

3.9 Budgets (HL)

The big picture

Cost management is one of the most important aspects of the construction industry. However, the real costs of a project are often very different from the costs that were planned at the start of the project. Every year, large construction projects around the world end up costing more than expected. From the Gulf Railway line connecting Qatar to Saudi Arabia, to the Navi Mumbai International Airport in India, many major construction projects have proved to be notoriously difficult to execute according to budget.

Germany's Stuttgart 21 railway construction project is another recent example. When the project was announced in 1994, it was projected to cost \$2 to 3 billion. With a projected minimum four-year end-date delay, the projected costs as of March 2022 are more than three times the original estimate. The video below explains how the construction costs exploded.

Germany's 27-Year Struggle to Complete a Rail Project



Video 1. The Stuttgart 21 mega-project.

A budget outlines planned spending and revenues for a period of time. Budgets help to give businesses financial discipline. They can set spending limits for managers who might otherwise be less cautious with the business's funds.

However, budgets are only an estimate. Budgets are only as reliable as the information on which they are based. In the real world, the external environment changes: resource costs may increase, equipment may break and revenue may be less than expected. When these things happen, it is important to be flexible. Budgets are only a guide; they are not set in stone.

But when a project goes over budget, both internal and external stakeholders will feel the impact. Profit margins may decline, resources may be wasted, and the business may even experience cash flow problems and face insolvency. So, good budgeting is essential to business sustainability.

In this subtopic, you will learn how to construct a budget and calculate variances. You will also learn the difference between cost centres and profit centres in a business.