

Configuring Advertising Budgets.

Q: I've never really done much advertising for my business; I've always relied on networking and word-of-mouth. Now I'd like to launch a small campaign, but I'm frightened it will cost a lot of money. How can I figure out where to start?

A: The first thing you must do is calculate your minimum and maximum allowable ad budgets:

STEP 1 Take 10 percent and 12 percent of your projected annual, gross sales and multiply each by the markup made on your average transaction. In this first step, it's important to remember that we're talking about gross markup here, not margin. Markup is gross profit above cost, expressed as a percentage of cost. Margin is gross profit expressed as a percentage of the selling price. Sell an item for \$150 when it only costs you \$100, and your markup is 50 percent. Your margin, however, is only 33.3 percent. This is because the same \$50 gross profit represents 50 percent of your cost (markup,) but only 33.3 percent of the selling price (margin.) Most retail stores in America (carpet, jewelry and so on) operate on an average markup of approximately 100 percent, some operate on as little as 50 percent markup and others add as much as 200. More expensive items, such as cars, recreational vehicles and houses, typically carry a markup of only 10 to 15 percent.

STEP 2 Deduct your annual cost of occupancy (rent) from the adjusted 10 percent of sales number and the adjusted 12 percent number.

STEP 3 The remaining balances represent your minimum and maximum allowable ad budgets for the year. At this point in the calculation, you may learn that you've already spent your ad budget on expensive rent, or you might also learn that you should be doing a lot more advertising than you had previously suspected.

Now let's calculate an ad budget. Assume that my business is projected to do \$1 million in sales this year, I have a profit margin of 48 percent, and my rent is \$36,000 per year. The first thing to do is calculate 10 percent of sales and 12 percent of sales (\$100,000 and \$120,000, respectively). Second, we must convert my 48 percent profit margin into markup, because markup is what we've got to have to make this

formula work. Most business owners know their margin by heart, but never their markup. To make the conversion from margin to markup,

simply divide gross profits by cost. Dividing \$480,000 (gross profits) by \$520,000 (hard cost) shows us that a 48 percent margin represents a markup of 92.3 percent. Bingo.

Now we multiply \$100,000 times 92.3 percent to see that our adjusted low budget for total cost of exposure is \$92,300. Likewise, we multiply \$120,000 times 92.3 percent to get an adjusted high budget for total cost of exposure of \$110,760. From each of these two budgets, we must now deduct our \$36,000 rent. This leaves us with a correctly calculated ad budget that ranges from \$56,300 on the low side to a maximum of \$74,760 on the high side.

Most advertising salespeople will tell you that "5 to 7 percent of gross sales" is the correct amount to budget for advertising, but don't you believe it. It simply isn't possible to designate a percentage of gross sales for advertising without taking into consideration the markup on your average sale and your rent. Yes, expensive rent for a high-visibility location is often the best advertising your money can buy, since a business with a good sign in a high-visibility location will need to advertise significantly less than a similar business in an affordable location. To prove this, just look at the example above and change the rent to \$75,000 per year. In this case, the ad budget would range from \$17,300 to \$35,760, representing just 1.7 to 3.5 percent of sales. The formula I've given you is the only one that reconciles your ad budget with your rent as well as the profitability of your average sale. Good luck!

Nicknamed "the Wizard of Ads" by an early client, Roy H. Williams and his staff have often been the unseen, pivotal force in amazing come-from-behind victories in the worlds of business, politics, and finance. Williams is the author of The Wizard of Ads, Secret Formulas of the Wizard of Ads, Magical Worlds of the Wizard of Ads, Accidental Magic and Free the Beagle.

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