Those of you who’ve joined me in seminars over the years are familiar with my asking that question. If we polled our readership, I’ll bet we’d have various answers to it, stretching from producing sales, to providing jobs, serving the customer base, giving back to the community, etc. While all of those reasons are commendable, let’s be clear. We’re in business for two reasons: profit and fun.

Profit is our lifeblood—it provides us the cash flow we require to meet payrolls, pay our bills and invest in expansion. Fun is the fire in the belly, the passion that drives us. And if we’re making money, chances are we’re having a lot of fun. If we’re not, business can be a real bummer.

This is the time of the year that we all prepare our budgets. You do prepare a budget, don’t you? Because Inc. magazine says that only about 15 percent of us small businesses actually prepare a budget. No one doubts a budget’s value, Inc. says. It’s just that most business owners don’t know where to start.

My advice? Start with what’s most important—profit—specifically net profit, and work up from there. Here are five steps to get you started:

1. Determine the amount of net profit you need to make.
2. Budget each overhead account using the “zero-based” concept of budgeting. The combination of net profit and overhead equals the amount of gross margin you must generate if you’re to be successful in meeting your cash-flow requirements and cover your overhead.
3. Determine your capacity. What do we sell in the service world? Labor mostly. So, prepare a labor budget that will help you determine the number of hours you have available to sell next year.
4. Determine your backlog. This is the amount of work you’ve already sold for next year. How much gross margin does this generate? This margin will offset the amount of margin determined in steps one and two.
5. What are your 2013 sales goals? We know how much margin we have left to sell, so ask yourself how much revenue is required to cover that margin.

Let’s discuss step No. 1: How much net profit do we need to make? Obviously, we want to make as much of it as we can, but the question is, “How much must I make to cover my cash flow demands?” We can calculate that from our balance sheet and the result will be our new break-even point.

First, make a list of all of the debt you intend to retire in the coming year. Add up only the principle payments, as interest is an expense found on the income statement.

Second, make a list of capital purchases you plan to make in the coming year, such as trucks and equipment. Then, itemize the cash payments you’ll be making throughout the year (down payments and principle payments).

Third, anticipate the amount of cash you’ll need to support your revenue growth. Here we will use a financial statistic that says in the service industry, it takes about 10 cents to support a dollar of revenue. So, if we plan to grow $500,000, we’ll need to raise net profits 10 percent of that growth, or $50,000, to maintain the adequate cash flow to meet payrolls and pay our vendors while we wait to collect our billings.

Our fourth cash need is the bonuses/dividends we’ll disburse if we generate the net profit we’ve budgeted. This is our way of saying thank you to the hard work our team accomplished in reaching a goal.

And, lastly, Uncle Sam. Calculate the amount of tax you’ll incur by reaching your net profit goal. (Your accountant can help here.)

Add the five values together, subtract next year’s anticipated depreciation—as this is a non-cash expense item on our income statement—and the result is the amount of net profit we must make to support our company in the coming year. Not “want to make” or “should make,” but must make if we’re to meet all of our obligations in the coming 12 months.

Now, it’s your turn.