Retail Management
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Lecture-45
Budgeting and Costing

Hello everybody, welcome to this NPTEL swayam course on retail management, this is professor Swagato Chatterjee from VGSOM IIT-Kharagpur who is taking this course for you. We are in week 8, this is lecture 45 and we were discussing about budgeting and costing in this particular video.

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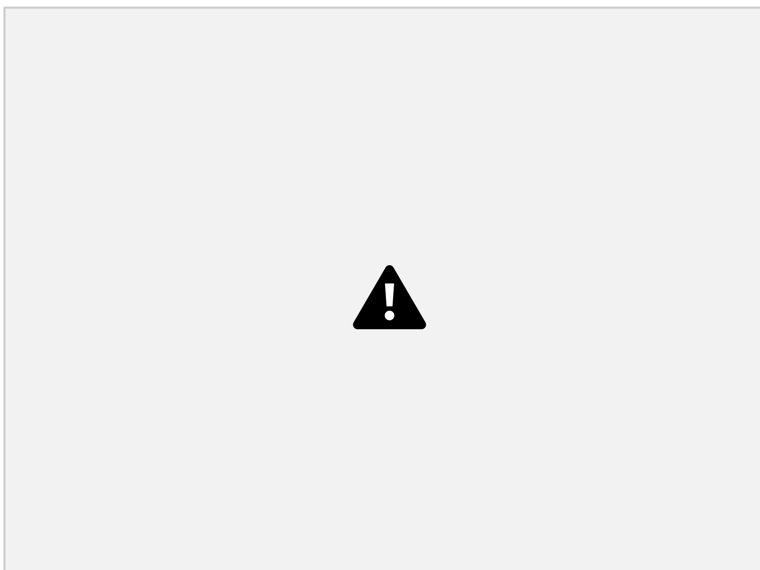

So, in the last class we were discussing about the requirement of budgeting. And we were saying that budgeting is required, so that the finance that is available the cash, amount that is available in my hand, I can put in different baskets. So, that my employee’s goal, my management goal and my target market whatever targeting I am doing are fulfilled.

And I have to also make sure that I do not go out of cash while doing the budgeting because if I am cash short then I have to probably take loans and interests will be higher, so I have to deal with that. So, in the retail budgeting process the first thing, the preliminary budgeting decisions is who developed the budget. So, is it the finance person or is it the marketing person or is it the HR person because everybody is connected within.

So, at the end of the day this is something where probably the strategy person will come to this story along with finance. So, strategy person is somebody who should have idea about all aspects of business. So, that person will be probably coming into this picture but this is a important decision that we will create the budget. Then what is the budgeting time frame? Are you doing for short run budgeting?

Short run is let us say here up to 2 years or midterm which is 1 to 3 years or long term which is more than 3 years. So, in what I would say time frame, how much duration is what the budget is getting created because what time things can change, the amount of budget you are allocating for today might change tomorrow. And that is a very common problem in many projects that we actually take up.

We do not see how the project cost will go up, we do not estimate or we do not forecast the increase of the cost as the go ahead. And because you cannot foresee what is going to happen in the future. And that impacts the amount of money that is left or the amount of money that is required for doing any activity which is also an important part. So, that is why it is always better to break it into multiple terms.

So, short-term budgeting should be done in one way, medium term budgeting should be done in another way and long-term budgeting will also be done in some other way. In a short term budgeting you have more clarity over staff, you might probably know that, it might not change within about 1 year, whatever unit costs that we are keeping, whatever employee cost that we are keeping, or whatever target market, the marketing cost you are thinking of, this will not change in the short term.

But in the medium term 1 to 3 years it might change, whatever cost that you are thinking about today and whatever cost structure that will be there tomorrow or a few years down the line might be very different. On the other hand in the long term the whole existence of the business is sometimes is in questionable. That you may not know exactly that whether the overall business will stay after 3 years or not.

So, that is another important decision, so what is your budgeting time frame? Then the question comes is that what is the budgeting frequency? How often you do budgeting or whether you are allowed to change the budget? So, if I am allowed to change the budget and I can do budgeting every 1 month then even if my range is for 1 year I will not go for 1 year, I will go for 1 month kind of a budgeting.

But if I cannot do budgeting anymore, if I have taken a choice and I have invested on that choice and then it is done for at least a year if I am doing short-term budgeting then that I have to be more careful. So, how much I can relax in my budgeting exercise and how much I have to be careful about in my budgeting exercise is also a very important problem when people decide on their budgeting process.

Then what cost categories are used? So, there can be some cost which is unavoidable cost, there is certain cost which are semi-avoidable cost and there are some cost which are avoidable cost. So, unavoidable cost is some call that you cannot avoid, you have to do, you have to be there, those costs are very important costs. And unless those costs are incurred your business will not even run.

For example let us say if I talk about the same thing in the context of a (()) (05:32) let us say, the unavoidable costs are let us say the cost that is related to admissions because if the admission is not happening then the business school will not run. The cost that somebody has to incur to teach the students because after the admissions is happening if the teaching that is not happening, teaching includes the cost which are let us say related to the books that you give, related to the cases that you provide.

All this will be part of the unavailable costs. Then there are certain cost which is permanent cost, they will not change or they will be staying even if the amount will change they will not go away. Then there will be there some cost which has semi permanent kind of cost or semi avoidable cost. For example the salary that you pay to the faculty members in the context of a business school.

So, let us say that salary you may have a lot of faculty members or you may have small number of faculty members, some of the cost can be avoidable there. The operating cost that you have, the electricity some amount of electricity will come to the fixed cost, some other amount will be operating cost. Certain extra variables that you are giving or let us say certain kind of maintenance cost that you are making.

So, instead of maintaining a too many laptop laptops of or PCs you can maintain only 50 and leave other 50. Or instead of giving a sweeping contract where the cleaning and sweeping and etcetera will be done every day in your premises, you can say that ok no, once in 2 days is fine. So, those are some of the semi avoidable cost, you cannot make them 0, you have to invest some amount of money but it might not be very high.

You have a control how high or how low you will be doing those expenditures. And then comes the avoidable costs which are let us say something which is absolutely your luxury cost. For let us say costs which are related in the (()) (07:41) context, again cost which are related to let us say faces or cost which is related to refreshments or cost which is related to certain kind of special gifts that you give to the guests etcetera.

These are can be available cost, so you have to put that also. Let us say the retail context, I give the example of (()) (08:06) because many of you probably are coming from that background and you will have an idea that what are the operations going on. But in a retail context if I talk about again see what is the unavoidable cost? Let us say in a brick and mortar retail context the unavoidable cost is the rent of the place unless the place is there you cannot sell.

You may or may not have many employees, so employee salary and etcetera is a semi avoidable cost or electricity cost is a semi avoidable cost, some amount you have to pay but rather you can live out, but the cost of goods sold or cost of the fixtures or cost of the (()) (08:47) these are unavoidable costs. But there are certainly avoidable costs also, for example the cost of the benefits that you give, for cost of the marketing activity that you are doing that ah sometimes let us say Mickey Mouse is jumping in.

Or certain shows are going on, all these things are probably avoidable cost, you have to categorize the costs first. What level of retail is used? Whether you want to estimate cost, costing also part is an estimation kind of thing; let us say there is certain cost which is shared by multiple SKUs. How will you find out exactly or how will you divide the overall cost into multiple SKUs is something is an estimation job.

And there has to be certain rules that has to be pre-decided, what level of retail is used is something that will basically guided by that particular rule. How flexible are your budgets? Is there any rigidity? Is there any upper limit and lower limit that within this I have to have my budget for a particular goal or I can have different kinds of budget I have plus, minus, I have let us say budget of 1 lakh rupees +- 10,000 rupees.

Then +- 10,000 rupees is the measure of flexibility, how much you are allowed to be flexible when you are doing the budgeting, so that is also another important decision when you take. So, once these are my preliminary decisions where once these are ready then I will go for the ongoing budgeting process. So, first time I am doing budgeting I have decided, now I will be studying the budgeting.

So, I have to write down my goals then the performance standards that goals are basically various attributes, it can be let us say I want to be the most known name in the context of let us say shoes or apparels that can be my goal. How will I measure that goal? Am I actually doing that or am I the most known brand in the case of retail, in the case of shoe retail or apparel retail? When I am having a goal I have to have a measure and I have to also not only have a measure I should also have a benchmark with which I will compare.

So, that is called the performance standard. So, what is the thing you want to achieve? How will I measure that you are achieving it or not? And what will be the benchmark for with which I will compare your achievement? So, those are part of your goals and performance standards. Once your performance standard is set, I have to plan that how you will reach that particular performance standard over and above the benchmark that I am thinking about.

And what amount of money will be required to you for doing that? So, that is your planned expenditure which is the 3rd step. Now planned expenditure and actual expenditure is different, often time's people do propose something to do and for various reasons they cannot do it, this is a very common problem in the course of any project management that you might have certain plans to do these, that.

But for various reasons for the economic conditions, for the changing customer preferences, for the change in the context of technology availability and etcetera, the plan expenditure that you wanted to do could not be done, so then there is an actual expenditure. So, how much is the difference between your plan expenditure and actual expenditure and how much that impact that the fact that you could not reach your goal?

Or you have reached the goal with a lesser expenditure; those kinds of things have to be taken care of. Then comes the monitoring results that ok, after doing the expenditure exactly what is the outcome that I received? I have planned for an outcome which is in the performance standard stage, whether I have reached that outcome or not and then you make the adjustment. So, this is probably a circular procedure and the again you come back here, then you again start planning that.

Sometimes may come back here, sometimes you may come back here depending on what is your condition is. You may probably also come back in these 2 phases, sometimes the adjustments can be for the goals also or the performance standards also or the planned expenditure and then this cycle keeps on going. So, that is the retail budgeting process that we adopt in the context of business.

So, let us say as I was telling that I want to be the most well known brand in the context of apparel. So, then I find out that how well known can be mentioned, let us say I take that the number of social mentions that I get is a measure of how our customers are? So, not always that might be a right measure because social mention is not awareness social mention is more like how many times people are speaking about you.

So, there are many people who might be avoid but awareness and interest together creates the speaking it is not only awareness speaking. So, you might have to find out that what is the way to find out measure awareness only? And then you plan that ok, to be most aware or most I would say preferred brand I have to make sure that my brand strength is higher than all the competing retail brands that I have.

So, once you have decided that what are there will be the competing middle brands and you have measured them, you try to invest on it. Now when you try to invest on the branding exercise, you are doing budgeting; there are multiple ways you can invest. You can invest on TV, digital media, in the radio, in the TV you can do campaign 1, campaign 2, campaign 3. In digital media you can do campaign 1, campaign 2, campaign 3.

Digital media are again of social media then what adverse? Which is basically search engine and then the search keywords these, that, there can be so many different ways and each of them might have 4, 5 campaigns. So, then ultimately you basically have a choice of let us say 50, 60 possible campaigns where you have to do your budgeting, you have to decide that how much I will put.

At the same time there will be budgets for employees, budgets for cost of production or cost of buying those products all those things has to be budgeted. And then you budgeted something, you did certain investments which probably more or less sync with the budget but may not exactly follow the budget and you see what is the outcome came up. And then with the outcome you try to find out that what is the relationship between this actual expenditure and the outcome, what is the relationship between this?

Based on that relationship finding you try to change your goals or you try to change your expenditure again. So, this is say something that is called the virtual budgeting process that is also very important.

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What are the benefits? Your expenditures are related to expected performance, so according to the performance you do. Costs can be adjusted as goals are revised, so the moment you are doing adjustments and your goals are changing, your cost will also change. Resources are allocated to right area, so basically it is a resource allocation problem, you have a fixed amount of money how will you distribute it? So, that distribution or allocation can be done in the right area.

Spending is coordinated, one spending and another spending goes hand in hand, so if you increase the spend in marketing that to also increase in the spending services that you provided otherwise there will be a gap that will get created. So, generally that gets coordinated through budgeting. Planning is structured and integrated. Cost standards are set, so you always can benchmark with other companies, other best practices in the industry to know that whether your cost standards are in sync with the other people's cost standards.

That means how much money you are spending for marketing activity is it same for other brands also or how much money that you are spending for employee benefits or construction activities is it similar for other brands also, you can always benchmark yourself through budgeting. Expenditures are monitored during a budget cycle; you can actually calculate the expenditure and measure the expenditure which will be monitored.

You can planned budget versus actual budgets can be compared, so whatever budgets you are creating in your mind or you are writing it down whether that is being followed or that can be followed is something that is also an important factor that which are try to compare and see that whether that is happening or not? Cost performance can be compared with industry averages.

So, sometimes we can also compare the cost performance with whether the ultimately whatever investment while this is the cost standards is basically benchmarking the planned expenditure and this is benchmarking the ROI. So, what is the cost versus the actual performance? How much money you spend actually and what is the actual performance you can benchmark the ROI So, both can be done using this budgeting.

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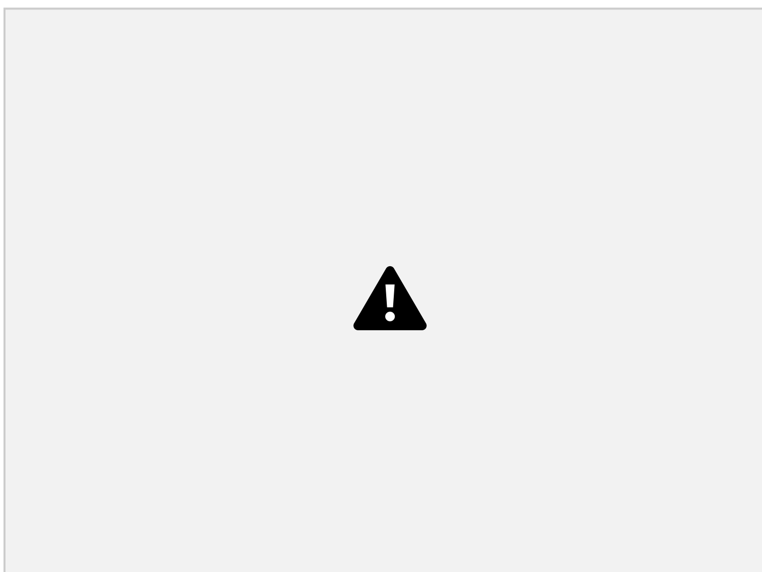

What are the preliminary budgeting decisions? As I told specifying the budgeting authority, define time frame, determine budgeting frequency, establish the cost categories, set level of detail and prescribe the budget flexibility, we discussed about that.

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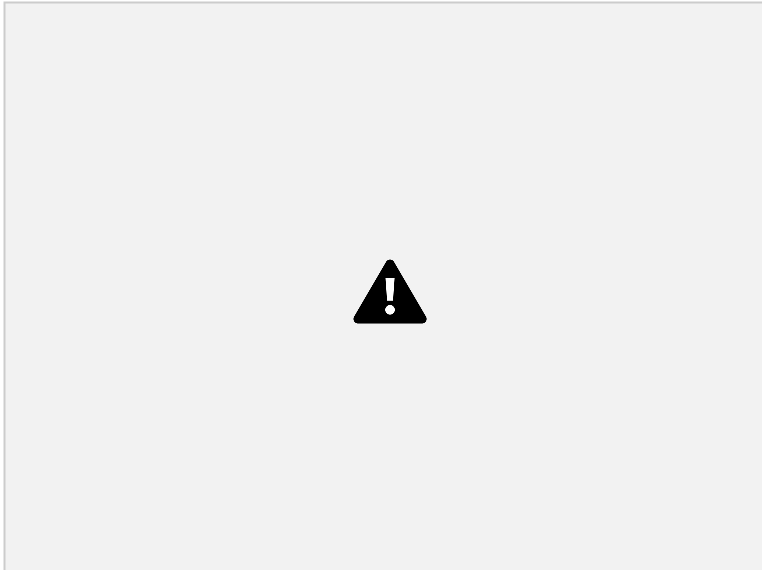

Then what are the cost classifications? Here we have done certain cost classification which is capital expenditure, fixed cost, direct cost, operating expenses and natural account expenses, so let us discuss about that little bit. What is capital expenditure which is long-term investments can be leased or often depreciated, it is like the amount of money that you spend to create various buildings or various fixtures, so long-term investments are called capital investments.

You can also spend money on creating let us say equipments, buying equipments within the retail store oftentimes or let us in e-commerce context you can spend money to create a website or e-commerce facility, so those are capital expenditure. What are the fixed costs? Constant over a range of sales, fixed costs are like the one that I told that the cost that you have to incur the rent is the fixed cost that whether you make sales or not you have to pay the rent.

Or the lease amount is the fixed cost or the monthly the salary of the people might be a fixed cost. Then there are certain direct cost, direct cost is cost which are directly related to a particular sale. For example can we trace to departments, stores or products, the cost of goods solds are a part of a direct cost, sometimes the inventory costs are part of direct cost. Then there are natural account expenses classified by names such as salaries.

So, this is basically expenditures which is natural account expenditures which is also one kind of cost. Then there are certain operating expenses, operating expenses are generally short run expenses, like variable cost based on sales level. So, the more you see that the more the sales is the more is the delivery cost is let us say. Because as sales increase you have to deliver more product, so that is operating cost.

So, the more the sales is the more will be in the retail context, the more will be packaging expenses again of variable cost. Then there are indirect expenses which are not directly related to any sales. For example general overhead that can be allocated to cost centers. And functional account expenses are classified by purpose of activity such as cashiers, customers. So, these are also another way to define.

So, operating expense, indirect expense and functional account expense also another way to define the costs. So, there are different ways you can define the cost, you can classify the cost I talked about the permanent, avoidable, unavoidable one, here its more functional kind of cost classification you can use them.

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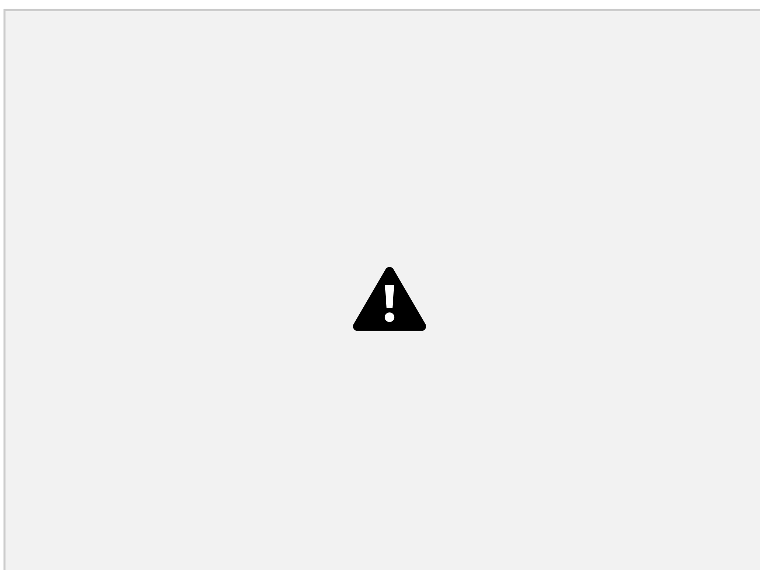

Then come some of the bad costs, some cost which are as I was telling avoidable costs. Bad costs are cost incurred for customer services that customers do not value and are not required by the customer. So, either they are not required or they do not value, so they will not pay any additional money for those kinds of services, that are called bad costs.

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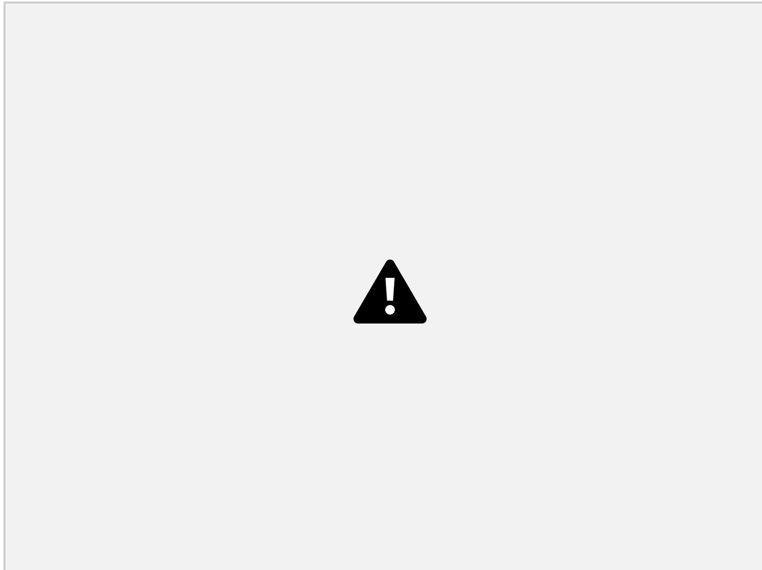

For example over centralizing stores operations. So, common hours of operation and services regardless of vocational needs. So, let us say there are different parts of India will have different time zone. So, if we have the same time zone in the both eastern part and western part of India there is a daylight utilization issue which becomes a problem. Now if I use a common hours of operation and services regardless I am placed in multiple cities but I use my I have a common centralized operation area that I say that ok open always at 6 am.

So, 6 am in Indian standard time will be too late for let us say Nagaland or Manipur or Mizoram or something like that and 6 am probably midnight for Rajasthan. So, question is that do you think that obey not 6 am is the right way to centralize your operations for all the stores if you are present in both the corners of the country. And think about bigger countries, now generally bigger countries have multiple time zones.

But still bigger in volume I am saying we are not in population, we are in the size but still even if they have multiple time zones sometimes within the time zone there is quite a bit of difference. So, that can create a problem and that is a bad cost. Reducing all expenses on a proportionate basis, so I blindly divide. This is the common practices many places and many, it is not only a problem of retail context, it is also problem of any business majorly let us say where costing is not done where we do not have people who can do very good costing.

Let us say educational institutes, let us say the certain kind of where people are not in a business actually. In those kind of places you will find that this is a very common problem that if you have a cost and you are doing costing, you are doing budgeting, a cost which is generally incurred which is a common cost you divide it in between everybody. So, in this context of retail you divide it between the SKUs.

You have all the SKUs, let us say 1 lakh SKUs in the retail store everybody has, but the amount of expenditure, amount of operating expenditure that is there for let us say a high volume product than a low volume product. Or a high frequently being sold product than a low frequently being sold product will be very different. So, some services are more high valued like low waiting lines or custom made sandwiches.

So, you cannot say that these expenditures are I will divide it between all the SKUs in the proportional basis. Then trading up to capture more affluent customers, so that sometimes create problem like alienating existing customers and not attracting more affluent ones. This is a very common problem when a smaller company tries to grow bigger, they spend a lot to sell to the bigger or more people who has more willing to pay, so they advertise a lot and etcetera, so to get that market but that market does not respond.

And the already existing people who are also there stop responding because then they think that this guy has increased the prices why he should do it? He is given the same services, so you are neither here nor there which creates a cost, which is a lost cost basically is a bad cost, bad investment that you are doing.

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Similarly not responding to the charges, changes in customer behaviour due to technology, so you ignore web, that is why order online and pick up in store using catalogs versus web, these are some of the examples. And not responding to competition, not understanding low cost competition or unbundled pricing opportunities, where you can reduce the bundle and sometimes people prefer individual product rather than the bundle.

It is verily applicable for let us say when you are detailing in a service sector let us say you are Netflix. So, you should sometime Netflix should know that there are opportunities where people will not want to pay a monthly subscription but they want to see 1 particular movie and whether that option is there or not, otherwise that is a bad cost.

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Now what is an ongoing budget process? I told the states the set goals, you specify performance standards, plan expenditures in terms of the performance goals that you have, you make the actual expenditure, you monitor the results and then you adjust your budget accordingly as per the requirement.

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Now next part is that once you do the budgeting you have to also make sure that you have created the budget but whether you have the flow of the cash to fulfill the budget. So, cash flow relates the amount and timing of revenues received to the amount and timing of expenditures for a specific time. So, what is the time and amount of the money in-flow and what is the time and amount of the money outflow?

So, you have to be as positive as long as possible if you are by chance cash negative you have to take loan and they have to pay interest for that. So, cash flow ensures that you remain cash positive. In cash flow management the usual intention is to make sure revenues are received before expenditures are made. In cash flow is weak, customer short-term loans may be needed as I was just telling or profits may be tied up in inventory and other expenses.

So, you might not be getting profit because your profit will be tied up with the inventory, you will be not be able to finish the job, it will be half done and then left because you do not have money to complete the job. So, that is how the in profit will get stuck in the inventory. And for seasonal retailers, erratic cash flow may be unavoidable, so when the sales are seasonal there are certain problems in the cash flow because you will not get.

In certain time the sales are very low, in the certain time the sales are very high, so also the money cash flow comes at a huge chunk and then for certain time it is very flat, you should be able to manage that kind of a situation.

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Then comes resource allocation. Resource allocations as I told there were 2 broad expenditure, one is capital expenditure which is long term investments in fixed assets and operating expenditure is short-term selling and administrative costs in running a business.

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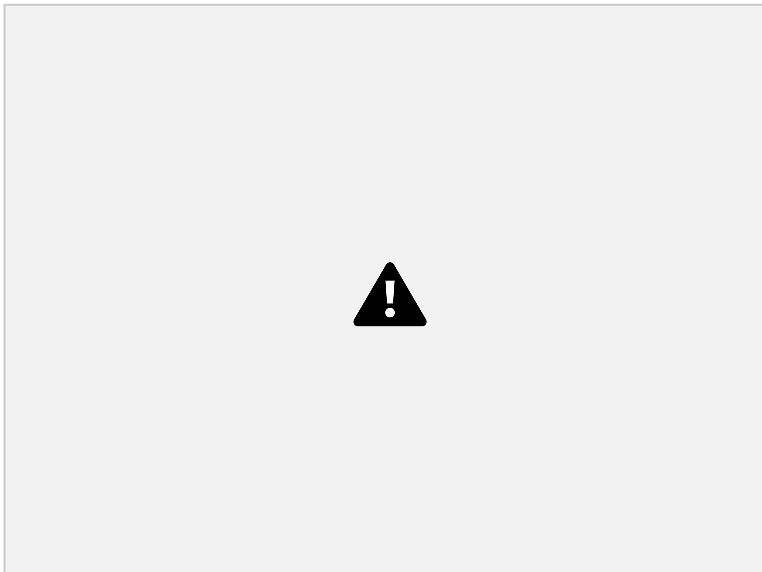

So, how to enhance productivity? A firm can improve employee performance, sales for food or space that means per area and other factors by better matching employee workloads to store traffic patterns and that should be patterns and upgrading training programs, increasing advertising, evaluating item wise probability or SKU wise probability and turnover. These are important to increase retail productivity.

It can be reduced costs by automating, having supplier perform certain tasks etcetera. So, certain tasks you can outsource, certain that you can let the supplier to do which might also improve your productivity which will ultimately impact reduce your costs and improve your overall ROI of the business.

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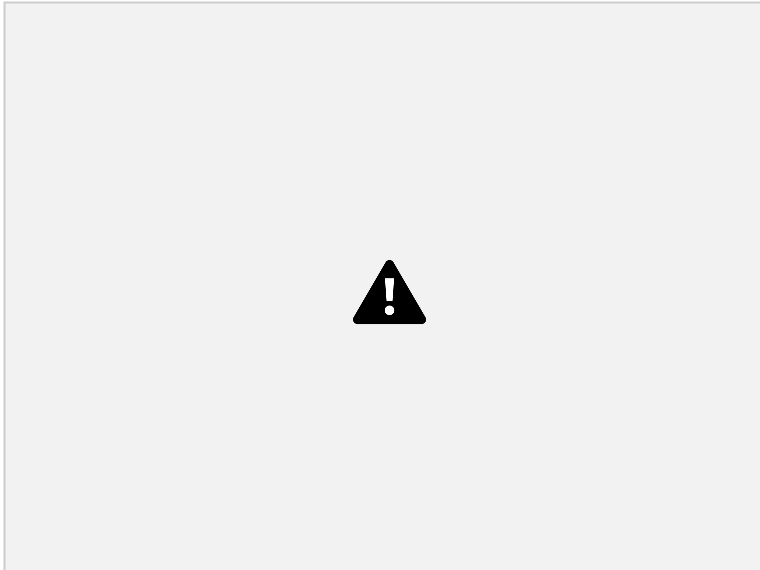

Then one important part in the context of this thing is called bankruptcy and liquidation. So, bankruptcies allow retailers to safeguard themselves against certain mounting depths as well as to continue in business. With this protection, retailers can renegotiate bills, get out of leases and work with creditors to plan for future, declaring bankruptcy has major ramifications as well. So, liquidation firms are ultimately go out of business.

So, generally you will see that often people often nowadays there is a bankruptcy law that has come up in India as well, where a company can call themselves the bankrupt and then the shareholders take control and decide that what will be do with the assets of the company? So, the advantage of that if you declare bankrupt or there is a way to handle the bankruptcy the employees does not get I would say the employees get saved or the company gets saved, the customers get saved.

Probably the ownership gets handed over but still the retail business can be still alive if you go for bankruptcy. So, this is also one of the major factors in the context of financial management. So, I will stop here this particular video and in the next class I will talk about financial management in the context of merchandise business, merchandising. And that is why we will stop this course as well, so thank you for being with me and I will see you in the next video.