 By Alan Friedman

Budgeting: The Ancient Art of Guessing

A savvy entrepreneur as well as a fabulous diva, Madonna knows the power of budgeting. In fact, the original title of her song "Express Yourself" was every good budgeter's credo—"Project Yourself."

Madonna knows the importance of using a budget (a.k.a., a projection or forecast) to project business revenues and expenses as well as cash inflow and outflow over a period of time. She estimates the sales revenue of her CDs, concert tickets and videos. I'm sure she budgets the cost of her bustiers and hair coloring as well. Madonna even used a budget to forecast the financial effect of touching herself and rolling around naked in her videos. She truly is the "material girl." (Actually, I have no idea if she uses budgets, but it's a part of my Madonna fantasy.)

The funny thing about budgeting is that it's really just a process of making educated guesses. Therefore, trying to project too far into the future may prove to be less than worthwhile. At the same time, a budget that doesn't look far enough into the future can't predict events early enough to plan business decisions or take corrective action. So, is it worth spending the time to create a budget? How far into the future should you plan? What if your budget is wrong? Well, the answers are "yes," "it depends," and "who cares." Let me explain.

Justify My Love (of Budgets)

A budget is the most fundamental and most effective financial management tool available to a business. Whether you're earning thousands, hundreds of thousands or millions of dollars a year, it's extremely important to know how much money you have to spend and where you're going to spend it. Although usually ignored, creating and using a business budget is the first step to any money management activity. Without it, you cannot control your finances and will almost always fall short of your goals.

Think about it. A carpenter would never start work on building a house without a blueprint. An aerospace firm would never begin construction on a new rocket booster without a detailed set of design specifications. Yet many music retailers are making, spending and investing money without a plan by which to guide themselves. Budgeting is about planning. And planning is crucial to achieving the desired result of net profit and cash. With a budget, you can organize and control your financial resources, set and realize goals and decide in advance how your money will work for you. A budget can be as simple as it is powerful; it's definitely "vogue."

Papa Don't Preach

Not sure budgets are for you? Here's 10 indicators that you should be on a budget:

1. Your checking account's bank statement has an average of 37 non-sufficient funds (NSF) charges every month.

2. The store cat mistakes the scattered vendor invoices on your desk for a litter box.

3. Your personal credit card is over its limit with store-related expenses.

4. You feel as though your financial dreams are taking a nap.

5. Ending a phone conversation with a supplier, he says "Bye now" and your Pavlovian reply is "Pay later!"

6. You carry enough credit cards to shingle the roof of your music store.

7. You consider balancing your company's checkbook akin to a death-defying circus act performed by skilled Ukrainian acrobats.

8. Both your banker and the Internal Revenue Service are on speed dial.

9. Your accountant is someone you fear or loathe, or both. And he's ugly, too.

10. You have enough inventory in your single store to supply a chain of seven music stores.

Budget Power

In short, here's the power you gain by using budgets as an integral part of your business:

Knowledge. Budgeting allows you to know exactly how much profit and cash you have or don't have—down to the penny. A budget is a self-education tool that shows you how your store is operating fiscally and how close you are to reaching your goals.

Control. Budgets give you the control to take charge of your store finances. They also let you make corrections on a timely basis when things don't go according to plan.

Organization. Even in its simplest form, a budget forces you to systematically organize store transactions and activities into categories of revenues and expenses. This allows them to be easily measured and monitored via the budget.

Communication. Creating a budget, with input from key store personnel, helps resolve misunderstandings about the store's financial goals. A budget also communicates priorities for spending store money.

Opportunities. Knowing the exact state of your store's financial affairs and being in control of them allows you to take advantage of opportunities that might otherwise be missed. Have you ever wondered if you could afford a new product? With a budget, you'll never have to wonder again—you will know.

Credibility. A budget can illustrate your financial plans to your banker and creditors, or any third party who questions how and when you spend your money. Being armed with such information also saves time and energy when applying for loans and credit.

Mo' Money. This might be every music retailer's favorite benefit. A budget will almost certainly produce extra money by allowing you to avoid costly mistakes. So "celebrate": You can take a "holiday!" (OK, I'm sorry, enough Madonna-isms.)

The Budget Example

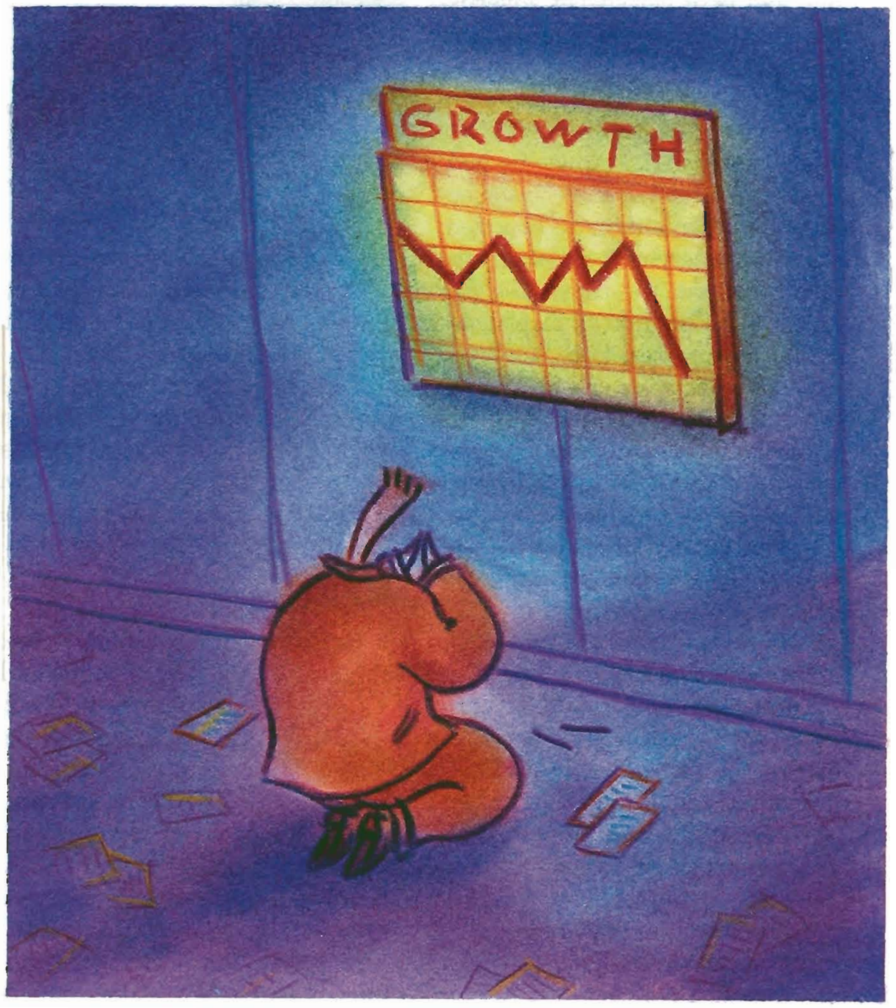
There are many ways to create budgets. You can use the trusty 12-column accounting paper. Better still, some accounting software packages have a budgeting feature built in. But if these two options don't appeal to you, the easiest and most flexible tool for creating a budget is spreadsheet software, such as Microsoft Excel or Lotus.

The inset 1999 revenue-and-expense budget for Big Al's House of Rock & Schlock [see page 28] shows what a typical budget might look like. For illustration purposes only, I've compared "annual" results to "annual" budgeted amounts, but I recommend preparing monthly budgets.

Analyze, Consider, Act

The real power of budgeting is the opportunity to act upon what the budget shows. Here's what Big Al's budget is telling him:

A. Although Big Al fell $70,000 short of his annual sales goal, who cares? He achieved $90,000 more



BIG AL'S HOUSE OF ROCK & SCHLOCK
1999 REVENUE and EXPENSE BUDGET

	Actual	Budget	Difference Good (bad)	
NET SALES (See Schedule 1)	$ 1,930,000	$ 2,000,000	$ (70,000)	(A)
COST OF GOODS SOLD				
Beginning inventory	550,000	550,000		
Inventory purchases	1,400,000	1,310,000		
	1,950,000	1,860,000		
Less ending inventory	750,000	500,000		(B)
COST OF GOODS SOLD	1,200,000	1,360,000	160,000	
GROSS PROFIT	730,000	640,000	90,000	(A)
OPERATING EXPENSES				
Salaries owner	30,000	75,000	45,000	(C)
Salaries sales staff, administrative	189,300	190,000	700	
Advertising	138,800	80,000	(58,800)	(D)
Rent	75,000	75,000		
Taxes	24,500	25,000	500	
Insurance	24,100	25,000	900	
Vehicle and delivery expense	23,800	24,000	200	
Store supplies	18,700	20,000	1,300	
Bank and merchant fees	38,200	20,000	(18,200)	(E)
Telephone and utilities	17,600	18,000	400	
Travel, meals and entertainment	43,900	15,000	(28,900)	(C)
Depreciation	14,700	15,000	300	
Professional fees	14,200	10,000	(4,200)	(F)
Maintenance, repairs, office expenses	13,600	14,000	400	
	666,400	606,000	(60,400)	
INCOME FROM OPERATIONS	63,600	34,000	29,600	
OTHER EXPENSE				
Interest	26,600	15,000	(11,600)	(G)
INCOME FROM OPERATIONS	37,000	19,000	18,000	
Income taxes	7,000	4,000	(3,000)	
NET INCOME	$30,000	$15,000	$15,000	

gross profit dollars than he expected. And we all know gross profit dollars are way more important than gross sales dollars.

B. His ending inventory of $750,000 is way higher than the $500,000 he budgeted. Accordingly, his inventory turns are only 1.6 (cost of goods sold divided by ending inventory). Big Al had better plan to have a "post-holiday" sale to reduce his excess inventory and generate some much-needed cash.

C. His $30,000 owner's salary is pitiful. He'd better look to cut some fat out of his discretionary spending (such as travel, meals and entertainment) to allow him to take a more deserving salary.

D. Big Al's advertising (which has a direct correlation to gross sales) doesn't appear to be working. Perhaps he should try more direct mail and local newspaper advertising, rather than cable television, radio and national magazine ads.

E. Big Al's bank charges and merchant credit card fees are way higher than he budgeted. Perhaps he budgeted too low, maybe more customers used credit cards than he expected, maybe his merchant rates are too high. Whatever the cause, Big Al's budget is telling him to investigate and take corrective action.

F. He spent more on professional fees than anticipated. Maybe Big Al's lawyer renegotiated his lease. Maybe he had a file server crash and needed some computer network expertise. Or maybe his accountant successfully defended him in an IRS audit. Any of these reasons may justify the overspending and require no further action on his part. But without a budget, how would he ever know that the real reason was that his lawyer and accountant raised their billing rates?

G. Big Al incurred more interest on his loans and financing than he budgeted. Perhaps his bank line of credit remained unpaid longer than in prior years or he had more floor planning at a high interest rate or he's borrowing more money than usual. Any of these factors could indicate not only a high cost of financing, but slow product movement.

Big Al's actual results say he made a profit, but did he? When you consider his salary was $45,000 less than budgeted, and his profit was only $15,000 more than planned, he clearly fell short of his plans.

Some Final Thoughts

Simply creating a budget won't guarantee you're going to make money. But careful monitoring, adjusting and acting upon a budget will greatly enhance your odds. Keep in mind that creating a cash-flow budget is equally as important as a revenue-and-expense budget because cash doesn't always flow in and out at the same time revenues are earned and expenses are incurred.

NAMM has a great resource book called *The Cost of Doing Business Survey* (which you can order by calling NAMM at 800-767-6266). Designed specifically for music retailers, this guide has balance-sheet and income-statement ratios by sales volume, store type and geographic region. It is a great tool for helping you create a meaningful budget.

So don't stay on the "borderline." "Get into the groove." Create your first budget "like a virgin," "count your lucky stars" and "cherish" your work. Project yourself. Then you can dance.

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