Budgeting: Flight Cafe Business Case Study

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Introduction

This report aims to critically examine variances in actual and expected budgets of Flight Cafe. The report begins with identifying objectives f the business to develop budgets and then continues to analyse pros and cons of budgeting for Flight Cafe. The report then calculate variances in given actual and expected budgets for the month of July and discusses various reasons that could cause them. Finally the report ends with suggestions to improve budget planning.

Objective of preparing budget for Flight Café

A budget is nothing other than the financial expression of planning, that is, the introduction of monetary values to the planning. But not always a budget carries with it a plan. In most cases, it is limited to being a simple list of properly arranged expenses, on the contrary, all planning, to carry it out, must be expressed in a financial plan, and it is a continuous process. The budget has a relatively short period, usually one year (Brigham and Ehrhardt, 2013).

In general, the objectives of the budget are:

- Plan integral and systematically all the activities that the company must develop in a given period (Brigham and Ehrhardt, 2013).
- Control and measure the quantitative, qualitative results and establish responsibilities in the different dependencies of the company to achieve the fulfillment of the planned goals (Marshall, 2016).
- Coordinate the different cost centers to ensure the progress of the company in a comprehensive manner (DRURY, 2013).

There may be many reasons to indicate the importance of budgets in the business world, however, some of these reasons in case of Flight Café are the following. The importance of budgets are reflected by their role in minimising risk related to business operations.Budgets identify reasonable limits for planners to carry out operations of the business within these limits.Budgets also serve a mechanism to review policies of the company and identify gaps in strategies to further indicate change in direction. They quantify various components of entire plan in financial terms and direct actions. Budgets help to increase the allocation of resources. They also help to save time and minimise waste for the company. They tend to keep the production in line with demand forecasts. Strategic planners can use budgets to ensure that strategic plans of the business are progressing in the intended directions and any variations are periodically identified and rectified promptly. Budgets are considered to be a tool of communication between lower management and employees and vertically upwards i.e. executives at the top level (Otley and Emmanuel, 2013).

Flight Café can derive several advantages from budgeting for example, each member of the company will think about the achievement of specific goals through the responsible execution of the different activities that were assigned to him.The firm's management conducts a study, an early study of its problems and creates among its members the habit of analyzing them, discussing them carefully before making decisions.Periodically, policies are rethought if, after reviewing and evaluating them, it is concluded that they are not adequate to achieve the proposed objectives.It helps in the proper planning of production costs.It causes to optimize results through the proper management of resources.It creates the need to devise measures to effectively use the limited resources of the company, given the cost of them.It is the most appropriate system to establish "average costs" and allows comparison with real costs, measures the efficiency of management in the analysis of variations and serves as an incentive to act more effectively.It facilitates the effective monitoring of each of the functions and activities of the company (LaviaLópez and Hiebl, 2014).

However, there are also some disadvantages. The data to be estimated will be subject to the judgment or experience of those who determined them.It's just a management tool. A budget plan is designed to serve as a guide to the administration and not to supplant it.Its implementation and operation takes time, therefore, its benefits will be available after the second or third period when experience has been gained and the personnel involved in its execution are fully convinced of its needs (Weygandt, Kimmel, and Kieso, 2015).

There are also some limitations of budgets as management tool which are as followed (Allen, Hemming, and Potter, 2013):

- Budgets are developed using estimates.
- New changes must be continuously integrated in budgets.
- There is no automatic execution and it is essential to understand the importance of human element.

- Budget is an instrument and is not yardstick for administration or management. Administration and management can use budgets to pursue strategic objectives.
- It is important to understand that budgets cannot be used as straitjackets that are developed by top management and deployed on employees. There is a need to ensure employees have full participation in developing and designing budgets so that they can provide realistic inputs.
- Financial resources are critical for success and management should use budgets as a tool to allocate them but they must be based on solid forecasts and analyses. Variances in expected and actual budgets are to be carefully examined and underlying assumptions are to be changed to constantly upgrade budget plan.

Variances in Actual and Expected Budgets of Flight Cafe for July

A variance is simply the difference between actual and expected or forecasted budget amounts. Managers calculate differences of various items in a budget such as revenues, expenses, direct material, indirect material, wages, etc. to understand any changes in underlying assumptions that were used to develop expected budget. A deviation in budget is not always unfavourable and shows that company is performing poorly (Brigham and Ehrhardt, 2013).

Considering the case of Flight Cafe, it can be observed that main variance occurred in number of meals served and actual quantity served was less than expected quantity, and thus the difference was (18000-17800 = 200). Due to this decrease all other budget items were also reduced which include revenues and expenses. There are no other variances in any other amount such as cost of labour, utilities, variable costs, etc. This variance indicates that management needs to review the assumption under which the expected quantity of meal served in July was derived (Marshall, 2016). By identifying faults or errors in this assumption Flight Cafe can improve its forecasts.

Recommendations

The main variance found in the budgets for July of Flight Cafe is in expected quantity of meals to be served. The actual quantity is less than expected, and thus the management needs to improve underlying assumptions to have better forecast. A number of reasons can be suspected to have caused this decrease. Firstly, there might be a decrease in number of passengers causing a reduction in demand (DRURY, 2013). This is beyond the control of Flight Cafe and thus mabnagement needs to carefully examine change in number of passengers to have better forecasts.

In addition, it is also possible that demand has decreased due to quality issues. Management can identify any quality complaints by conducting a survey among customers and focus on various quality indicators that have direct impact on demand (Otley and Emmanuel, 2013). Once these factors are identified the managers can easily identify which factor has compromised quality leading to a reduction in demand of meals. Furthermore, it is also possible that the price of meal served is higher than competitors and thus customers are switching to competing brands (LaviaLópez and Hiebl, 2014). It is therefore recommended that flight cafe management must conduct a thorough market analysis and understand factors that affect competitiveness of firm in terms of price. If there is competitor who is offering less prices while same quality, then management must take necessary actions. One option is to reduce price, however, it will also reduce profitability. Price reduction must always be supported by reduction in cost to ensure high level of profitability (Weygandt, Kimmel, and Kieso, 2015).

On the other hand, the management may also add a unique feature to its product to make it distinguishable from competing products. Once an attractive element is added to the product, managers can attract more clients. However, it is important to note that adding another element will increase cost of the production and thus affect profitability of the business. Therefore, it is important for managers to ensure that additional element also enable management to increase price per meal so that revenue also proportionately increase, otherwise, profitability is bound to reduce (Allen, Hemming, and Potter, 2013).

Finally, this report also suggests that Flight Cafe, should aim to increase customer loyalty in order to maintain demand. The main tool to ensure high level of customer loyalty is to use marketing and advertising campaigns (Brigham and Ehrhardt, 2013). However, there are certain costs and expenses associated with marketing campaigns and managers need to ensure that they bring in significant return in order to maintain profitability of the business.

References

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