between different departments and members of the organization through regular meetings of budget committee. All levels of staff must understand and support the system. All managers expected to administer and live under budgets must have a part in their preparation, so that they understand the budget and are loyal to them
* Efficient forecasting and research is necessary for the formulation of realistic budgets. Sufficient time should be allowed to obtain desired results from budgeting. The budget period should be appropriate to the nature of the firm.
* Human factor is very important in budgeting. Due credit should be given for the job well done. Persons unable to achieve budgeted results should be held accountable. Budget should be designed only as tools and not to replace management. Budget should not be overdone to seriously compromise the authority of managers.
* The system should be designed to meet the needs and conditions of the particular enterprise. Proper flexibility through alternative budgets, regular revisions etc. and effective follow up are important aspects of sound budgeting.
* Key to effective budgeting is developing and providing standards, by which a manager’s work can be translated into needs for manpower, material, money and other resources.
* Budgetary control should not be used in situations where other control systems are more suitable.

**How budgetary control is applied:**

Budgetary control is enforced to accomplish the goals and objectives of the hotel. For this it is important to follow the course of action that would make the realization of budgeted targets possible . Whenever the manager finds that there is deviation in actual from the budgeted target, he must immediately find the cause and promptly decide and implement the corrective action to set those deviations right.

**Essentials of effective budgetary control**

* Quick Reporting: Juniors who are actual operators are required to submit a performance report immediately to their boss. Further, these reports must be analysed quickly on the basis of the past data and other available information for quick remedial action to be taken.
* Seriousness in implementation: The top management should take the budget seriously. Only then will the juniors have a sense of seriousness.
* Responsibility matched by authority: Those who have been made responsible to accomplish the budgeted targets are given appropriate authority to do so.
* Rewards and Punishments: As per the performance, the employees must be suitably awarded, appreciated or punished.
* Flexibility: There should be no hesitation in changing / modifying or refining the budget from time to time as per the current need which will be broadly dependent on business conditions and various other factors. But at the same time, budget figures should not be altered too much or too often.
* Have Patience: It always takes time to show results. Hence budget should not be modified too early without any sensible reason.

**Advantages of Budget Control**

Some of the advantages of budgetary control are as follows:

* Eliminates uncertainty: It provides a planned approach to every activity of hotel within which expenses have to be incurred and results achieved. This eliminates uncertainty and ensures that the hotel is not caught unawares in the face of actual situation.
* Result of various brains: The involvement of top management brains in making the budget ensures that budgets are not framed according to subjective standard and a single individual.
* Good incentives to workers at times: High standard budgets at times provide incentives to employees to work towards it.
* Optimum use of Capital resources: It guides the hotel to use its capital resources in a most profitable manner.
* Easy availability of working capital : The cash receipts and expenses budget ensures that sufficient working capital and other necessary resources for efficient functioning of the business are available.
* Effective co-ordination: Budgeting makes co-ordination between various departments more effective as the goals of each department are interlinked with the other for the achievement of the hotel goal in totality.
* Responsibility can be pin pointed
* Spotlight on deviation : Deviations can be pinpointed and areas of weakness can be discovered and suitable corrective action can be taken to bring the performance to required standards
* Optimum utilization of man, machine and material : Budgeting aims at distributing production programme according to production capacity and makes most effective utilization of men, material and machine.
* Serves as a beacon light: Budgeting provides a benchmark for actual performance and shows the path to achieve the standards.

**Limitations of Budgeting:**

* Budgets are estimates and can never be 100% accurate. They are only as good as the data and forecasts on which they are based. Inflation and rapid changes in business environment tend to distort budget data before they are put into operation.
* The budget is simply a tool to efficient management and not a substitute for it. An efficient system of budgeting can achieve nothing without effective planning and control
* Budgets cannot guide as to what action should be taken
* Sound system of effective supervision is necessary and the lack of it would make the budget ineffective
* Budgeting entails the danger of inflexibility as everyone becomes conscious that they must adhere to the projected budget, otherwise they will be called inefficient. The budget is not something that has to be adhered to under all conditions but a measure of performance and a guide which should be adjusted to meet new situations.
* Budgets may be misused by managers to find fault with their employees and restrict performance rather than improve it.
* The initiative and creativity in an employee may be hampered if the supervisor and managers stick to budget strictly.
* Budgeting is a time consuming process and involves expenses. There is a tendency of going into excessive details which restricts freedom of action.
* Budgeting goals may lead people to supersede the enterprise goals. Budgeting may be used to hide inefficiencies as past practices become evidence for the present. There is also the need to safeguard against overemphasis on factors that happen to be easier to observe.
* Success of budgeting depends on the motivation of people who are to install and use budgets.
* Budget making is a tempting exercise. It provides an opportunity to grapple with situations that are yet to arise. Budget making can be effective only when there is some correlation between the cost of the system and the benefit to be derived from it. (Lack of cost benefit analysis)
* Budgeting is but a means to an end, the end being the successful achievement of budgetary targets. However, this is not always the case. It is too often assumed that introduction of a budget programme by itself is not enough to guarantee its successful execution.
* Although budgeting is a big help in arriving at proper decisions, very often it is seen as a substitute rather than as a tool of management. If, taking cover under budgeting, the management, whose job is to choose the best among the alternative courses of action, turns a blind eye to its responsibility of decision making, then the situation may lead to harmful consequences for the business.

**Suggested reading**

* Principles of Hotel Front Office Operation – Sue Baker, Jeremy Huyton, Pam Bradley
* Hotel Front Office Management: James A. Bardi
* Managing front office operations: Michael L. Kasavana, Richard M. Brooks
* Back office operations and administration: Dennis L. Foster