Performance management through budgets. Drafting and launching the company's sales budget

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Abstract

In the economic activities enterprises set goals which, if achieved, enable performance improvement. In this regard, it becomes necessary to develop forecasts mentioned in budgets, which are used as tools for enterprise performance management. Creating an effective budget system, closely related to the medium and long-term plans of the company, is the key to profitable economic activity, which allows to find the right path to achieving the proposed objective and to promptly detect any obstacles. The budget is thus a strategy to improve performance by achieving better productivity, more efficient money spending, and to motivate employees to fulfil the budgetary provisions.

In the process of budgeting, the starting point is the sales budget, based on the sales program to which the company aims. Within it, the quantity, the selling price and the projected turnover are broken down into different time periods. Preparing a budget of marketing expenditures constitutes a logical consequence of the commercial activity as defined in the sales budget, thus allowing the establishment of the costs for the sale of the company's products and the commercial margin.

Keywords: *Forecast, performance, sales budget, turnover, costs.*

JEL Classification: *M11, M41.*

Introduction

In the current economic climate, companies are concerned with the efficient management of resources and use for this purpose the budgets, as tools for financial management, both at the level of their main activities, as well as for the entire enterprise. Economic activities of companies are permanently enrolled in the relationship of balance between revenues and expenses that requires a complex analysis, because their interaction takes the form of enterprise performance. Venkatraman and Ramanujam (1986) showed that the performance is a recurring theme in all management areas, including managerial accounting.

The strategic objectives of the company are set by managers, according to the general economic forecasts and to the predictions that characterize the industry in which the company operates, the company's priorities and resources, the relationships between management and employees. These long-term plans are defined at the level of each financial year in short-term plans called budgets. Managers' performance is considered achieved by meeting the budgetary targets (Anthony and Govindarajan, 2007).

The budgets entered the world of management theory and practice as a tool for forecasting the revenues and restraining the expenditures. The ensemble of forecasts on company performance and its financial position represents the consolidated budget, formed by modelling operational budgets. Between the budgets developed by a company there is a close connection. Viewed in their entirety, the budgets must form a coherent image. Therefore, the sales budget is not just an exercise designed to estimate future sales quantities or values, it also implies a series of measures taken by the company to achieve its strategic objectives.

1. Literature review

The theme addressed in our study was the subject of much research and debate (Veran, 1990; Bouquin, 1992; Villeseque, 2003; Sullivan and Sheffrin, 2003; Sponem and Lambert, 2010).

Budget is the most well-known management tool of the first half of the twentieth century (Weber and Linder, 2005). The budgeting practice emerged in the 1920s almost simultaneously in the US, France and Germany, and in 1930 the International Conference in Geneva established the budget as the first performance monitoring tool for large industrial enterprises (Johnson and Kaplan, 1987). Subsequently, especially after the Second World War, the budget became an instrument used by most enterprises. Since the '50s, the primary objective of enterprises' activity was profit maximization, which could only be achieved by planning and achieving the planned objectives. In addition, the economic environment characterized by stability and economic growth, has created favourable conditions for the generalization of the budgeting practice .

The evolution in time of budget process is significant and shows the various roles of the budget as a management tool. Anthony (1988, p. 17) defines it as "a plan for the next year, generally expressed in monetary terms". While some see the budget as an instrument to improve the organization's performance (classical approach), others consider it an organizational legitimacy tool or a disciplinary tool. Mui Yee, Wong Sek Khin and Ismail (2016) studied the direct and indirect relationship between the decision-making process and the organization's operational performance. Organizations should maximize efficiency and effectiveness in the process of budgetary control in order to maintain competitive advantages. Owning an adequate budgetary control enables companies to improve their managerial attitude and performance and provides useful information to solve financial challenges.

According to Anthony (1988), the criteria to assess the managers' actions are effectiveness and efficiency. The role of the budget in achieving effectiveness and efficiency is important, because they allow the conversion of long-term programs in short-term action projects, ensure budgetary control, coordinate the decision-making process and ensure the convergence of the enterprise's strategic objectives.

2. Research methodology

Overall, this study aims to improve knowledge in the field of managerial accounting, the expected contribution being both theoretical and practical, by showing the detailed process of budgeting the sales of an enterprise.

The purpose of the research is the presentation of budgeting as a source of growth for the enterprise's performance, by studying the relationship between sales budget and decision-making process, showing how the budget supports achieving organizational performance.

In this context, the first research objective is to describe the sales budget in terms of functions, methodology development and liaison with business strategy. To achieve this objective, the qualitative research methodology was used; several scientific papers in the literature were analysed.

The second objective of this paper is to extend the research through a quantitative approach which aims to present the methodology employed for sales budgeting in the case of hypothetical enterprise, which is applicable to real organizational systems. In this regard, we conducted a quantitative research, using the case study as a research tool. Through this model we aim to place the budget process, and consequently the sales budget, within the scope of management control.

In the last part of the paper we created the premises for future research on the methodology for marketing budgeting by presenting the importance of forecasting marketing expenditure, in line with the sales budget.

The research results can be included in an integrated model for management decision support. Furthermore, research should be expanded through a quantitative approach to the budgetary control of sales, which will highlight the variances between the forecasted and real turnover and the necessary corrective measures.

3. Methodology for preparing sales budget

In the process of budgeting the starting point is the *sales budget,* as the basis on which entire budgeting process depends, because all the activities of a company are dependent on its sales and anticipated earnings. In addition to the sales budget, there is drafted the budget of marketing expenses, which shows in detail the expenses related to the promotion of the products, the distribution costs and the expenses related to after-sales services provided by the company.

The overall size of the enterprise's sales budget can be influenced by the business goals of the company (turnover, target market and market share), the trade policies of the company (products, customers, pricing and discounts policies) and by the general business situation.

A sales budget is a financial plan for sales of goods and services of a company. It serves as a guide for the company in terms of sales objectives and targets at the strategic level (overall turnover), operational (for the sales department) and individual (for each salesperson).

There are two stages in budgeting sales:

1. forecasting of sales (quantitative and value) and marketing expenses; and

2. breakdown of annual budgetary provisions for shorter periods (quarters, months), by products or groups of products, geographical area, responsible trading etc., namely into different budgets that facilitate regular monitoring of the annual forecasts.

The sales budget is correlated with the production budget, and both budgets determine the parameters of all other budgets. At the time of preparation, the sales and the marketing expenses budget are interconnected: if the manufacturing capacity is insufficient to produce all goods whose sale is possible, the initial forecast of sales should be reduced, or the manufacturing capacity should be developed; if, on the contrary, the possibilities offered by the sales market are insufficient to use the full manufacturing capacity, the working tine should be reduced or must part of the equipment should be released from use.

3.1. Sales forecasting

Sales forecasting is the most important activity, reflected in studies and research regarding the detection of potential market outlets, to which the company may have access, and the market share that it intends to conquer.

Sales forecasting can be defined as the advanced establishment of sales, in both quantitative and value terms, by taking into account the limits of the company. When developed on the long-term, these forecasts allow the establishment of an investment program and a financing plan. On the short term, the sales forecasts help to develop the manufacturing program (and, accordingly, a budget of stocks of finished products or work in progress), in developing the acquisitions program and further in drawing up expenses budgets (selling, provisioning) and also the cash budget. Both in terms of operational and investment activities, sales forecasting is crucial and deserves the name "cornerstone of the budgetary construction".

The projected level of enterprise sales is established by managers on higher hierarchical levels, based on data from marketing and production sectors.

Long and medium-term forecasting. The issue of forecasting should be studied by taking into consideration the limits within the enterprise.

Outside the company, the limits are those imposed by the market on which the company is present. To reduce the uncertainty, certain techniques can be used. To

study the long-term trend, trend curves and long-term correlations are used, which represent methods based on extrapolation or, in other words, projecting the past into the future. The market study is based on the intentions or the present needs of consumers and determines their behaviour in future years.

Inside the company, the limits are caused by the financial constraints (financial independence), human resources (personnel matters, or recruitment problems in general), geographic (space issues, spatial planning, ecology etc.).

Representing a matter of general policy, decisions are made by the general manager, together with his collaborators (financial manager, commercial manager, technical manager etc.). Given the future limitations, the sales forecast is determined for the next years. The main limitation for the enterprise is the market, and the company must adapt as well as possible to its evolution.

The s*hort-term forecast* is made for a one-year period, which corresponds to a budget year and is particularly centred on the products.

The organization may have a range of products that can change from year to year, in the sense that some products are dropped from manufacturing, due to the

unfavourable impact on the public or to the insufficient profit margin, or to the emergence of new products, as a result of technical research or commercial research conducted by the company.

Short-term forecasting work is greatly simplified for companies producing goods with a relatively long production cycle (ten-eleven months on average); the forecasting activity can be performed directly on the basis of orders received from customers.

Long-term forecasting, as well as short-term forecasting, is performed taking into account the restrictions determined both by the external environment (the market), for which there can be made economic analyses (correlation curves, trends) or commercial (market surveys, questionnaires), and by the existing limitations within the enterprise, which may vary depending on the size and nature of the enterprise's activities: commercial means (network sales, quality of the sellers, sales prices etc.), manufacturing capacity (material, equipment, workers), earnings per product (the danger that the development of a product with low profitability might pose), launching new products (the public reaction, the reaction of competition etc.), short-term development opportunities.

Figure 1. Model on the overall situation of short-term forecast
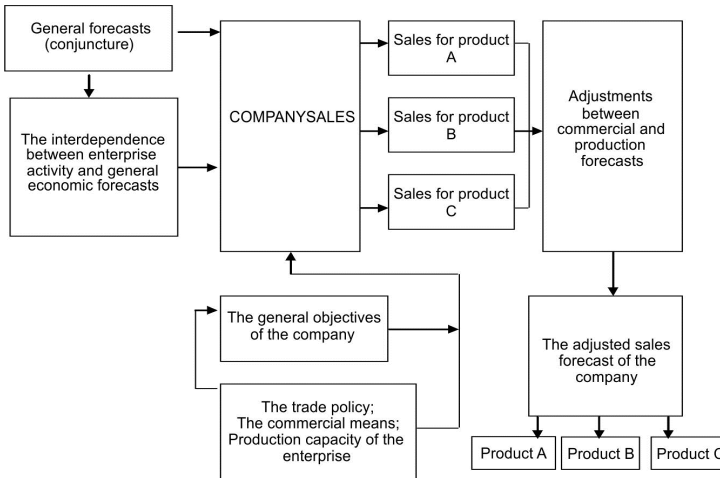
Source: Authors' adaptation from Gervais, 1994

The forecasting methods can be divided into: qualitative methods (determination of views); causal methods (relationships with an external variable); quantitative methods (mathematical treatment of chronological series). Qualitative methods consist of interrogating the management staff (jury opinion), the sales representatives (questionnaires), the customers (through market research) to identify their views about future sales.

3.2. Breakdown of annual budgetary provisions

Once established, the sales budget can vary depending on the centres of interest retained by the company, such as: the budget for a certain period of time, for sellers or for a region, budget for a product or product category, overall budget.

The budget for a period of time. This delimitation in time of sales targets is conditioned by the considered period and the manner in which the forecasting is performed.

The choice of the period is dictated by the needs of control of the enterprise. No enterprise would normally expect the passage of a year to verify the predictions made; on the other hand, any check has a cost, therefore conducting frequent checks is costly; thus, in practice, there must be determined a medium term, which is usually the month. When the sales program is likely to be changed frequently (due to events, competition etc.), it is indicated that that the forecasting for the first quarter to be performed separately for each month, and for the next period for each quarter, in order to reduce the effort of making predictions which will be revised.

When sales are affected by seasonality, to establish the sales program, businesses rely on past experience, which they adjust to the objectives considered for the next year. Analysis of past situations can highlight a fixed seasonal structure, in the most favourable and least frequent case, which allows the extension of the previous year structure in the year under review, subject to foreseeable changes. The same analysis can show a variable seasonal pattern, which is the most common situation. In this case, the evolutions from previous years can be used as the baseline for the decisions made for the forecasting year.

The budget for sellers or for a region. Following comparison between the situations in each region, and within these, each seller's effort, the company may develop a budget for different geographical regions, based on past experience and showing what is the desired objective for the future.

The budget for products allows the company to track and analyse sales trends for various items in the product range.

The overall budget. For giving a synthetic view of the program, all forecasts (per periods, regions or products) should be regrouped. This task involves some difficulties, as, for example, changes in volume-sale price or structural changes. If the price variation is uniform for all items, the correction factor is easy to apply. If the price variation is differentiated, there must be calculated a weighted correction factor. Within the overall budget, different structures (period, region, product) are compared, which generates differences during the year for a period, region or product.

4. Case study – the development of the sales budget

Starting from theoretical delimitations above, hereinafter we will show a practical model of budgeting sales. In this sense, we use the example of Mobilrom S.A., a company specialized in manufacturing furniture. The company has three main manufacturing sectors: Sector I - PAL, Sector II - Processing and Sector III - Assembly. Each sector consists of several workrooms where successive technological operations are run. We will consider, for example, a furniture product for the lobby, called *Andorra Wardrobe*.

4.1. Sales forecasting

Sales forecasting is based on ***statistical methods***, which involve the extrapolation of past data for the near future. The most common methods are linear correlation method and linear adjustment method.

a. **The linear correlation method** is based on the relationship defined by the first degree function of the type y = a*x+b, which underlies the calculations based on *the method of least squares*. Under this method, we can determine a relationship of dependency between the sales volume *y* (determined variable) that we want to predict and another variable *x* (determinant variable); *a* – the degree of variability, and *b* – fixed element.

In this example, using the least squares method allows to determine the degree to which the evolution of determinant variable *x* (*the rank of the month*) influence the evolution of the determinant variable *y* (*sales of the month*), by calculating a correlation coefficient *r*.

To determine the coefficient *r*, for the example chosen, there will be used the data in **Table 1**:

	Table 1. Variable calculation - least squares method					
x_i	y_i	$(x_i - \bar{x})$	$(y_i - \bar{y})$	$(x_i - \bar{x})(y_i - \bar{y})$	$(x_i - \bar{x})^2$	$(y_i - \bar{y})^2$
1	270	-2.5	-40	100	6.25	1,600
2	290	-1.5	-20	30	2.25	400
3	300	-0.5	-10	5	0.25	100
4	310	0.5	0	0	0.25	0
5	340	1.5	30	45	2.25	900
6	350	2.5	40	100	6.25	1,600
$\bar{x}$ = 3.5	$\bar{y}$ = 310	-	-	Σ = 280	Σ = 17.5	Σ = 4,600

Source: Authors' processing

Calculated by the relationship:

$$r = \frac{\sum x_i * y_i}{\sqrt{\sum x_i^2 * \sum y_i^2}} = \frac{\sum (x_i - \bar{x})*(y_i - \bar{y})}{\sqrt{(x_i - \bar{x})^2 * (y_i - \bar{y})^2}} \quad (1)$$

It results:

$$r = \frac{280}{\sqrt{17,5 * 4600}} \cong 0,99$$

Theoretically, the linear correlation coefficient *r* should be close to 1 or -1. Based on this value close to 1 ($r \cong 0,99$), it is considered that the evolution of the variable *y* is influenced by the evolution of the variable *x*, and therefore, least squares method can be adopted for the forecasting of the variable *y* (volume sales).

The value of *a* will be calculated by the formula:

$$a = \frac{\sum x_i * y_i}{\sum x_i^2} = \frac{\sum (x_i - \bar{x})*(y_i - \bar{y})}{\sum (x_i - \bar{x})^2} \quad (2)$$

a = 280/17,5= 16

The value of *b* will be calculated by the formula:

$$\bar{y} = a * \bar{x} + b * b = \bar{y} - a * \bar{x} = 310 - 16 * 3,5 = 254$$

Sales forecasting for the first semester of N year is achieved using the function:

$$y = a * x + b * y_i = 16 * x_i + 254$$

Thereby, the following values are obtained, according to **Table 2**:

Table 2. Sales forecasting program	
X_i (month)	y_i (Quantity-pcs.)
1	366
2	382
3	398
4	414
5	430
6	446

Source: Authors' processing

b. **Linear adjustment method**. One of the variants of this method is the forecasting of sales based on seasonality coefficients.

b.1. In the simplest form, seasonality coefficients corresponding to each month are determined by the ration between the average monthly sales and the average annual sales (**Table 3**), using data on quantities sold in at least two consecutive years.

Table 3. Determination of seasonality coefficients					
Month	**Sold quantity (pcs.)**			**Monthly average of quantities sold (pcs.)**	**Seasonality coefficient**
	Year N-2	**Year N-1**	**Year N**		
January	286	312	350	316	7.02%
February	262	370	385	339	7.54%
March	274	375	404	351	7.80%
April	280	385	424	363	8.06%
May	293	402	487	394	8.76%
June	305	410	488	401	8.92%
Total semester 1	1,700	2,254	2,538		
Total for year	3,800	4,200	4,500		

Source: Authors' processing

We predict monthly sales schedule for the next year N+1, as shown in **Table 4**, by multiplying the total amount projected for next year (5,000 pcs.) with the seasonality coefficients established.

Table 4. Program of sales forecasting		
Month	**Seasonality coefficient**	**Quantity predicted year N+1 (pcs.)**
January	7.02%	5,000 x 7.02% = 351
February	7.54%	377
March	7.80%	390
Total first quarter		**1,118**
April	8.06%	403
May	8.76%	438
June	8.92%	446
Total second quarter		**1,287**
Total first semester		**2,405**
Total year N+1		**5,000**

Source: Authors' processing

b.2. In a more complex form, the seasonality coefficients are adjustments of the theoretical values obtained through a function y = a*x + b, due to periodical causes which have a different influence on the two variables for different periods of time. Thus, seasonality coefficients can be calculated either as a ratio between the achieved and forecasted quantities for the same period of the year N, or vice versa, according to **Table 5**:

Table 5. Determination of seasonality coefficients			
x_i 1	y_i realized N (pcs.) 2	y_i planned N (pcs.) 3	Seasonality coefficient 4 = 2/3
1	270	270	1.00
2	290	286	1.01
3	300	302	0.99
4	310	318	0.97
5	340	334	1.01
6	350	350	1.00

Source: Authors' processing

To determine **the quantities sold forecasted for the year N+1**, the following steps shall be undertaken, whose results are listed in **Table 6.**

Steps:

- The function y = a*x + b = 16*x + 254 allows to determine the *theoretical projected sales volume for the year N+1 (column 2).*
- By multiplying this result by seasonality factors there is obtained the *forecasted sales volume for a season (column 4).*

- In column 5 there are entered data on *sales volume increasing by a maximum accepted market share* of 30%, determined by multiplying the volume achieved for each month of the year N with 1.3.
- The sales volume forecasted (column 6) corresponding to each month and mentioned in the sales budget is the minimum amount of *forecasted sales volume* (column 4) and *the maximum permissible increase market sales volume* (column 5).

Table 6. Program of sales forecasting					
x 1	Theoretical forecast of y for N+1 (pcs.) 2	Seasonality coefficient 3	y planned (pcs.) 4 = 2*3	The maximum permissible increase (pcs.) 5 = y planned /N*1,3	The final forecasted quantity (pcs.) 6
1	366	1.00	366	351	351
2	382	1.01	387	377	377
3	398	0.99	395	390	390
4	414	0.97	404	403	403
5	430	1.01	438	442	438
6	446	1.00	446	455	446

Source: Authors' processing

4.2. Preparation of sales budget per product

The sales budget aims to forecast turnover, taking into account the sales program (amounts projected using the statistical methods presented above) and the forecast of sale prices. Final decisions lead to establishment of program sales (i.e. quantities being sold in a given period) and sales budget (quantities * their selling prices,

values that represent useful information for production technicians, especially for financiers).

The physical volume of sales (Qv), reflected in the sales program, is determined by the production volume which is to be manufactured (Qf), considering of the initial stock (Si) and the final stock (Sf), according to the relationship:

$$Qv = Si + Qf - Sf \qquad (3)$$

The volume of production which is to be manufactured is used in the production budget, and the final stock depends on the company's inventories policy (supplies budget) and the company's capacity to produce and sell.

The value of sales or *Turnover* (CA) reflected in the sales budget expresses the relationship between the physical volume of production intended for sale (Qv)

and its selling price (pv), according to the relationship:

$$CA = Qv * pv \quad (4)$$

The forecast for year N sales (broken down for the first semester), as entered into the sales budget, is as follows (**Table 7**):

Table 7. The sales budget - Product: Andorra Wardrobe			
Month/ Year N	Forecasted quantity (pieces)	Selling price planned (lei/piece)	Turnover planned (lei)
January	351	800	280,000
February	377	800	301,600
March	390	800	312,000
April	403	800	322,400
May	438	800	350,400
June	446	800	356,800
FIRST QUARTER	2,405		1,924,000
TOTAL YEAR	5,000		4,000,000

Source: Authors' processing

5. Marketing expenses budget

Sales forecasting is made in conjunction with marketing expenditure forecasting as they are interrelated: marketing costs are a consequence of sales, and sales may be influenced by advertising expenses and/or costs of improving the sales network.

Preparing a marketing budget expenditures is constituted as a logical consequence of the commercial activity, as defined in the sales budget, thus allowing the establishment of the costs incurred for the sale of the company's products on the internal and external markets.

The elaboration of marketing expenses budget is approached differently by each company, depending on the characteristics of its activities and its size. Before the forecasting, the main problem is identifying the expenses that relate to the sales activity, from the wide range of expenses classified by their nature.

Thus, *marketing costs*, which are classified by their nature and highlighted in general accounting by the accounts of class 6 *Expenses accounts are transposed* in marketing expenditures by functions, which is a classification specific to managerial accounting. In

general, the budget aims to estimate the costs of the main functions involved by the marketing of products:

- administration of sales – corresponds to commercial line;

- marketing - advertising and promotion management, launching new products;

- sale - contracting customers, knowledge of needs;

- packaging - dispatch - delivery;

- after-sale services.

Subsequently, *the forecast of marketing expenses* will be achieved, as part of ante-cost calculation for determining the full costs. Marketing costs vary depending on the level of activity; so there are three types of costs:

- *Variable costs,* which are directly proportional to the volume of sales (i.e.: sales agents' commission, packaging materials, distributors' wages, transport charges etc.). The forecasting of these expenses will be made by the equation: $y = a*x$ where y = variable expenses, x = sales and a = coefficient of proportionality of costs in relation to sales.

- *Semi-variables costs* that are partly proportional to the level of marketing activity and in part have a fixed character (for example: the phone used to sell and to resolve various administrative issues related to sales, the salaries of commercial services employees etc.). The representative equation is of the type: $y = a*x + b$, where b = constant of proportionality, which corrects the level of sales;

- *Fixed costs*, independent on the short-term of the level of trading activity (i.e.: advertising, supervisory staff salaries, electricity, travel expenses, depreciation, professional training charges etc.). The equation that determines the level of these charges is the type: $y = b$.

The proportionality coefficient (*a*) and the constants (*b*) shall be based on data recorded in previous years on variable and fixed costs and sales.

To forecast marketing costs as realistically as possible, there is considered the causal link *between the sales activity and the costs necessary to undertake this activity:*

$$Marketing\ expenses = F\ (Sales\ activity)$$

The forecasting of marketing expenses (advertising, promotion, business studies, launching new products etc.) can be performed according to several methods, which take into consideration: the maximum cost that the company can support, the business goals set for the next year, a percentage of sales or the costs incurred by competitors.

To determine the marketing expenditure budgeted, several *factors* will be considered*:* positioning of the product within its lifecycle (larger advertising costs for new products), market share, rate of acquiring customers, quality and the uniqueness of the product.

Establishing an optimal level of marketing expenditure is a difficult task, as the inter-relationship between the marketing costs and sales does not usually have an immediate effect.

The forecast for other marketing expenditures is based on data from previous years, extrapolated for the year for which the budget is prepared. But, because this projection of the past over the future does not eliminate the negative aspects of the past, a cost/benefit analysis should be carried out, for

removing the inefficient costs from the marketing expenditures. However, extrapolations will be updated depending on changes in the company's specific business goals and commercial policies.

Forecasting of sales and marketing expenses should be performed at the same time because they are interrelated to each other. The marketing expenses budget can be drawn up separately from the sales budget or the marketing expenses forecasts can be mentioned as a separate section at the end of the sales budget, thus allowing determination of the *commercial margin* as the difference between turnover and marketing costs.

Conclusions

Because of the importance of sales within a company, it can be said that the sales budget affects all aspects of a business. Sales budget can be considered as the main annual budget of the company as it determines the parameters of all other annual budgets: manufacturing capacities, raw materials supply, volume and structure of the staff, strategic investment decisions etc. Preparing the sales budget can support a company to achieve its sales goals, providing at the same time a basis in determining and evaluating individual and team objectives and successes.

Preparing the sales budget is, however, a process accompanied by certain limitations. It can be a significant time consumer for the management staff and often, pending the final version of budget, it may cause conflicts between certain departments of the company. It is important that realistic goals be established in the budgeting process, with achievable indicators. This can be seen in the performance reports by comparing actual data with budgeted data.

Being convinced that budgets represent valuable guidance for the actions taken by managers, we propose as directions for our future research: the theoretical analysis and case studies for other budgets within the budgets network of the enterprise, such as investments budget, production budget, purchasing budget, treasury budget, human resources budget or administrative expenditure budget.

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