Building Better Budgets: How to Use Them to Improve Your Bottom Line

Introduction

There are few things a normal publishing person dreads more than building a budget. There are all those details, and the numbers! And you have to try to peer into the future and make guesses on paper, guesses that someone might hold you to! Yup, there's no doubt about it – budgets are *no* fun, even for number-crunchers like me.

Still, I think we can make them a little less awful. Today, you'll see how do build these things, one step at a time, and then what to do with them, so that your budget doesn't just sit in a file, wasted effort.

Use a spreadsheet program

The first step in building a budget is to open your spreadsheet program … Seriously, though, the first step is to set up separate worksheets for each step of the process. You'll probably want to have bunches of these, so that the calculations are simple and obvious for each step, and yet you'll want to link them, with formulas reaching back and forth, so that the data flows automatically from one to the next.

The separate worksheets, and simple formulas for each step, are so that mistakes, and you **will** make mistakes, are easy to find, and the fixes are obvious.

The automation, and linking the separate worksheets, helps you not to forget to copy a critical change into each and every step. Inevitably, the phone will ring, or a colleague will stop by, just when you are in the middle of something tricky. Automation makes this kind of difficulty less of a problem.

All of these separate worksheets should be in one file, that Excel calls a workbook. Why? Because then, when you insert a line, or change the placing of a total, all the rest of the formulas will correctly track the new locations, if you follow a few simple rules.

The overall theory here is a combination of the KISS rule, and goof-proofing. Try to make things hard to foul up, and make it so that mistakes will ***show up*** when they happen.

Now, what should those worksheets look like? Well, almost every one will have lines for each title, and columns for every month. You'll have columns for subtotals, and a row for subtotals. The overall total of the columns and rows should be the same. (That's one of those error detection things I mentioned.)

You'll also want a summary or cover sheet, that brings together all of the totals from each major worksheet, and shows the overall picture for the year.

In our example, this summary is the first sheet in your handouts. We aren't actually putting anything on it, yet, but that will make it easier to flip to it when we do need it.

Building a budget works best if you start with sales, and work down the income statement from there.

Revenues

Begin by trying to project your gross sales, in number of copies, for each title.

You probably already estimated your life-of-title sales (and expenses) for each title, before you decided to publish it. Gather and update those estimates before you start.

We'll build a very simple budget today, for a publisher that has no backlist and will release only two titles this year. In your handouts, you will find the projections for these two titles. In an excess of originality, we're calling them Title Projection #1 and #2 (pages 2-5). The books themselves are **Making Books Make Money**, and **Bestseller . . . Or Not**.

The sales numbers on these sheets are life of title. Today, we'll be pretending that we expect these titles to go out of print 12 months after release. In a moment, we'll convert those first year sales numbers to month-by-month numbers.

After you have all these files, then find or make projections for this year's sales of your backlist (titles released before this year), also in number of copies sold. We're skipping that today.

Now, go back and look coldly at those numbers. Are you sure that they're realistic? In my experience, they're probably a bit on the positive side. Dial them down a touch, if you agree.

Develop standard patterns for your sales and returns. Most publishers see only a few different sales patterns in the first year after they release their books. If you look at your handouts, you'll see a graph showing 4 different patterns that this mythical publisher thinks might represent her lists. We'll use something like a "Big Bump" pattern, for today's exercise. If you were doing this for your company, you would need to draw those patterns that seemed likely to match your expectations or experience, and sort your front list by the pattern each title fits.

After you have your graphs, work out what percent of your total sales will occur in each month. The next page in your handouts does just that for these patterns. There's an easy way to get the month-by-month percentages:

- Draw the curve on graph paper.
- Count the number of squares under each of the 12 months, then
- Add those numbers for a total.
- Work out the percent each is of the total, and you're done.

You may want to do 2 separate curves: gross sales and the timing of actual (not accrued) returns. You'll follow the same method, but do it twice. In your handouts, the Standard Pattern of Sales we are applying to this company has rows of projections for accrued returns and for actual.

Use those percentages to compute how many copies each title sells, in each month after the release date. To go from the standard pattern to the actual projections, multiply your total expected sales (from the projections you did) by the percentage for that month.

If you are doing accrual accounting, you will accrue returns in the month that the original sales occur. If you are on cash basis accounting, and when you are projecting your cashflows, you will want to use the actual return patterns.

[I recommend against cash-basis accounting for all but the smallest businesses. It's much easier to avoid a crisis if you can see it coming, and that usually requires accruals.]

You can see an example of how I treat returns in the next page of the hand-out, The Sales Worksheet. The columns show the title, the release date, and the total sales from the projections we looked at initially. Then the columns show each month's sales in copies, and title subtotals.

You can see that I have combined several worksheets on this one page. This sample company has such a small list that you can get away with that. I wouldn't recommend it as a general practice.

So, having projected your gross sales, your returns trundle after, in much the same way.

Once you have gross sales and returns, getting net sales is trivial, so that's the next section of your worksheets.

From these 3 worksheets, you now need to derive the sales in dollars. Multiply the number of copies by the list price and 1 less the discount rate, which you can see in the second and third columns in the bottom half of this page of your hand-out.

Transfer your results to the summary page. Monthly subtotals for your sales in dollars should be transferred (automatically) to the appropriate spots on your summary worksheet. If you flip to the first page of your handouts, you will see that we have done just that.

Subsidiary Rights Income: Before you leave the revenue part of your budget, project your subsidiary rights income. You may already have done this for your individual projects. On the other hand, if you have a sizable list, and some experience, you may just project a certain amount for each season of your catalog, based on some rule of thumb.

I don't normally like rules of thumb. An alternative approach is to look for reasonable titles and amounts, then multiply by the probability of the sale. If you have enough possibilities, playing the odds this way will work reasonably well over time. Still, this is one of the few situations where a rule of thumb might do as well.

If you go back to the revenue worksheets, you'll see that we have included a page that projects the actual returns and the net sales with returns as they actually come in, rather than as they are accrued. You'll need this later, when we start projecting cash flows. Let me just say that it was projected in almost exactly the same way that we did the sheet with accrued returns.

COGS

Depending upon the number of titles you have, you may want to do your Cost of Goods Sold, or COGS, worksheets on 3 separate pages. You may also want to do them as we do here in your hand-out: 3 areas on one page.

Pull numbers of copies, release dates, etc. from your other worksheets, and then feed the sub-totals back to the summary page. Now, let's look at the 3 separate types of COGS expense: plant, PPB, and royalties.

Plant costs are those where the total expense doesn't change when you print more copies. Examples include:

- Editorial work
- Indexing
- Cover design
- Illustrations, if the illustrator isn't given a royalty.
- Text/interior design
- Etc., etc.

Plant costs should be accumulated, as you spend them, in an asset account, and then amortized as and after you release the book. Some companies amortize them over the life of the book, some over the expected number of copies. Some used to move the whole shebang into the expense column on the pub date. The IRS frowns hard on that last. I do NOT recommend it.

If you are doing accrual accounting, you should apply whatever amortization method you are using to the plant you have accumulated already and the amounts you expect to spend for each book, and then sum to your monthly subtotals.

If you are using cash-basis accounting, you will be projecting the expenses for your future titles, and the amounts needed to finish your current season's titles.

PPB is defined as Paper, Printing, Binding and anything else on the printer's bill. Apply the unit cost for each title to the number of units sold, net, for the month. Pick up the number of units from the Net Sales, in Copies sheet. *NEVER* include plant or royalties in your unit cost for the budget, financial analysis, or financial statements, whether you are doing accrual accounting or cash-basis. This is the most common accounting error that publishers make, and it can lead to all kinds of bad decisions, very easily.

The only exception to that rule is when you contemplate selling books "at cost plus royalty" for a special sale or book club deal. Then the price includes plant.

Royalties should be computed even if you are a self-publisher. If so, you may want to pay yourself as an author separately, in order to understand what money comes from which effort.

Apply your royalty rate to your royalty base (copies times list, net sales, whatever), pulling the numbers in from the appropriate page of the Sales worksheets. Here, we are paying 10% of net sales in dollars. I recommend accruing your royalty expense when you record the sales revenue, but if you are on cash-basis accounting, you will record it instead when you pay it.

Consider whether the book will earn out the advance or not. If not, you may want to treat the advance as you treat plant costs.

Now that you have these figures worked out, feed them into the summary sheet.

Gross Margin

We often look at gross margin because the COGS, while large, may be relatively difficult to reduce, after you look at the obvious areas. Those might be things such as picking trim sizes to fit the machinery of the printers you like best, or sending out enough RFQs to be sure that you are getting the best possible price consonant with your other requirements.

Looking at all other expenses as a fraction of Gross Margin can be illuminating. Some companies prefer to subtract selling expenses before computing Gross Margin, but that isn't my usual method.

Selling Expenses

Often this consists of a distributor's charges. Some of them will be a simple % of sales. Other times, the distribution cost comes out of revenue, when the distributor, technically, buys the books at a discount from you. If your distributor does this, you may still want to calculate an effective distributor's commission, in order to examine the true costs and benefits of the relationship.

Don't forget to include warehousing and similar fees here.

Marketing Expenses

Remember, back at the start, we gathered the projections for each of your front list titles. They included a line for marketing expenses. Let's suppose that this line was based on a marketing plan for each.

Now, you gather those plans, itemize the different kinds of marketing expenses (publicity, ads, co-op, display stands, mailings, whatever). Collect them by type, across titles. This may be a separate spreadsheet, or even better, one for every title with a column for each month, and a row for every type, and a cover sheet summarizing it all.

This example is so simple, that we just put 3 lines on the summary sheet and proceeded.

Examine cost and benefit carefully, especially for any non-publicity expenses, when you are making marketing plans. You may want to use the budget as a vehicle for re-examining all those plans.

General and Administrative Expenses

These are the expenses that keep the company functioning: rent, salaries and benefits, office supplies, and so on and so forth. The easiest way to project them is to look at the current year's expenses. Decide what major changes are likely to occur, add in a margin for inflation, and you have your idea of the likely next year's expenses.

Major categories, such as salaries by department should each get a line, in any company more complex than the example. This makes it easier to locate and assess areas where small changes can have large effects.

We should note that this sole proprietor isn't paying himself or herself a salary. That's not recommended, but is pretty common.

The Bottom of the Income Statement

Just as on your financial statements, Operating Income is defined as Gross Margin less the rest of the expenses above. Then you will project taxes (use your current rates) and interest.

To project interest, look at the projections of cashflow, which follow, to try to assess how much borrowing you may need to do, or how much excess cash (Well, if you get a breakout book, it COULD happen. Maybe.) you have to invest.

Extraordinary Items come next. You're highly unlikely to have these. They will be major events, and from outside the normal course of your business.

Earnings, aka Total Income, is Operating Income, less Interest, Taxes, and Extraordinary Expenses.

You may have heard finance types talk about EBITDA. It's Earnings Before Interest, Taxes, Depreciation and Amortization. This is a measure that many analysts use to assess corporate earnings. This would be a good time to look at it for your firm. Try to compare your firm to others your size (and good luck finding that data!). More realistically, you can compare it to the numbers from the financial statements of large, publicly held publishers. Just call their investor relations offices, and ask for a copy. Even more data can be found in the 10K and 10Q filings they make with the SEC. These are also public documents, and are usually made freely available by the firms themselves.

Budget your Cash Flow

This is a critical part of the budget process, and one that is done less frequently. It requires more estimations piled upon guesses, but you also get frequent feedback, so that you can update it and keep it realistic more easily.

Even if you are on accrual-basis accounting, the cash flow for most expenses occurs when the expense does. The largest exceptions are Sales and COGS, but they're big items.

Add a summary sheet and supporting sheets for cash flow to your budget workbook.

Revenue: If you are distributed, your contract probably lays out the payment pattern for sales revenue. This example is 50% at 90 days, 30% at 120 days, and 20% at 180 days in our example. You'll also use actual returns, not accrued. We already projected this when we were doing our revenue projections earlier.

If you don't use a distributor, look at your Aged Trial Balance reports (most accounting programs have them in the Accounts Receivable section) and compare them to the total sales. Determine the normal payment pattern, and apply it as we do the contract in this example.

Make a line for each month's total net sales, starting before the beginning of your budget year, as customers usually take some time to pay for their purchases. (In the example, we would start 6 months back, because of the contract terms: they pay out the last bit after 6 months. EXCEPT: there are no sales before the beginning of the year. We did that for simplicity's sake.)

The columns of your spreadsheet will be the months in your budget year.

Set up formulas that place the right portion of each month's net sales into the columns for the months in which it will be received. Check that the total for each row matches the total original sales. (The first few times you try to do these formulas, it's common to make a mistake or three.) Look at the first few lines of the revenue page in your cash flow hand out.

Sum to sub-totals for each month -- column, and row. Transfer the month-received subtotals to the summary page for cash flow.

Don't count on sub-rights for your cash flow, unless you have many titles and a fair bit of experience upon which to base your projections, or unless you have already sold the rights to a US publisher, and know the due date for the second part of the advance.

COGS – Plant: Now, we're going on to the next page of your handouts: the COGS worksheet for cash flow.

Develop a schedule for each book in your pipeline. Assume that you will need to pay half of the cost of every task when it is begun and the rest on completion, unless you have a different arrangement already with your freelancers.

COGS – PPB: Apply your printers' terms to the cost of each projected print run for each title. Remember to think about whether you will be doing extra print runs as the book sells, or whether you will be trying to hit the bulls-eye with one run.

COGS – Royalties: Many publishers pay advances 1/3 on signing, 1/3 on acceptance and 1/3 on publication. Map the advance payments out for each title in your current pipeline, and allow for the purchase of future titles.

Compare the expected royalty expense for each new title to the advance. If it will earn out during your budget year, allow for the payment of the excess according to your author boilerplate. Calculate the average royalty rate for your backlist, and enter that amount as well, as per the schedule in your author boilerplate.

Check your overall cash flow against your EBITDA. If EBITA and cash flow are significantly different, check for errors. It is possible that, if your company is changing size quickly, your accounts receivable and your accruals will be increasing in ways that disconnect your cash flow from your income, but it may also mean that you have an egregious math error. We all, ALL, make them.

Now that you have it, what do you do with it?

After all, if you don't have some use for this thing, why bother?

First, this process should have helped you to re-examine your plans in a systematic way, and to test them for feasibility.

Second, look at the budget and the cash flow projections and try to find times when gaps or problems may confront you. Try to find a way to avoid them, or to plan a solution before you hit them. For instance, the example company will be deeply in the hole at the beginning of the year. And they'll have a significant period with negative cash flow toward the end of the year, too.

If you are going to have a cash-crunch, in particular, you need to start working on it NOW. Things that you might want to try include:

- Shifting a release date
- Adding or subtracting titles from your list
- Borrowing money from a commercial lender (perhaps with an SBA guarantee)
- Getting some sort of joint venture partner, or new investor
- Re-shaping the plans for a book that has large potential or large plant costs.

Those are the obvious uses, but there are others that are less obvious:

- Show it to creditors, banks, and potential investors. It can go a long way to convincing them of the viability of your operation, and of the professionalism of its management.

Use the graph functions of your spreadsheet program to look at your projections in new ways. In your handouts, you will find some examples of this. Usually, you would look at these in color, and you'd have a *lot* more categories than in these intended for black and white copies.

You'll be surprised at how things pop out at you. Maybe your salary line is too high, or your editors aren't putting out enough new titles to earn their keep.

The last two graphs do a better job of highlighting gaps and opportunities than pure numbers do. (Month by Month Expenses, Revenue and Month by Month Cash flows)

Some of the other things you should do with your budget, now that it's finished, include:

Compare past, current and budgeted results, and keep this comparison updated. These comparisons are like the dashboard instruments on your car: they tell you how you're doing. You may be able to plug numbers into your accounting program and get this report very easily, or you may have to pull totals from prior years' results and do your own comparisons. Whichever you do, you will also want to graph it all again. Fortunately, once these things are set up, it's simple to do another month. Thank goodness for spreadsheet programs!

Examine elements of your operation for possible improvement.

- Can you reduce your plant costs without killing sales? What developmental costs are highest? Are there alternate strategies? (Ask your free-lancers.)
- Can you alter your trim sizes, paper types, etc. and change your PPB? (Ask your printers, and your designers.)
- Can you improve the cost-benefit ratio on your marketing?
- Would new markets be better?
- Are some markets not worth the effort?
- How do your numbers, as a % of sales, compare to those of large publicly-held publishers? With the published benchmarks from BISG, BP Reports, etc.?

Repeat and Update Regularly

You're done with this budget. Get a cup of coffee, or maybe some champagne, and congratulate yourself. Enjoy the fact that you have met, and tamed, the beast.

Now do it again! Budgets are like housework, you just have to keep doing them.

About Marion Gropen and Gropen Associates, Inc.

Marion has been in publishing for the last 16 years, including 8 as an executive in charge of finance and operations for a modest-sized company ($5 to 10 million/year in sales). For the last 3 years, she has helped very small publishers rise above many different types of challenges. You can find out more about her at www.GropenAssoc.com.

The texts and handouts from many of the other courses she has given are freely available from that site. While you are there, you may also want to explore the other resources (also offered without charge) in the Reference Desk section.

The handouts for this course use part of one of the downloadable tools available on that site for a nominal fee.