

# Budgeting vs. Forecasting for Your Business

7 min read



Some small engineering firms can get by with just the back-office essentials: a sound, secure, and efficient bookkeeping and accounting system that maintains compliance while supporting the nuts-and-bolts operations of the business.

## Key Takeaways

- **The Purpose of a Business Budget:** The purpose of a business budget is primarily to provide your company with a short-term spending plan for the upcoming year (or another set financial period)...
- **Know How to Create a Budget:** First, you need to gather your financial records. Then use the information to reasonably estimate what your revenue will be for the upcoming financial period. If you've shown a trend of growth or...
- **Support Your SMB's Budgeting and Forecasting With a Solid Back Office:** If your SMB struggles to keep its back office in order, then outsourced bookkeeping, accounting, and CFO services might be right for you. These services cost a fraction of the price...

Business budgeting and forecasting are highly useful practices in businesses of all sizes. While they're both important tools for business management and strategy, it's common for business owners to confuse budgeting and forecasting. So, what's the difference between business budgeting and forecasting and how can you use budgeting and forecasting in your business?

## Budgeting vs. Forecasting: What's the Difference?

### What Is a Budget?

**Budget Definition:** A business budget is an outlined plan for income and spending. The budget contains individual line items for each of the company's projected (expected) revenue and expenses over a set period of time. Businesses typically have annual budgets that are created once a year. The budgets are then compared to the company's actual numbers and adjusted, as needed, throughout the year.

### What Is a Budget Deficit and What Is a Budget Surplus?

A budget deficit occurs when an entity's spending exceeds its income over a certain period of time. A budget deficit typically results in a negative cash flow. a Budget deficit

can be remedied by accessing funds through a loan, a cash injection from an investor, or with the business's savings.

On the other hand, a budget surplus occurs when a business's income exceeds its spending over a certain period of time. A budget surplus can create a positive cash flow and provide a business owner with options regarding how they intend to use the surplus (reinvest in the business, put it in a savings account, or pay out dividends to investors).

While it is better to have more money than your business needs than not enough, too much of a surplus can indicate that your business is not using its resources in the most efficient way.

**Read More:** [The Value Of An \(Updated\) Budget: Getting Your Business on Track for Success](#)

## **The Purpose of a Business Budget**

The purpose of a business [budget](#) is primarily to provide your company with a short-term spending plan for the upcoming year (or another set financial period). A business budget ensures that a company sets spending limits based on its anticipated revenue. This helps business owners understand and maintain the company's financial health within set spending [guidelines](#).

A budget's objective is to help a business owner plan the upcoming year's expenses and business operations while maintaining a positive cash flow and healthy business

## **What Is a Forecast?**

**Forecast Definition:** A financial forecast is a model that contains information intended to help a business owner understand what could be possible for their business.

Forecasting can use an expert's opinion, the company's historical financial data, or a combination of both to create a possible projection for the company's future growth, cash, equity, income, valuation, etc. over a longer period of time.

Forecasts typically contain more sweeping, overarching, long-term information than a budget which looks at specific line items for the upcoming financial period.

## **The Purpose of a Business Forecast**

Business forecasting is most commonly used to understand the future scenarios that are possible or likely for a business.

When forecasting, a CEO can apply various business models to the company's existing data or a set of aspirational financial data to determine how the business can realistically achieve its goals. Additionally, forecasting can be used to assist in the creation of a business plan or budget that is designed to handle a variety of different challenges, such as an economic recession or cash flow shortage.

**Read More:** [Revenue Forecasting For Decision Making? Here's How To Use It...](#)

## 6 Budgeting Best Practices for Businesses

While it's good to forecast to help develop your future vision for your business and also to mitigate risk with worst-case-scenario forecasts, budgeting will help you keep your daily operations and spending on track to help you achieve those long-term goals. Use the following budgeting best practices when creating and using a budget in your SMB.

### 1. Know How to Create a Budget

The first step is to understand the basic process of creating a budget. First, you need to gather your financial records. Then use the information to reasonably estimate what your revenue will be for the upcoming financial period. If you've shown a trend of growth or shrinkage, be sure to take that into account. Then create a list of all your company's expenses and what you project them to be in the upcoming year. Finally, consider if you have any upcoming revenues or expenses that are unique to the year and determine how you will work these into your new budget.

### 2. Choose the Budgeting Method That Makes Sense for Your Business

While the broad strokes of budgeting are always the same, there are a variety of different methods that you can apply to your business's budget. Some of the most popular include zero-based budgeting, incremental budgeting, activity-based budgeting, value-proposition budgeting, and top-down budgeting.

### 3. Don't Work Alone

Not working alone when you make a budget for the business is essential to ensuring you don't forget about any line items or important upcoming, departmental expenses. Ask your department heads or project managers to provide you with their own budgets and projections for the upcoming year so that you can aggregate all of this information into a global budget for your business. Additionally, collecting departmental budgets will help to ensure that every part of your company is aligned with common goals that are going to support your business's long-term strategy.

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## 3-Year Scenario Planer

A high-level vision of your finances to help you make decisions to hit profit goals.

[Speak to a Business Performance Specialist to learn how to see this with your business's own numbers.](#)

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### 4. Use Your Financial Forecast

While financial forecasting is a separate business activity, you can use your forecasts to create your business budget. If you have different forecasts, such as optimistic forecasts, realistic forecasts, activity-based forecasts, and worst-case-scenario forecasts, then use each of these to generate a different budget for your business. This will help ensure that you have a spending plan in place for any financial outcome.

### 5. Be Realistic and Conservative About Your Numbers

Business owners must be naturally optimistic, and this can sometimes make it difficult to build realistic numbers into your budget. Try not to be overly optimistic about the upcoming year's revenue growth and be realistic about the amount you'll be spending on each line item in the budget (and which expenses you can actually cut).

Additionally, remember to take inflation into account when creating the upcoming year's budget. With the kinds of inflation rates we've been experiencing recently, these rates do not represent insignificant changes. Don't forget that inflation reduces the value of your cash, resulting in increased prices.

### 6. Compare the Budget to Your Actual Numbers All Year

Throughout the year, you should be comparing your budget to your actual income and spending number. When you encounter budget variances, be sure to make adjustments to your budgeted spending plan so that you can continue to stay on track throughout the [rest of the year.](#)

## Support Your SMB's Budgeting and Forecasting With a Solid Back Office

Both budgeting and forecasting are powerful tools for business owners. However, budgeting and forecasting require a sound back office and access to comprehensive, accurate financial data. Without a clear record of your company's past spending and revenue that enables you to identify trends, it can be nearly impossible to budget and forecast accurately; predicting the future with accurate data is already tough enough.

If your SMB struggles to keep its back office in order, then [outsourced](#) bookkeeping, accounting, and CFO services might be right for you. These services cost a fraction of the price of hiring an in-house back-office team, they provide all of the benefits. With an outsourced back office, you can begin collecting data to keep your budget and spending on track with automated processes while identifying the profit drivers that can help your business turn its most optimistic forecasts into reality.