Budgeting and Costing

Dr. Swagato Chatterjee
VGSOM, IITKGP

NPTEL

Funding Sources

- Mortgage refinance (due to low interest rates)
- REIT (retail-estate investment trust) to fund construction
  - Company dedicated to owning and operating income-producing real estate
- Initial public offering (IPO)

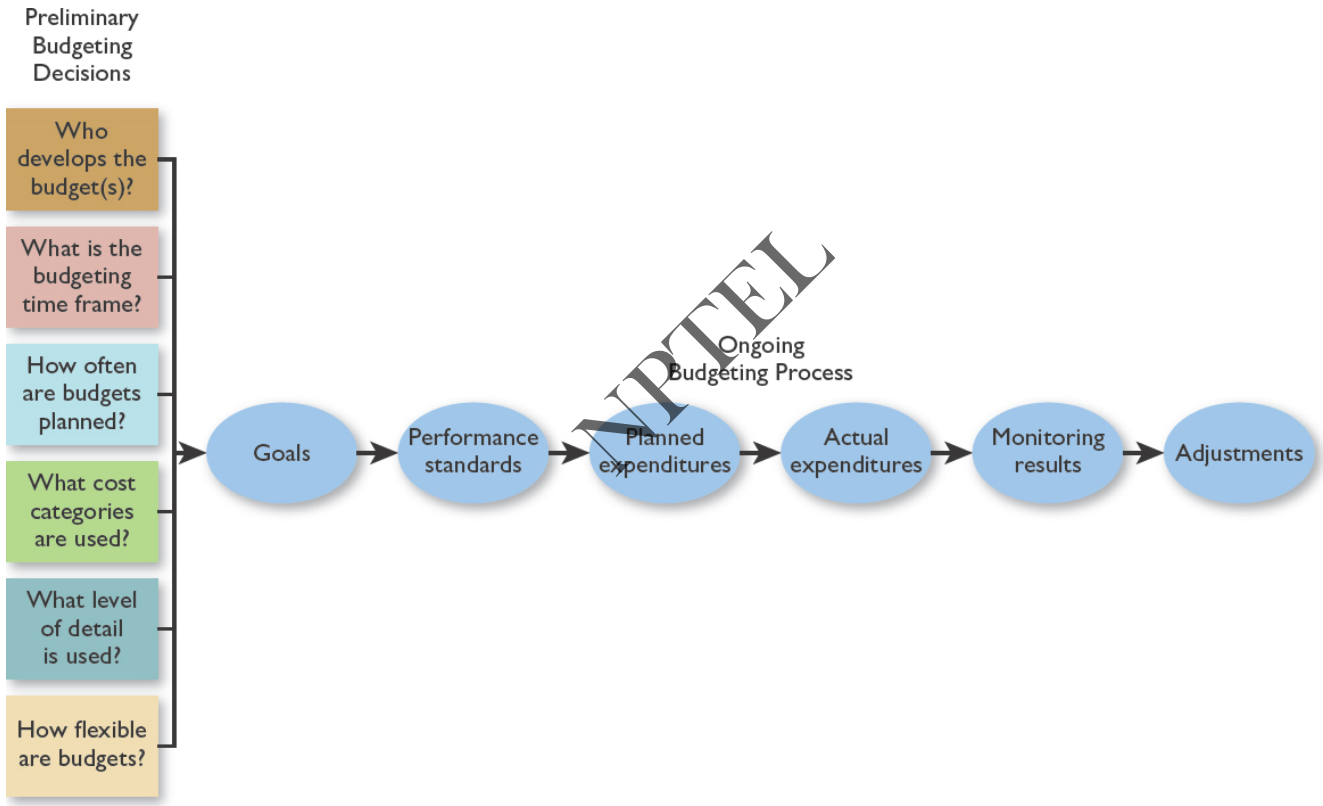
NPTEL

Budgeting

- **Budgeting** outlines a retailer's planned expenditures for a given time based on expected performance.
- Costs are linked to satisfying target market, employee, and management goals.

NPTEL

The Retail Budgeting Process



NPTEL

Benefits of Budgeting

- Expenditures are related to expected performance.
- Costs can be adjusted as goals are revised.
- Resources are allocated to the right areas.
- Spending is coordinated.
- Planning is structured and integrated.
- Cost standards are set.
- Expenditures are monitored during a budget cycle.
- Planned budgets versus actual budgets can be compared.
- Costs/performance can be compared with industry averages.

NPTEL

Preliminary Budgeting Decisions

1. Specify budgeting authority
2. Define time frame
3. Determine budgeting frequency
4. Establish cost categories
5. Set level of detail
6. Prescribe budget flexibility

NPTEL

Cost Classifications

- Capital expenditures—long term investments (can be leased, often depreciated
- Fixed costs– constant over range of sales
- Direct costs—can be traced to departments, stores, products
- Natural account expenses—classified by name such as salaries
- Operating expenses—short run expenses
- Variable costs-based on sales levels
- Indirect expenses-general overhead that can be allocated to cost centers
- Functional account expenses-classified by purpose or activity, such as cashiers, customer service personnel;

NEFEL

Bad Costs

- Bad costs are costs incurred for customer services that:
- Customers do not value (will pay not additional prices for)
- Are not required by customers

NPTEL

Causes and Examples of Bad Costs (1 of 2)

Cause	Example
Over-centralizing stores operations	Common hours of operation and services regardless of location needs
Reducing all expenses on a proportionate basis	Some services are more highly valued like low waiting lines or custom-made sandwiches
Trading-up to capture more affluent customers	Alienating existing customers and not attracting more affluent ones

NPTEL

Causes and Examples of Bad Costs (2 of 2)

Cause	Example
Not responding to changes in consumer behavior due to technology	Ignoring Web– order on-line and pick up in-store; using catalogs versus Web
Not responding to competition	Not understanding low-cost competition, unbundled pricing opportunities

NPTEL

Ongoing Budgeting Process

- Set goals
- Specify performance standards
- Plan expenditures in terms of performance goals
- Make actual expenditures
- Monitor results
- Adjust budget

NPTEL

Cash Flow

- **Cash flow** relates the amount and timing of revenues received to the amount and timing of expenditures for a specific time.
- In cash flow management, the usual intention is to make sure revenues are received before expenditures are made.
- If cash flow is weak, short-term loans may be needed or profits may be tied up in inventory and other expenses.
- For seasonal retailers, erratic cash flow may be unavoidable.

NPTEL

Resource Allocation

Capital Expenditures

- Long-term investments in fixed assets

Operating Expenditures

- Short-term selling and administrative costs in running a business

NPTEL

Enhancing Productivity

- A firm can improve employee performance, sales per foot of space, and other factors by better matching employee workloads to store traffic patters, upgrading training programs, increasing advertising, evaluating item profitability and turnover, etc.
- It can reduce costs by automating, having suppliers perform certain tasks, etc.

NPTEL

Bankruptcy and Liquidations

- Bankruptcies allow retailers to safeguard themselves against mounting debts, 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 the future. Declaring bankruptcy has major ramifications. Sports Authority bankruptcy video
- Liquidations firms ultimately go out of business

NPTEL

Thank You

NPTEL