Plan Your Advertising Budget

Summary

Deciding how much your advertising should cost - including how much should be invested in making sales grow - and how that amount should be allocated is completely up to you, the small business owner-manager.

Advertising costs are a completely controllable expense. Advertising budgets are the means of determining and controlling this expense and dividing it wisely among departments, lines or services.

Your budget will help you choose and assess the amount of advertising and its timing. It will also serve as the background for next year's plan.

Methods of Establishing a Budget

Each of the various ways in which to establish an advertising budget has its pros and cons. No method is perfect for all types of businesses, nor for that matter is any combination of methods.

Here, concepts from several traditional methods of budgeting have been combined into three basic methods: percentage of sales or profits; unit of sales; and objective and task. You will need to use judgment and caution in choosing your method or methods.

Percentage of Sales or Profits
The most widely used method of establishing an advertising budget is to base it on a percentage of sales. Advertising is as much a business expense as the cost of labor and should be related to the quantity of goods sold.

The percentage-of-sales method avoids some of the problems that result from using profits as a base. For instance, if profits in a period are low, it might not be the fault of sale or advertising. But if you stick with the same percentage figure, you will automatically reduce your advertising allotment. There's no way around it: two percent of $10 000 is less than two percent of $15 000.

Such a cut in the advertising budget, if profits are down for other reasons, may very well lead to further losses in sales and profits. This in turn will lead to further reductions in advertising investment, and so on.

In the short run a small business owner might make small additions to profit by cutting advertising expenses, but such a policy could lead to a long term deterioration of the bottom line. By using the percentage-of-sales method, you keep your advertising in a consistent relation to your sales volume - which is what your advertising should be primarily affecting. Gross margin, especially over the long run, should also show an increase, of course, if your advertising outlays are being properly applied.

What percentage?
You can guide your choice of a percentage-of-sales figure by finding out what other businesses in your industry are doing. These percentages are fairly consistent within a given sector of business.

It is fairly easy to figure out the ratio of advertising expense to sales in your industry. You can find these ratios through Industry online information source Strategic or through Reports published by financial institutions such as Dun & Bradstreet which you can access on their Web site. http://www.dnb.com/us/

Knowing the advertising sales ratio for your industry will help you spend proportionately to your competitors. You must be careful however, not to base your entire budget on these reads. Your particular situation may require you to advertise more or less than your competition. You may feel that at this point in your business life cycle, it is important to spend more than average on advertising. The decision is ultimately yours. After all, growth requires investment.

No business owner should let any method bind him or her. It may be helpful for you to use the percentage-of-sales method because it is quick and easy. Not only is it a sound method for stable markets, but it may also keep your advertising budget from getting way out of proportion. Note: if you are looking to expand your market share, you will probably have to use a larger percentage of sales toward advertising than the industry average.

What sales?
Your budget can be determined as a percentage of past sales, of estimated future sales, or as a combination of the two:

Past sales
Your base can be last year's sales or an average of a number of years in the immediate past. Consider, though, that changes in economic conditions may cause your figures to be too high or too low.

Estimated future sales
You can calculate your advertising budget as a percentage of your anticipated sales for next year. The most common pitfall of this method is an optimistic assumption that your business will continue to grow. You must always keep general business trends in mind, especially if there is the chance of a slump. Remember to assess the directions in both the industry and your own operation.

Past sales and estimated future sales
The middle ground between an often conservative appraisal based on last year's sales and a often overly optimistic assessment of next year's, is to combine both. This method is generally more realistic during periods of changing economic conditions. It allows you to analyze trends and results as well as predict future sales with a little more accurately.

Unit of Sales
In the unit-of-sale method you set aside a fixed sum for each unit of product to be sold, based on your experience and trade knowledge of how much advertising it takes to sell each unit. For example, if it takes two cents' worth of advertising to sell a case of canned vegetables and you want to move 100 000 cases, you will have to spend $2 000 on advertising. If it costs X dollars to sell a refrigerator, you will have to budget 1 000 times X to sell one thousand refrigerators. Using this method you are simply basing your budget on units of sale rather than dollar amounts of sale.

Some people consider this method just a variation of percentage-of-sales. However, since unit-of-sales is based on what experience tells rather than an overall percentage of your gross sales estimate, it is probably a more accurate estimate.

The unit-of-sales method is particularly useful in fields where the amount of product available is limited by outside factors, such as the weather's effect on crops. If that's the situation for your business, you must first estimate how many units or cases will be available to you. Then, you advertise only as much as experience tells you it takes to sell them. Thus, if you have a pretty good idea ahead of time how many units will be available, you should have minimal waste in your advertising costs.

This method is also suited for specialty goods, such as washing machines and automobiles; however, it's difficult to apply when you have many different kinds of products to advertise and must divide your advertising among these products. The unit-of-sales method is not very useful in sporadic or irregular markets or for style merchandise.

Objective and Task
The most difficult (and least used) method for determining an advertising budget is the objective-and-task approach. Though it is more complex (and therefore less attractive) than other methods, this approach is the most accurate and therefore best method for determining your budget.

It relates the appropriation to the marketing task to be accomplished.

It relates the advertising appropriation under usual conditions and in the long run to the volume of sales, so that profits and reserves will not be drained.

To establish your budget using this method, you need a coordinated marketing program with specific objectives based on a thorough survey of your markets and their potential.

While the percentage-of-sales or profits method first determines how much you'll spend without much consideration of what you want to accomplish, the task method establishes what you must do in order to meet your objectives. Only then do you calculate its cost.

You should set specific objectives: not just "Increase sales", but, for example, "Sell 25 percent more of product X or service Y by attracting the business of teenagers". Then determine what media best reaches your target market and estimate how much it will cost to run the number and types of advertisements you think it'll take to get that sales increase. You repeat this process for each of your objectives. When you total these costs, you have your projected budget.

Of course, you may find that you can't afford to advertise as you'd like to. It's a good idea, therefore, to rank your objectives. As with the other methods, be prepared to change your plan to reflect reality and to fit the resources you have available.

How to Allocate Your Budget

Once you have determined your advertising budget, you must decide how you will allocate your advertising dollars.

First, you will have to decide if you'll do any institutional advertising or only promotional advertising.

After you have set aside an amount on which to build your image (if that is your plan for the year), you can then allocate your promotional advertising in a number of ways. Among the most common breakdowns are:

Departmental Budgets
The most common method of allocating advertising dollars is "percent of sales". The departments or product categories with the greatest sales volume receive the biggest share of the budget.

In a small business or when the merchandise range is limited, the same percentage can be used throughout. Otherwise, a good rule is to use the average industry figure for each product.

By breaking down the budget by departments or products, the goods that require more promotion to stimulate sales can get the required advertising dollars. Your budget can be further divided into individual merchandise lines.

Total Budget
Your total budget may be the result of integrated departmental or product budgets. If your business has set an upper limit for advertising expense percentage, then your departmental budgets, which are based on different percentages of sales in each area, might be pared down.

In smaller businesses the total budget may be the only one established. It, too, should be divided into merchandise classifications for scheduling.

Calendar Periods
Most executives of small businesses usually plan their advertising on a monthly or weekly basis. Your budget, even if it is for a longer planning period, should also be calculated for these shorter periods. It will give you better control.

The percentage-of-sales methods is also useful here to determine how much money to allocate by time periods. The standard practice is to match sales with advertising dollars. Thus, if February accounts for 5 percent of your sales, you might give it 5 percent of your budget.

Sometimes you might want to adjust advertising allocations downward in some of your heavier sales months, so you can boost the budget of some of your poorer periods. But this should be done only if you have reason (as when you competition's sales trends differ markedly from yours) to believe that a change in your advertising timing could improve slow sales.

Media
The amount of advertising that you place in each advertising medium - direct mail, newspapers, radio, etc. - should be determined by past experience, industry practice, and ideas from media specialists. Normally it is wise to use the same sort of media your competitors use. That is most likely where your potential customers look and listen.

Sales Areas
You can either spend your advertising dollars in areas where your customers already frequent, or you can use them to stimulate new sales areas. Whatever you choose, remember that it is usually more costly to develop new markets than it is to maintain the ones that are already established.

A Flexible Budget

Any combination of these methods may be employed in the formation and allocation of your advertising budget. Based on your advertising needs, you may find that you need all or only one of these methods to meet your advertising objectives. Whatever the case, make sure that your budget is flexible. It must be easy to adjust when there are changes in the market.

The duration of your planning and budgeting period depends upon the nature of your business. If you can use short budgeting periods, you'll find that your advertising can be more flexible and that you can change tactics to meet immediate trends.

To ensure advertising flexibility, you should have a contingency fund to deal with special circumstances - such as the introduction of a new product, specials available in local media, or unexpected competitive situations.

Beware of your competitors' activities at all times. Don't blindly copy your competitors, but analyze how their actions may affect your business - and be prepared to act.

Getting Started

Your first budget will be the most difficult to develop - but it will be worth the effort since it will help you analyze the results of your advertising. By your next business year you will have a more factual basis for budgeting than you did before. Your plans will become more effective with each budget you develop.