

ACCT 2301 SU1 2009: Budgeting Assignment (in class tomorrow)

Consistent with some prior assignments in this class, there will be no ‘right vs. wrong’ answers *per se* on the budgeting assignment.

As a quick recap of today’s budgeting discussion, budgeting involves judgment (i.e., thinking about uncertain future events) and mechanics (i.e., properly assembling information). Whether or not you perform budgeting mechanics correctly is an objective assessment. Whether or not you use good judgment and communicate effectively is a subjective assessment.

Tomorrow, you will receive various bits of historic information (primarily financial) and various projections about the future (again, primarily financial) for an organization that would like to compare budget projections for two different strategic options.

You will have two hours to (1) think about this information, (2) assemble this information in a logical, clearly described fashion, and (3) summarize your budgets.

Previously, you have had an opportunity to become familiar with how the budgeting assignment will be graded.¹ Specifically, the assignments will (again) be graded by Mr. Beau Barnes and he will focus on the following: (1) Professionalism, (2) Comprehensive answers (i.e., allocate your time in order to complete all requirements), (3) Clarity (think about how to organize your budget report), and (4) Conciseness (eliminate unnecessary information).

Preparation for tomorrow:

To maximize your time during tomorrow’s budgeting assignment, I strongly encourage you to print the material provided on the class website and read it carefully before class. This material “sets the stage” for tomorrow’s assignment by providing context for the task that you will perform. In addition, a few suggestions are provided that will (hopefully) help prepare you for tomorrow’s assignment.

Please highlight anything that you feel might be useful in preparing your budgets and bring a printed copy of the posted material with you tomorrow. Feel free to highlight any information from the background material that you believe is important.

¹ About 95% of the class took advantage of this opportunity. If you did not, but would like some feedback, (1) ask a group member (or multiple group members) if you can see their graded May 27th assignment and/or (2) review post #7 (“Grading feedback for the budgeting assignment”).

Budgeting Assignment: Prelude

Given that Mr. Barnes will grade the assignments, his name has been inserted as the business owner in the following story. As previously noted, the story is intended to provide context that might affect your budgeting decisions.

Hopefully, using Mr. Barnes' name (as the owner) adds realism to the following business story and to the budgeting task. In the following story, you will be asked to play the role of an accountant who is preparing a budget report for the owner of a company. Mr. Barnes (the grader) will play the role of a business owner evaluating whether his accountant provided a high quality report.

Budgeting Assignment: Background Story

Mr. Beau Barnes is a successful entrepreneur in the catering business; however, his business philosophy is not all about "making money". In fact, Mr. Barnes began his business by accident...literally.

To explain, Mr. Barnes has always enjoyed cooking large quantities of food (with the help of others) for church gatherings, fundraisers, and other social events. Mr. Barnes is an excellent cook with many special recipes. In the past, numerous people have encouraged Mr. Barnes to start a catering business; however, it took a traffic accident to begin the process. Specifically, a friend familiar with Mr. Barnes' culinary abilities previously worked for a large company in the DFW metroplex. This company had an important business event scheduled for a particular Friday evening, and that morning, the business was informed that their catering services' kitchen was destroyed in a tractor trailer accident.

Mr. Barnes (and friends) responded to "an emergency call for tasty food – in large quantities" and the result was a smashing success.

Within months, Mr. Barnes began his business (Barnes Catering) with the company slogan, "Family Food for Professionals." He hired several people he had known from volunteering at social events. The people Mr. Barnes hired tended to have similar goals regarding their employment. Below are two profiles of employees which exemplify the kind of people who currently work for Barnes Catering.

Employee Example #1 – Terrie Stanbaugh

Terrie is a married mother of two children. One of her children is a sophomore in high school and the other is a freshman in college. Before working at Barnes Catering, Terrie was a stay-at-home mother and she spent time keeping the family's finances in order, preparing meals, volunteering at church and school, and assisting her husband and children as they worked towards their own personal goals in business and school.

Terrie's husband earned enough money to support the family, but Terrie sometimes found herself wanting extra cash for non-essentials (dinners at nice restaurants, family vacations, etc.). When Mr. Barnes offered Terrie a job catering part-time she thought that it was perfect timing and she accepted the offer.

Since accepting the offer Terrie has consistently worked 20 hours a week and she earns \$15 an hour. While Terrie originally planned to use her earnings for 'non-essentials', she quickly began to depend on the money to pay for her daughter's college tuition. Terrie believes this is money well spent and she is now so busy that she rarely thinks about 'non-essentials'. Because Barnes Catering is able to offer Terrie her desired 15 to 20 hour per week schedule, she can still contribute to her family the way she did before

the job (e.g., preparing dinners, keeping the family finances in order, etc.). Additionally, working at Barnes Catering eases the financial burden that college tuition puts on the Stanbaugh family. In her mind, Terrie has achieved the perfect balance between work and family.

Employee Example #2 – Leon Bruner

Leon is a 62-year-old retired school teacher who raised his two grown children as a single father. Prior to working for Barnes Catering, Leon volunteered at various social events simply because he enjoyed interacting with the other volunteers. (Mr. Bruner met Mr. Barnes at a volunteer event.) Previously, Leon lived off his fixed-income retirement and considered himself financially comfortable. More recently, Leon's financial and life circumstances changed when his elderly father fell off of a ladder while hanging Christmas lights.

To explain, Leon's father cared for Leon's mother. After the accident, the family's physician suggested that Leon's parents needed full-time professional care (i.e., a nursing home). As the couple's only son, Leon took on the responsibility of paying for the nursing home and monitoring the well-being of his parents.

Similar to Terrie, Leon began his second career with Barnes Catering working 20 hours a week and making \$15 an hour. Leon believes he has the perfect job because the money he earns allows him to pay nursing home bills but the part time schedule allows him free-time to visit his parents and spend time with his three grandchildren (plus, he still very much enjoys the social interaction provided by the Barnes Catering work environment).

Overall, Leon appreciates his job. While this was not exactly the retirement he had mind, working at Barnes Catering gives Leon the ability to handle newfound financial responsibility without really compromising his lifestyle. Leon believes that alternative employment opportunities do not compare to the Barnes Catering work environment.

Mr. Barnes' Business Philosophy

Mr. Barnes attributes his business success to 'sticking to his core values'. Specifically, Mr. Barnes believes in (1) serving good food at a reasonable price, (2) respecting the work/family balance of his employees, and (3) making intelligent business decisions.

Serving Good Food at a Reasonable Price

Mr. Barnes has always weighed cost against quality. He personally tastes the food his company serves and does not serve food that fails the Barnes 'taste test'. At the same time, Mr. Barnes monitors the prices of different suppliers and always gets what he believes is "bang for the buck." Most catering company owners are not willing to invest time monitoring multiple supplier prices and tasting each dish served; however, Mr. Barnes sees this as time spent gaining cost savings and controlling quality. This allows him to stick to his core value, to serve *good* food at *reasonable* prices.

Respecting the Work/Family Balance of his Employees

Mr. Barnes is committed to 'doing right by his employees'. Specifically, Mr. Barnes has, in almost all cases, allowed employees time off for important life events (as long as employees give a bit of advanced notice). In addition, Mr. Barnes has allowed employees to 'self-select' whether they work during the weekend (Friday, Saturday, Sunday) or during the week (Tuesday, Wednesday, Thursday). While some employees prefer to work during the weekend, more prefer to work on weekdays. Historically, Barnes Catering employees have had minimal objections to 'taking their turn' on needed weekends.

Mr. Barnes recognizes that the people who work at Barnes Catering do not want to work a standard 40 hour week (they generally want to work about 20 hours a week). In the past, Mr. Barnes has frequently turned down catering jobs because “he doesn’t want to over-work his staff.” Barnes Catering employees are aware that business is often ‘turned away’ and they are appreciative...although not openly discussed with employees, Mr. Barnes believes turning down business sends the signal “customers need to schedule in advance if they want the best catering service”.

Mr. Barnes feels that accommodating the schedules of his employees allows him to maintain his commitment to providing his staff with “family-friendly” employment. Mr. Barnes believes this core value makes business sense because his employees consistently show up for work, employee turnover is extremely low, and – in the rare case of ‘emergencies’ – his employees have always been willing to help Mr. Barnes and Barnes Catering.

Making Intelligent Business Decisions

Like most entrepreneurs, Mr. Barnes is a bit of a risk-taker. Mr. Barnes took a risk when he dropped everything to become a caterer. Like most risk-takers, Mr. Barnes expects a reward for the risks he has taken. Mr. Barnes believes a commitment to making intelligent business decisions is a commitment to this reward; and – like most businesspeople - Mr. Barnes prefers his reward to be sizeable. “Breaking even,” in Mr. Barnes’ view, is far from acceptable.

Lately, Mr. Barnes has spent considerable time analyzing the financial position of Barnes Catering. For medium-range planning, Mr. Barnes thinks in terms of return on investment (ROI). When considering any large catering opportunity, Mr. Barnes’ first reaction is to ask, “What’s the ROI?”

Mr. Barnes employs you (an independent accountant) and, like many of your better clients, Mr. Barnes keeps you “in the loop” regarding major business decisions under consideration. Having had Barnes Catering as a client for some time, you are accustomed to Mr. Barnes request for “ROI projections” for potential business opportunities.

In summary, Mr. Barnes is a thoughtful, well respected businessperson who is committed to his core values (and to running a successful business).

The Past Has Been Very Good

When Barnes Catering opened for business in the Dallas/Fort Worth area, the company filled a gap in the area’s catering industry. Others offered standard fare (box lunches and cafeteria-style foods over Bunsen burners) to corporate clients. Barnes Catering, in contrast, served family-style meals. In other words, Barnes Catering didn’t divide meals into individual units (boxed lunches) nor did they arrive with heated stainless steel dishes of boring looking (and tasting) food. Instead, Barnes Catering provided large dishes placed on the center of tables (much like a large family might have at Thanksgiving).

Corporations saw the new style of catering as a way to promote bonds among employees; and Barnes catering was the only family-style caterer in town. So, the services were in high demand and the corporate clients were not very price sensitive because they saw the meal as more than food; Barnes Catering offered a bonding experience.

In the past, there has been little competition and business has run smoothly. Employees have been happy with fairly flexible schedules (and relatively high wage rates). In contrast, other catering services in town are known to “burn out” employees and offer relatively low wages.

The Future Will Be Different

Success gets copied.

The wife of a wealthy oil man fancied herself to be a great cook, and a job was needed for their youngest son (a recent MBA who wanted immediate CEO-style authority). The result was the extremely well funded, Katie's Katerin' – a direct competitor to Barnes Catering in the DFW area. (Katie's opted for the unoriginal slogan "Home-style Food for the Professional" in order to directly assault Barnes Catering's "Family Food for Professional" slogan).

Katie's has copied the Barnes Catering business model (sadly, with some very tasty food) and Katie's Katerin' has positioned themselves as a low-priced option to Barnes Catering.

Barnes Catering clients are now demanding lower prices for the same services and food.

Mr. Barnes speculates that Katie's Katerin' is able to charge less for similar services for two reasons:

1. They are able to gain economies of scale on food because they operate on a larger scale than Barnes Catering. Katie's Katerin' takes on as many jobs as possible.
2. Katie's Katerin' is extremely well funded (by the husband of the owner). Short term losses might mean very little to Katie's (if the goal is to grab market share from Barnes Catering).
3. Katie's pays a relatively low labor rate.

Mr. Barnes still believes that his business can be competitive. He believes that his employees make a good team and the benefits of this 'team', in Mr. Barnes opinion, somehow outweighs the benefits of reduced wage rates. Many Barnes Catering customers have commented that Barnes' employees are 'friendlier' than Katie's employees.

The Business Decision

Mr. Barnes is faced with a relatively difficult near-term decision. His lease will soon expire, and he needs to decide whether to extend the lease on his current building or sign a new lease on a more modern, larger building.

The Current Building

The good thing about the current building is the price. It's cheap; however, it is also small. The kitchen is only large enough to accommodate 4 to 5 employees preparing food at a time. This is fine for the current operation because no more than 5 employees are preparing food at the same time.

The Potential Building

The building is more expensive, but it can accommodate up to nine employees preparing food at the same time. Barnes Catering would need to make use of this increased capacity in order to afford the new building (so people would have to be more flexible and possibly work more hours).

Tomorrow's Assignment:

Mr. Barnes is considering two options for the future.

The first is a 'steady state' strategy while the second is a 'controlled growth' strategy.

Two different locations are under consideration, and the appropriate location depends – to some degree – on the strategy Mr. Barnes will take.

Mr. Barnes would certainly prefer to stick to his core values; however, he is not sure what this implies. Specifically, the ‘steady state’ strategy would likely allow Mr. Barnes to continue “doing right by employees” in the near term; however, it is becoming clear that maximizing employee satisfaction is not necessarily an intelligent business decision. It appears that the new business environment will cause two of Mr. Barnes’ core values to be at odds with one another.

As Mr. Barnes’ accountant for the past few years, you will be asked to create two different budgeting scenarios (1) a ‘steady state’ scenario and (2) a ‘controlled growth’ scenario. Mr. Barnes suspects that higher profits are available under scenario #2; however, he believes scenario #2 puts his company’s family-friendly atmosphere at greater risk than scenario #1. Specifically, he is concerned that his employees’ work/ life balance will suffer with the increased work-load which will accompany a growth strategy. Similarly, he is confident that the loyalty he has shown employees (and vice versa) will be harmed to some extent with a growth strategy.

On the other hand, Mr. Barnes is concerned that a “steady state” strategy will not give him adequate return for the risks he has made. In other words, he is not sure that the steady state strategy will ultimately be a sound business decision.

Tomorrow, you will receive some historic financial information about Barnes Catering and some projections about future economic conditions.

Mr. Barnes requests that you create two unbiased budget scenarios (one for the ‘steady state’ scenario and one for the ‘controlled growth’ scenario).

Mr. Barnes’ strategic decision will not be based purely on your projections...all that Mr. Barnes requests from you are realistic (and justified) budget projections to help inform his strategic choice. Mr. Barnes has prior experience with your budgeting work and he is confident that you will be able to provide him with solid, unbiased projections. Mr. Barnes is comfortable that you understand his core values, and what’s important to the company. And - as always - he will be particularly interested in the answer to his knee-jerk question, “What’s the ROI?”

An Important Note on Mr. Barnes

Mr. Barnes prides himself on giving each employee his full attention when discussing matters of employment such as benefits, wages, time-off, etc. While this is an admirable trait, it can take its toll on a person in management. Due to the increased time expected to manage a larger workforce, Mr. Barnes is very hesitant to increase the number of employees in the short term. He is confident that he has the right people...and he is unwilling to hire anyone who is not ‘right’ for his company (especially in the current economic environment).

Tips for the assignment:

- No time value of money: You will be asked to calculate ROI for both scenarios (this will be the “summary number” that Mr. Barnes considers).
- Be unbiased. Can you take provided information and create two reasonable scenarios? Can you explain what you’ve done clearly and why each budget is a feasible path for Barnes Catering?
- Keep your time-frames consistent. Information is often provided over different time horizons (years, months, weeks).