GUIDES TO PRACTICAL BOOKSELLING

BOOKSHOP FINANCE

BUDGETS & STOCK CONTROL

1. Introduction

Budgeting is a really important part of being an effective business, and there are three main areas to consider:

1. Budgeted profit & loss (income & expenditure)
2. Budgeted cash flow
3. Stock and purchasing budgets

Why should we bother to budget at all?

2. Why Budget?

By budgeting you will:

- Know how much you can order for the coming month.
- Know whether you'll have cash to pay staff or yourself in three months.
- Know whether you'll make a profit and possibly have a tax bill.
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First we look at the expected money coming in.

Then we look at all of the expenses.

Comparing these estimates will show whether we think the year will show a profit, or a loss. By extending this to a cash flow budget, we can see how we expect our bank balance to look each month.

So let's look at a dummy budget.

A budget is not your daily or monthly sales target.

Calculate the main forms of expenditure for your bookshop:

- Rent
- Loan
- Council Rates
- Utility bills: Electricity, water rates, etc
- Staff costs

Below is a list of the typical costs for a bookshop taken from the Booksellers Association fitness programme.

Dividends/drawings - owners/directors
Salaries/benefits - owners/directors
Salaries/benefits - other permanent staff
Payments to temporary workers
Rents/rates/mortgages
Utilities
Insurance
Advertising/marketing/events
Website development/maintenance
Carriage/postage/packing
Repairs/maintenance
Bank charges/credit card charges
Legal//professional/accountancy fees
Subscriptions
Other/unspecified

Using these headings try to calculate approximately how much to budget for each line.

Budgeted Profit and Loss

The key to an accurate budget is good data on which to rely, so the better you understand your income and expenditure now, the better you will be able to budget.

3.1 Sales

Setting an accurate, **realistic sales budget** is critical to the whole process.

To estimate your monthly sales – **start with the sales you made each month for the last few years** (*if you don't have them, you'll have to estimate*).

Please note that sales should be **excluding VAT**. Get into the habit of recording all sales and expenses excluding VAT.

See the note in cashflow regarding recording sales on your till.

Looking at last year's actual sales for each month, try to spend a little time **thinking about the following**:

1. Were there any exceptional factors that influenced last year's sales (for good or bad)? – an author event/signing, terrible weather, local road works etc.
2. Are there any factors you know of that will impact on this year's sales? An extra public holiday, a world cup, a great new biography coming out in July….
3. Consider the number of trading days and Saturdays in each month – this year and last year - and the timing of Easter – as these will have an impact on your sales.

Now you are in a position to estimate your sales for each month next year.

You can build your spreadsheet something like this:

% Sales Increase Year on Year	W/ending	Bookshop Sales	School Sales	W/ending	Bookshop Sales	School Sales
111%	03/01/2015	£ 5,000.00	£ 1,200.00	03/01/2014	£ 4,500.00	£ 1,200.00
111%	10/01/2015	£ 5,000.00	£ 1,200.00	10/01/2014	£ 4,500.00	£ 2,000.00
111%	17/01/2015	£ 5,000.00	£ 1,200.00	17/01/2014	£ 4,500.00	£ 1,200.00
111%	24/01/2015	£ 5,000.00	£ 1,200.00	24/01/2014	£ 4,500.00	£ 2,000.00
111%	Monthly	£ 20,000.00	£ 4,800.00	Monthly	£ 18,000.00	£ 6,400.00
109%	31/01/2015	£ 6,000.00		01/02/2014	£ 5,500.00	£ 2,000.00
109%	07/02/2015	£ 6,000.00	£ 2,000.00	08/02/2014	£ 5,500.00	£ 9,000.00
109%	14/02/2015	£ 6,000.00	£ 500.00	15/02/2014	£ 5,500.00	£ 4,500.00
109%	21/02/2015	£ 6,000.00	£ 2,000.00	22/02/2014	£ 5,500.00	£ 2,000.00
109%	Monthly	£ 24,000.00	£ -	Monthly	£ 22,000.00	£ 17,500.00
110%	YTD	£ 44,000.00	£ 4,800.00	YTD	£ 40,000.00	£ 23,900.00
108%	28/02/2015	£ 7,000.00	£ -	01/03/2014	£ 6,500.00	£ -
108%	07/03/2015	£ 7,000.00	£ 2,000.00	08/03/2014	£ 6,500.00	
108%	14/03/2015	£ 7,000.00	£ 4,000.00	15/03/2014	£ 6,500.00	£ 400.00
108%	21/03/2015	£ 7,000.00	£ 5,000.00	22/03/2014	£ 6,500.00	£ 2,500.00
108%	Monthly	£ 28,000.00	£ 11,000.00	Monthly	£ 26,000.00	£ 2,900.00
109%	1st Qtr	£ 72,000.00	£ 15,800.00	1st Qtr	£ 66,000.00	£ 26,800.00

3.2 Gross Profit

Once you have estimated your sales, you have to apply a gross profit margin. Look at your history, and use that to estimate the margin going forward.

The industry average is between 35% & 40%

If your stock is full of old, dead titles valued at full cost, then the reality is that you will have to lose some of your gross profit at some point by selling them off cheap.

Many retailers that have come into difficulty have a large volume of terrible stock that they have valued at full cost in their accounts. It is a real blow to the owners when the liquidated value of the stock is far less than they thought, so if you know that you have some clearing out to do, over and above the norm, then take this into consideration when setting your budgeted gross profit.

This section of the budget also includes your budgeted stock levels for the year.

3.4 Overheads

Now estimate your annual and monthly costs. Some of these are much easier and fixed than others – rent for example is easy to pin down – unless you have a rent review due – in which case use a best estimate.

The overhead categories on the enclosed budget are suggestions only – use whatever works best for you – ideally tying in with the format of your annual accounts to help you look back at actual spending in previous years.

Having established your overhead categories, fill in the figures as best you can. Use a mix of experience – what did you spend last year – and any knowledge that you have about the year ahead that might influence that spending in the year ahead. Remember not to include the VAT if you are able to claim it back.

Once again – be realistic. Don't budget to spend less this year unless you know how you will be able to do that. Recognize that some costs will rise with inflation. Others such as water, electricity and gas are currently going up by significantly more than inflation.

Some areas of expenditure will be fairly evenly spread out over the year, whilst others may be specific to a particular month. It is worth talking to your landlord about paying the rent monthly as this will help your cash flow.

You may need some assistance with this element of the budget, as well as the
'Depreciation' line. The person that prepares your accounts should be able to help you with this.

Once you have entered all of the costs onto your P&L, it is a good idea to go back to your last set of accounts and compare the various components of the budget to the actual results you are used to achieving. If there are big difference, for good or bad, you need to understand why they are different – or check to see if you have missed something.

4. Budgeted Cash Flow

Once you are happy with your budgeted profit & loss, you have now done much of the hard work.

To get a budgeted cash flow, you need to estimate what your opening cash balance will be. Then you can link in the money coming in (sales) and the money going out (purchases and overheads) from your budgeted P&L. (Exclude depreciation from this though). My model assumes that purchases are paid for in the 2nd month after purchase

(April purchases are paid in June) – that would be the case if you average 45 days credit.

If your P&L above is on an accruals basis (eg your rent is showing in each month), you need to make an adjustment in the cash flow to reflect when you actually pay the money out. This sort of adjustment may be necessary in the following areas:

- Rent (if paid quarterly)
- Rates (if not paid over 12 months)
- Utility bills (if paid quarterly)

Finally, add in a row for any capital expenditure you are planning – new shelves for example.

You should now be able to arrive at an estimated cash balance for the end of each month.

5. Interpreting your Budgets

Once you have completed your first draft of the budgets, you need to look at the results that it gives you, and see if they make sense.

Firstly, does it come out with a profit or loss in line with your 'normal' results for a year? If not, is the budget wrong or is there a known reason for the difference.

If the resulting profit/loss looks about right, then you need to turn to the cash flow. You need to make sure that the cash balance either remains positive, or you have in place the facility to go overdrawn to that amount. If this is not the case, you need to reconsider your spending during the year – this is a real danger sign that you will run out of cash at some point during the year – this is what we are trying to avoid. Do not be tempted to inflate your sales to make it look OK – this is simply denial – very tempting – but very unhelpful.

If there is a marked decline in cash from the start of the year to the end, then again, you need to understand why this is taking place. It may be that you have deliberately planned some spending on fixtures and your cash balance can take it. But if you are not sure why the cash balance is declining, look at the stock levels that you have budgeted for the year and see if they are budgeted to rise – you may need to think again. Likewise, you may need to examine the overheads – painful but sometimes necessary.

At the end of the budgeting process, you need to end up with a budgeted profit and loss that you believe is realistic, and in line with your normal patterns of trade and previous trading results. The monthly cash balances need to be at levels that will enable you to be paying the bills, staff, rent etc on time without upsetting your bank manager or resorting to the credit card.

6. Monitoring your performance against budget

In completing a budget, in some senses you have done all the hard work. However, if you now put it away in the drawer and forget about it until next year, then you will have

wasted your time. As the year progresses, you need to constantly monitor how you are performing against the budget – for sales, gross profit, overheads, stock levels and cash flow.

6.1 Sales

It should be relatively easy to monitor your sales against budget for the month (remember to take out VAT). If sales are going to plan, great - if they are better than planned, don't go crazy – but it may offer the opportunity to spend some more on fixtures or marketing than you had planned.

If they are below budget for more than a month or two, you need to do something. It means that you are not getting as much money coming in as you thought you were. You need to make sure that your purchasing is lower, and may need to look at overheads or investment plans. A re-working of the budget may well help if things are way off expectations.

Top Tip:
If the sales are lower than expected/budgeted you have two choices: Reduce the upcoming orders for new books or return books to the supplier. Whilst the returns will not put money into the bank account it will reduce the monies owed to that supplier in the next month. That way you can still continue to order the new stock.

6.2 Gross Profit

You can only monitor your actual gross profit with a stocktake (unless you have a stock control system that gives you live stock valuation). For this reason, I would strongly encourage you to count your stock at least twice a year. At least you then have time to react half way through the year rather than get a shock at the end of the year.

No one likes the extra effort involved in stocktaking, but it reveals a highly important piece of financial information.

6.3 Overheads

Ideally you want to monitor your overheads against budget each month, but that will depend on how routinely you analyse your costs. Quarterly is much better than annually. Even if you can only look at the major cost areas, it is much better to find out as the year goes on that spending is too high – rather than wait until the cash runs out.

7. Budgeting for Stock and Purchasing

Your business will pay more for stock than anything else each year, but often has less financial control over this than all of the other spending. Whilst not a perfect science, there are ways of budgeting for stock and purchases that will highlight when your shop is starting to increase stock levels above how you planned.

You will remember from earlier that we included a stock 'closing balance' as part of the gross profit margin.

In some ways there is nothing clever in this – it was simply 12 numbers typed in!.However, how you get those 12 numbers will require some thought.

A good starting point will be looking at the stock valuation when you last counted stock. Try to remember whether the shop felt 'well stocked' then, or had lower stock on the shelves than you would have liked.

Stock levels are likely to fluctuate during the year. A typical pattern will start the year with stock falling after the highs of Christmas trading – hopefully most of your Christmas stock was sold out by the end of December. January will hopefully see any remnants of Christmas stock sold off, and maybe you will have had the opportunity to have a sale to keep the dead stock moving out. Stock levels may rise slightly for Easter, but then typically fall for the quieter summer months until the Christmas stock start to arrive from August onwards.

Build up a pattern of expected stock levels during the year for the budget – of course you will have to use an estimate for your opening stock so try to make it as accurate an estimate as you can.

Once you have your estimated stock levels for the year, you can run the 'stockturn test' on the figures:-

1. First, take the 'Cost of Sales' figure from the budgeted P&L.
2. Calculate the average closing stock figure (the total of all 12 figures, divided by 12).
3. Divide the cost of sales by the average stock figure.

On our budget examples, the average stock figure calculates to be £33,000.
Our cost of sales figure was £83,790.

So our budgeted stockturn is $\frac{£83,790}{£33,000} = 2.54$

You will remember that we said that for a small shop, you should aspire to a stockturn of about 3. Now that is not always possible, or may take a year or two to get to – but it is at least something you can use as a target.

If you feel that your stockturn is too low, hone your budget over the course of the year to bring it more in line. You will still need to increase stock in the autumn, but maybe by a little less than originally planned.

So - once these stock budgets are set for the year, you need a mechanism for monitoring them and producing a purchasing budget each month.

8. Monitoring stock levels and purchasing

Obviously, no one would relish the thought of counting their stock every month, and yet, having set a month-by-month stock budget, we need to be able to monitor how we are doing compared to that budget.

And so we need a mechanism for estimating stock levels each month. Whilst not 100% accurate, we can use an estimate that will be good enough for controlling stock between counts. It does rely on one important piece of information that you may or may not be keeping at present – a goods-in book, which records the value of the stock you receive into the shop. This should also record returns as 'negative' goods in.

The golden rule in making this calculation is that you are dealing with stock at cost. Your starting point will be a stocktake. To calculate your next month-end's stock value, you need to do the following calculation:

Eg to calculate stock value at 31st January:

1. Take your opening stock value (eg 1st January's stocktake) **£32,345**

2. Add the value at cost of your goods-in (less any returns) **£4,227**
   (Remember – this should be at cost – not retail value)

3. Deduct the cost of the goods you sold in January
   To estimate this, takes the month's sales figure (excluding VAT)
   multiply it by 100 minus your budgeted gross profit margin
   and divide it by 100

   ie if your sales for Jan were £8,412 and your budgeted GP is 33.5%,

   $$\text{Cost of goods sold} = 8{,}412 \times \frac{(100 - 33.5)}{100} = \textbf{£5,594}$$

So your estimated stock at 31 Jan = 22,345 + 4,227 - 5,594 = **£30,978**

This may sound a bit complicated first time through, but all you are doing is taking your known stock level, adding to this the stock you have purchased, and taking off the stock you have sold.

Whilst not 100% accurate, this is a reasonable estimate for the stock value each month. A mid-year stock count will give you another accurate point, as well as show you how good your estimates have been so far. This does rely on well-kept 'Goods-In' records, but is well worth the effort.

You can now compare the Jan 31 stock figure to your budgets – and act accordingly. Overstocked? Trim your buying in February. Understocked? If sales have been going OK then you can probably afford to buy a little more in February.

9. Purchasing Budget

A purchase budget takes our calculations in the last section just one stage further. It can seem little complicated, but if you follow these simple steps, it can be a really useful tool each month.

Now that we have calculated the stock figure for 31 January, we can calculate your purchase budget for February.

We know that our sales budget in February is £8,000 (at retail prices). With our gross profit at 33.5%, the budget shows that the cost of these budgeted sales is £5,320. We also know that at the end of the month, we are budgeted to have £30,000 of stock in the shop.

So how much can we purchase during February?

1. To calculate this, start off with the budgeted closing stock	**£30,000**
2. Add the budgeted cost of sales for February	**£5,320**
3. Deduct our 31st January stock figure.	**£30,978**
This gives you your purchase budget for February	**£4,342**

9.1 Using your purchasing budget

Once you have your purchase budget for the month, you can keep a running total on your Goods-in book, to see how your buying through the month is going. If you have spent 75% of the month's budget by the middle of the month, then you need to be careful for the last two weeks!

Always try to anticipate goods coming that will use up your purchase budget – dated material coming every quarter, promotional scale-outs will obviously have an impact.

The real strength of this purchase budget system is that if you over-spend, or under-spend in one month, then it automatically adjusts your target for the next month to get you back on track with budgeted stock levels. Of course there will always be exceptions – events, unexpected extra promotional opportunities etc. and if a month's sales are going really well, then it makes sense that you will need to purchase more to replenish that stock.

10. Conclusion

This may seem like a lot of work. However, if you keep up the spreadsheets and management of costs/sales on a monthly basis it should only take about an hour.