CHAPTER 10

Budget Planning

A BUDGET IS A FINANCIAL ESTIMATE of future income and expenses. It is one element in the plan of operation in projecting how much will be spent and how much will be earned. Budgeting entails using the best judgment, based partly on past experience, combined with an investigation of current cost factors.

A financial statement is documentation of past expenses and revenues over a finite time period: monthly, quarterly, or annually. The financial statement is normally audited and prepared by an independent auditor and becomes a part of the filing for the IRS Form 990 that is required of all nonprofit organizations. For-profit performing arts companies use audited statements as part of their annual corporate tax preparation. Form 990 becomes a public document and can be accessed over the Internet at www.guidestar.org. Financial statements give a history and should, to the extent possible, be truthful in reporting income and expenses for the organization.

Budgets and financial statements are among the most important tools in the exercise of sound management. This chapter will discuss the opposites in the budgeting process: costs and revenues.

General Budgetary Considerations

Planning and Using a Budget

Financial planning is a process that should be approached seriously—and somewhat conservatively—before work begins on the project and certainly before commitments are made or contracts are signed. Accurate financial planning depends on the experience and expertise of those who devise it. In order to maximize accuracy and control, every department within an organization that will eventually have an impact on expenditures or earnings should be involved in the budget-planning process. While methods for doing this are discussed in the next chapter, it ought to be said here that, once adopted, no budget can be adhered to with fanatical zeal. As policies, plans, costs, and income change,

the figures in the budget should be revised. A budget must be flexible enough to deal with unanticipated emergencies and unforeseen expenses. Nonetheless, when used as a well-informed and intelligent projection, a budget is a good barometer for measuring the fiscal health of a particular project or the organization.

Zero-Based Versus Incremental Budgeting

Unless an operation is absolutely static, meaning that there is no change in the operation or program from year to year, a combination of zero-based and incremental budgeting will be used in the development of a new budget. Pulling out the previous year's budget or financial statements often starts the annual budget process. Then, figures for the new budget are simply based on the past year's figures, taking into account inflationary and operational growth increases. Such incremental budgeting can work when the financial climate is steady, and when the company wishes to continue the same policies and methods of operation as in the past. But when this is not the case, zero-based budgeting probably offers a better approach. This requires that every budget item be justified from the first dollar. This encourages more sophisticated analytical thinking about finances and, hence, about policies and priorities.

Because the largest budget area for a performing arts company is that of production, and because each production tends to be unique, most of the budgeting in this area is zero-based. Therefore, operating budgets might be designed incrementally while the production elements are designed using zero-based methods. Clearly when a company operates under the umbrella of a larger parent institution or has an endowment that generates significant income, a higher level of budget security is added. However, this does not negate the need to plan diligently and monitor the overall budget. Production budgets, such as those illustrated later in this chapter, are often problematic in that a series of productions is being budgeted for the same season. This encourages comparative analysis and also permits more flexibility than if each production were planned independently. Resources can be manipulated between productions—i.e., resources from production number one might be put into production number two—or if there are residual resources from an early production, they might be used to enhance a production later in the season.

The Contingency

Budgets should contain both a "miscellaneous" and a contingency or reserve fund. The miscellaneous category can be based on experience and provides funds for minor but unanticipated costs due to inflation, staff overtime, and equipment repair. The contingency or reserve category should be no less than ten percent of the total budget. The contingency is a hedge against the unknown and is the primary budget insurance against a downturn in box office receipts, canceled productions or performances, costly equipment replacement, and temporary loss of facility usage because of natural disasters.

Unfortunately, some budget allocations, such as those from college, university, and government institutions or agencies, do not recognize or provide contingency or reserve

funds. In this case, the organization or department making budget requests is virtually forced to overestimate its costs and thereby create a built-in contingency. Once such allocations are received, if the amounts were not purposely inflated, the recipient must usually readjust budget commitments to provide for miscellaneous and unexpected costs. When every dollar is closely and specifically budgeted, slavish adherence to the budget is a likely—and undesirable—result.

Deficit Spending

While it usually "takes money to make money," it is a peculiarity of fundraising that it may take a deficit to gain more revenue. Many nonprofit organizations believe that if they maintain sizable cash assets and are therefore known as "rich" organizations, they will not attract contributions. And, while it might be possible for a nonprofit company to build up its cash reserves by economizing, what would this do to the quality of its work? The money that comes in is meant to further its stated mission and goals, not to compromise them. The line between solvency and bankruptcy is often very thin; the line between quality and mediocrity is very broad. Deficits, consequently, are a fact of life for many nonprofits. Most have the ability to carry a limited deficit all of the time and a large deficit some of the time. An organization may seek to dramatize its financial need through the press or other publicity as a way to attract grants and contributions. Normally there must be a strong justification for a subsidy before one is granted. On the other hand, if the organization cannot prove its value to society as well as its financial need, and demonstrate the strength and wisdom of its management, then fundraising efforts will seldom be successful. Most donors want to be associated with success and will give to a successful organization before giving to one that is always on the brink of insolvency.

Cost Averaging

Operations that offer a season or series of different productions often plan in terms of average box office income and average costs so that popular shows can carry less popular ones, and expensive productions are balanced by inexpensive ones. This permits a greater range of production than is possible on Broadway where each show is a separate enterprise. It is also a practice that emphasizes the overall picture or season, rather than each production. And it provides an average weekly or per-production-operating figure that may serve as a break-even point for the purpose of paying royalties and percentages, or for the purpose of estimating profits, which are also called "marginal revenue." Royalties and percentages are variable costs determined by the actual box office gross. Let's say that a performer is guaranteed a weekly salary of $2,000 against a percentage of twenty-five percent over the break-even point. If the theatre determines its break-even —weekly operating cost—at an average of $18,000, the performer will earn a percentage of box office income only if the break-even exceeds $18,000, but his or her $2,000 weekly salary is assured regardless of the box office receipts. If that agreed *average* weekly operating cost for that particular week was higher than the *actual* operating cost, then management got a bargain, as no additional payments need be made.

Cost averaging helps to show a broad, general profile of projected or actual costs and revenues. figures are averaged over a series of units, which may be performances, weeks, productions, or whole seasons.

The Variable Cost

In large commercial operations and presenting organizations especially, many costs, such as rent, performer fees, booking fees, and royalties paid to the creative team, are tied to the actual box office gross and cannot be determined until that figure is known. Small professional companies and most nonprofessional groups usually pay flat royalty amounts for performance rights, which are based on the number of performances or size of the theatre; rarely are they involved in percentage deals.

Variable costs suggest or imply that there will be a difference between the fixed weekly operating cost and the actual weekly operating cost for a producion. Basically, this means that the higher the box office gross, the higher the royalties and percentage payments. So the estimated weekly operating cost is not a static figure. The fixed costs plus the variable costs, based on the actual box office gross income, comprise the total, actual costs.

The Marginal Cost

An operating budget is always based on the assumption that the producing organization will present a certain number of productions and a certain number of performances per production, per week. When the cost of doing this is averaged out among all the performances, the resulting figure represents the "per-unit cost" of producing a product. In theatre the unit is a single performance, a week, or a season of performances.

As any manufacturer knows, it is cheaper to produce one hundred units of the same product than one hundred different products. Live theatre's inability to do this is the core of its economic dilemma. Hollywood can produce one hundred prints of the same film for release in one hundred different movie houses simultaneously and all for about the same investment and the same number of employee hours required to produce a single print of the film.

The performing arts, on the other hand, cannot even contemplate such economies of scale. However, there are several ways live theatre may decrease its per-unit cost. One of these, when business warrants it, is to increase the number of performances presented in a given week or the number of productions presented in a given season at the same theatre. Capital, operating, and production expenses remain essentially the same whether a theatre presents four or eight performances per week.

If the budget is based on a schedule of eight performances per week, and the show is a hit, the producing organization might want to know how much an extra performance would cost during that same week.

The figure that answers this question is called the marginal cost and is illustrated in the budget for a twelve-week community theatre season at the end of this chapter. It shows how the per-unit cost decreases as production of the units increases.

Variables in Cost-Estimating

The most common variables to be taken into account when drafting a budget for a theatrical project are:

1.) Does the project operate under union agreements?
2.) Is it affiliated with some other group or institution?
3.) Does it plan a single production or a series of productions?
4.) Does it rent or operate its own facility?
5.) Is it commercial or nonprofit?
6.) What are the general overhead and maintenance costs?
7.) What is the seating capacity of the facility?
8.) What is the physical condition of the facility?
9.) What is the location of the facility?
10.) What is the nature of the production(s) being offered?
11.) What is the number of performances (per day, week and season)?
12.) What are the total anticipated revenues from all sources?

Theatre budgets share similarities with all budgets. For instance, all federal withholding taxes are computed in the same manner, as are union benefits. But there are variables that deserve special attention.

The Larger the Capacity, the Higher the Cost

The volume of space within the physical plant will influence the dollar amount of many budgetary items. Larger buildings require more maintenance, more heat and air-conditioning, greater repair and renovation costs, more powerful and extensive machinery and electronic systems, and, of course, a larger staff and more complicated security provisions.

The Newer the Theatre, the Higher the Cost

Old buildings invariably present operating problems that account for high costs, especially in the areas of maintenance and repair. Poor plumbing and wiring, leaking roofs, and aging equipment often inspire the tenants of an old plant to lease or build a new one believing that it will be less expensive to operate. A new building should offer greater operating efficiency than an old one, but only at a price. A new building will probably contain more electronic systems, more electrical wiring, more plumbing, and more computer technology than an older building. New surroundings and new features can be wonders, but are they assets or liabilities? A new facility, like a new employee, must be broken in—this requires both time and money. Perhaps it will be necessary to correct the acoustics in the auditorium, enlarge the box office, or hire pole climbers from the circus to change the light bulbs in the chandelier. In short, replacing the old with the new can sometimes amount to little more than swapping one set of frustrations and expenses for another.

The new or beginning organization may be more costly to operate because it must spend more on marketing to build a nucleus of loyal customers and inform the public of its location and what it is doing. A young organization will sometimes unavoidably make expensive mistakes: mistakes in staffing, in programming, in production policy, in the choice of vendors. Inexperience can be expensive.

A new building or newly established operation also invites myriad inspectors and officials who may ignore or go more gently with established operations. Labor unions may demand that more of their members be used where nonunion employees were previously hired. Building and public safety inspectors will almost certainly make thorough investigations of the building, and these investigations may result in unexpected costs. Building codes and operating regulations are often more stringent for new buildings or for extensively renovated ones than for existing structures.

However, while a new building may indeed result in higher operating costs, it may also result in increased income during the two- to three-year "honeymoon" period, when many people will attend the theatre solely because it is new. This can offset the higher operating costs during the initial occupancy and give the company an opportunity to match its operating budget to the new space.

The More Geographically Remote, the Higher the Cost

Operations located off the beaten path may spend a lot merely to call attention to their existence and to direct customers to their doors. They may also have high transportation costs for personnel and supplies and it may be difficult to find convenient housing for artists and staff. If located away from shopping centers, it can become a time-consuming safari to run a simple errand.

The More Unusual or Esoteric the Fare, the Higher the Cost

Because the general public is hesitant about what is new or unfamiliar, extra marketing is usually necessary to promote unique or esoteric types of entertainment. Generally speaking, opera is more difficult to sell than musical comedy, William Shakespeare more difficult than Neil Simon, the new play more difficult than the established hit, the unknown actor more difficult than the household name. Unusual productions often require employees who possess special skills or training and who therefore command higher salaries. Novelty, sophistication, or extravagance may also require special or additional equipment in terms of stage lighting, scenery, sound systems, costumes, and properties, and possibly insurance. The extra expenses may pay off at the box office, but rarely unless the elements that mandate them can be justified artistically. Also, if the play or musical is a new work, extra rehearsal time will be required as the writers adjust the script. In addition to this there will be increased fees or commission for the new work.

Affiliations Can Lower the Cost

Often, two or more theatres will join in the production of a play or musical—co-

producing the work and moving it between theatres. Both theatres share the production costs and they can be spread over a longer run of the show. While the cost involved in moving the production must be taken into account, as well as designing the production for what might be two stages of different size and technical capabilities, the savings in rehearsal and production costs, professional technical and theatrical personnel and marketing can be substantial. Sharing a production should always be seriously considered.

Three Important "Don'ts"

Don't Spend Income before It's Earned

Most earned income in the performing arts is derived from the sale of tickets. A theatre ticket is a rental agreement—license—that entitles the buyer to a particular seat in a particular theatre, at a particular time and date, for a particular performance, at a particular price—possibly featuring particular performers. Those are a lot of particulars! If for any reason the producer cannot deliver on them as promised, the price paid for that ticket may have to be refunded.

Owing to this possibility, ticket revenue

1.) Should be held until the performance for which it was paid has concluded.
2.) Should never be regarded as money earned until the performance has occurred.

In other words, one should recognize the fundamental difference between earned revenue and deferred revenue—money that has been received but not yet earned. These deferred revenues constitute a production's "advance sale," meaning money that is taken into the box office for future performances yet to be played.

This distinction is especially clear in regard to Broadway productions, because the law requires that producers and their backers—limited partners—provide all the capital necessary to finance the production up to and including its opening night. Advance ticket revenue, which can be considerable, is held in order to pay for weekly operating costs. If the weekly ticket sales are insufficient to cover weekly operating costs, the show is usually closed—or the producers must lend money to the production in order to meet the week's expenses. If a production closes, all money being held for future performances is refunded to ticket holders for those canceled performances.

But if weekly sales do cover weekly operating costs, any excess ticket income is used to first repay the investors who put up the money for the initial production—capitalization; any excess revenue thereafter is paid out as profits to the producers and investors.

As a practical matter, it is impossible for a production to tap into its advance on Broadway because the production only receives the dollar amount earned for that week's performances as reflected by the box office statements. The theatre owner holds the advance money.

In a situation, however, where advance money can be accessed, it is always tempting to dip into it. In large operations, season tickets or subscriptions may be sold as much as a year in advance and the amounts of money can be substantial, and all the more tempting. Only the interest earned on that money could safely be spent. But the wisest policy is to regard such income as money being held in trust and to keep it in a safe and separate (insured) savings account, and to transfer it into an operating account only as the daily or weekly box office reports show that it has been earned.

Most theatres or performing arts organizations commit themselves to a minimum number of performances per production, regardless of what they may earn at the box office—a policy that presents considerable risk. Whether or not tickets are sold, the show goes on and the attendant expenses are incurred.

In the case of commercial ventures, the producer or promoter should have the personal resources to underwrite any losses or find another person or company to agree to assume this risk in exchange for a percentage of any profits.

If the operation is a nonprofit, it should arrange to cover anticipated losses with contributions of various kinds. Few corporations or foundations, however, will long support an operation that fails to earn at least fifty or sixty percent of its costs at the box office. But revenue from such sources as well as from individuals—as long as it is promised in writing—is like money in the bank and may be spent immediately, within the limits of any conditions attached to it. Although concessions and merchandise income may supplement box office receipts, caution should be used in estimating potential revenue from such sources as program advertising, parking lots, or food and beverage concessions. Profits rarely meet expectations.

When an organization or company has estimated its costs and sees that it will need its contributed income plus more than sixty-percent-of-capacity business in order to break even, it is usually a sign that its costs should be reduced, its revenue increased, or its plans revised or abandoned.

Don't Spend or Budget the Same Dollar Twice

There is always a need to stretch a dollar as far as possible, but there is a limit to how much this can be done. Optimism or inexperience sometimes leads people into the illusion that the same dollar can be spent twice. For example, many theatre companies must post bonds with unions before they can sign contracts with members of those unions. The bond may be in the form of cash, a savings account book, or some other security. Although the person or company posting the bond is entitled to receive any interest it earns, the principal, itself, will not be returned until after the production or the season has concluded. And, if there is unfinished business or a dispute between the two parties involved, the bond will be held until everything is settled. Bonds are returnable and represent a cash asset, but they do not represent readily available cash and, indeed, could eventually be lost because of arbitration or litigation.

Sales tax collected as part of ticket or merchandise sales—or payroll tax withheld from salaries—belongs to the government. If spent by the organization, it would be

money spent twice. And budgeting for labor costs also holds possibilities for spending the same dollar twice. For example, it may be assumed that one employee can fulfill the functions of both receptionist and box office treasurer, but handling box office and front office traffic simultaneously may prove impossible for one person.

Don't Get Into the Boat Unless You Can Afford to Sink

If a project is initiated and financial commitments are made before there is good assurance that the necessary capital will be forthcoming, a lot of money is likely to be lost, and a lot of reputations damaged. Because theatre is so highly speculative and because so many unexpected things can happen to increase expenses or prevent productions from taking place, producing organizations must always keep the possibility of financial disaster in mind and protect themselves, their investors, and the ticket buyers accordingly. Of course, it is sometimes necessary to take calculated risks. The New York producer may never be compensated for the time and money she or he spends trying to secure an option on a certain property. The organization trying to establish an acting company or construct a new theatre building may never see its efforts pay off.

Estimating the Expenses

Most performing arts operations must absorb four basic types of expenses, and four different types of budgets traditionally reflect these:

1.) Capital Budget includes one-time business and facility expenses, such as incorporation, board development, feasibility studies, facility design construction, renovation, and new equipment.

2.) Annual Operating Budget includes ongoing business and facility expenses that continue over an entire season or year without being greatly influenced by what productions are offered—these include utilities, real estate taxes, in-house staff, insurance, and office supplies.

3.) Preproduction Budget—sometimes called a Production Budget—includes one-time expenses related to the preparation of a theatrical production, such as auditions, rehearsal salaries, director's fee, costume and scenic construction, seasonal or preopening marketing, nonartistic production personnel, and the opening night party.

4.) Production Operating Budget—sometimes called an Operating Budget—includes ongoing expenses per week or per performance that are directly related to the stage show itself—these include royalties, performers' salaries, advertising, stagehands, company transportation, per diems, and equipment rentals.

While a single production company or organization may absorb all the items covered in all four budgets, it may not have direct responsibility for estimating and controlling them. For example, the cost of operating a Broadway theatre and the corporation that owns it is paid by the tenant production company to the landlord in the form of rental fees. But the production and operating costs for a bus and truck company are paid as fees by the promoter or presenting organization to a commercial producer. The presenting organization may control its own facility and therefore control its own capital and annual operating budgets, or it may rent a facility and pay for such costs in the form of rental fees. Or a resident stock company or a LORT theatre that operates its own facility and originates its own productions would have control over all four budgets listed above. Because separating expenses greatly clarifies the planning process, such budget categories are often maintained even when the same company or organization controls all four.

Capital Budget

Virtually all producers or groups that seriously intend to organize a professional production or a company must form a legal entity of some type. This process is discussed in Chapter 1. Not surprisingly, this process requires money and the services of an attorney. Drawing up a limited partnership agreement or limited liability corporation, an offering prospectus, a set of bylaws, or other one-time obligations related to setting up a business will also require a lawyer. Generally, independent not-for-profit organizations will have a statutory board of directors or trustees, with the board having the ultimate responsibility for the financial health of the organization and the ultimate liability for any losses or law suits, as well as the having the responsibility of hiring and firing the chief executive officer. Organizations that are part of a larger entity, such as an institution of higher learning or a municipal cultural center, may be covered under the legal umbrella of the larger organization and may not be required to have a separate statutory board.

Such start-up costs are shown in the capital budget or, in the case of a commercial production, in the preproduction budget, which is the capital budget for the show as well as for its single-purpose production company. Most ongoing theatre companies must also find a more or less permanent theatre space in which to present their work. As discussed in Chapter 2, there are a variety of buying, renting, or sharing possibilities for the production space. Many a theatre company starts out in a modest, rented space and later acquires its own home. So initial start-up costs may be minimal—limited, perhaps, to the cost of incorporation, which can easily be absorbed into the first annual operating budget; or they may be very high because they might include such things as buying and renovating an old movie theatre or warehouse. Or, a theatrical entrepreneur may begin by purchasing an existing theatre and then producing or booking the productions that will perform in it.

The budget related to renovation or new construction costs should be separate from those related to production and operating expenses. The acquisition of a new facility may require a separate public relations and fundraising campaign as well as paying for

consultants who are not directly related to regular production activity. The producing organization that is already presenting plays should not endanger its production activity by committing its operating capital to other uses. Eventually, construction, renovation, and other capital costs will appear in the operating budget in the form of plant amortization. If a mortgage or loan has been secured, the payments will constitute the organization's rent or "occupancy cost." Organizations that operate in campus or civic facilities may not be required to contribute directly to capital expenditures. But when financial responsibility for facility acquisition and renovation does rest with the producing organization, then a capital budget must be developed. At the beginning, the capital plan, although based on expert advice and containing detailed numbers, is only an estimate. If it is a new or remodeled facility, consultants should be engaged to give specific numbers to the special requirements that will allow the development of a detailed estimate for bidding and construction. Often, this stage is undertaken prior to a major fundraising campaign in order to provide the visual materials for the campaign and to determine, with some certainty, the capital costs of the project.

Using the hypothetical example of a professional nonprofit theatre company, let's look at sample budgets of the four basic types and then see how each contributes to the total annual cost of the operation. Later in the chapter, we'll examine how this company might also estimate its income to determine whether or not its plans are realistic. The sample budgets that follow cannot provide full details of actual circumstances, but they show the major items and should suffice to illustrate the budgetary process.

Sample Capital Budget
(Nonprofit Professional Theatre)

Capital fundraising drive	$175,000
Purchase price of building	1,230,000
Title search, legal fees, etc.	12,000
Permits, licenses, etc.	7,900
Consultant fees	30,000
Architect's fees and costs	45,000
Renovation costs (interior)	500,000
Renovation costs (exterior)	115,000
Landscaping	64,000
New, permanent stage equipment	562,100
New, permanent office equipment	109,000
Miscellaneous	50,000
Contingency	100,000
Total Estimated Capital Expenses	$3,000,000

Annual Operating Budget

Once the occupancy cost has been determined, whether in the form of a mortgage or loan payments or rent payments to a landlord, then the organization must estimate its annual operating expenses. How much will it cost to operate the facility, including an amortized portion of the capital cost? A successful fundraising campaign may provide all of the required funds, thereby letting the company occupy the building free of any payment for borrowed funds. In a very successful campaign, an allocation for one year of operating expenses will be included in the initial start-up costs. This enables the company to work without compromising its artistic vision. Personnel and staffing will account for a large portion of ongoing, annual expenses. These items in an annual operating budget have little flexibility. They will essentially be the same whether the theatre presents five or eight performances a week, or six or sixteen productions during the year. Like the rent or occupancy cost, the total of all annual operating costs may eventually be amortized or averaged over each week in the year or season, or into the cost of each production, whichever will better assist the planning and evaluation process.

Sample Annual Operating Budget (Nonprofit Professional Theatre)

Mortgage payment	$120,000
Interest	6,000
Salaries:	
Artistic (annual contracts)	500,000
Administrative (annual contracts)	165,000
Technical (annual contracts)	190,000
Security and maintenance (annual contracts)	85,000
Payroll taxes and benefits	376,000
Company vehicles expense	27,000
Utilities	68,000
Insurance	39,000
Legal and auditing	32,000
Licenses and permits	56,000
Maintenance and repair	42,400
Internet technology	85,000
Plant opening and closing	25,000
Office and building supplies	78,000
Travel and transportation	39,000
Seasonal marketing expenses	400,000
Seasonal development expenses	69,000
Equipment rentals	29,000
Board meetings and expense	3,600
Postage (general)	5,000
Miscellaneous	60,000
Total Estimated Annual Operating Expenses:	$2,500,000
AEA and ATPAM Bonds (returnable)	55,000

Production Budget

A production budget contains the one-time expenses involved in mounting a specific production, which makes it the capital budget for that production.

Thus far, the cost of acquiring a facility and operating that facility have been estimated, but the theatre is still dark. A third budget, which would estimate the cost of putting together a stage production, must be drawn up. There should be a separate production budget for each show that is being planned. Items included in such budgets will be determined in part by how goods and services are contracted. If production supplies such as lighting supplies, scene paint, and lumber are purchased annually in order to take advantage of bulk-rate discounts, they may be shown in the annual operating budget. The same might also be true for personnel—including directors and designers—hired for a whole year or season rather than for a single production. Again, the budgeting and accounting system that most helps the decision-making process is the one to use.

Productions being mounted on a one-time basis—as for Broadway and the road—are budgeted as independent, one-time ventures. It is comparatively easy to isolate the cost of each item because the full cost of virtually all items can only be charged to the one production. On the other hand, budget items for ongoing, multiproduction companies or institutions, can more easily be manipulated in order to create a particular impression. In fact, the same figures can and sometimes are organized into several different budgets for different public information purposes: the press, the state arts council, the IRS, and major donors/grantors. The same may also be done with financial reports.

The budget sample that follows reflects the costs for a professional nonprofit theatre that does not maintain a resident acting company.

Sample Production Budget
(Not-For-Profit Professional Theatre: Nonresident, Nonmusical, Five-Character, One-Set Show)

Fees:	
Director	6,000
Set designer	2,500
Costume designer	1,500
Lighting designer	1,500
Salaries (rehearsal):	
Actors (5 × 5 wks × $600)	15,000
Stage manager(5 wks × $425)	2,125
Ass't stage manager (5 wks × $380)	1,900
Ass't set designer	1,000
Ass't costume designer	800
Ass't lighting/sound	800
Ass't director	500
Payroll taxes and benefits	3,450

Rehearsal & Audition Expenses:	
NYC studio	2,000
Audition stage manager	500
Stage manager's rehearsal expenses	200
Scripts, parts, and duplicating	200
Rehearsal props	225
Per Diems:	
Director	1,500
Designers and assistants	3,000
Company Travel:	
R/T from NYC	750
Local transportation	600
Physical Production:	
Scenery	38,000
Properties	2,000
Costumes and accessories	4,100
Electrics	400
Sound	200
Marketing/Promotion:	
Advertising	6,500
Brochures, flyers, mailings	2,100
Press kits	200
Graphics, design	1,500
Miscellaneous:	
Box office expenses	1,000
Departmental	1,500
Opening night party	1,500
Contingency	10,000
Total Estimated Preproduction expenses:	$115,050

Operating Budget

An operating budget projects those costs directly related to the performances of a work after it has been designed, constructed, and rehearsed. Naturally, the production that requires twenty rather than two actors will be more expensive. Musicals and recent hits carry higher rights costs than other shows while works in the public domain—excluding recent translations, adaptations, or revised versions—carry no rights expenses at all. The use of accomplished and well-known actors, directors, and designers not only requires high fees or salaries but also may require other expenditures in order for them to work at their highest levels of achievement. In short, the manner—shoestring or deluxe—in which an organization chooses to produce its productions is the most flexible budget

element. While most actors will work for the Equity scale appropriate to the classification of the theatre—e.g., LORT C—seasoned professionals and stars will be able to negotiate higher salaries and perhaps a percentage of the gross ticket sales.

Ongoing theatre productions from Broadway to nonprofit professional theatres are budgeted and operate on a weekly financial basis, typically Monday through Sunday. Touring productions that play split weeks or one-night engagements are sold to presenters on a per performance basis even though the company's producer thinks of the production in terms of its *weekly* expenses.

The production operating budget is designed to represent how much performances will cost, apart from capital and ongoing theatre-operating costs. By isolating this part of the operation, it is possible to compute the cost of extending the run of a certain production. As most standard Equity contracts cover eight performances per week, it seldom makes economic sense to offer fewer than that number. Capital, annual operating, and production budgets all involve fixed or inflexible estimates. The amount spent on each item can be determined in advance with reasonable accuracy. Marketing expenses, for instance, may go up or down depending on the show and the advance ticket sales, but those expenses can nonetheless be controlled and determined in advance. On the other hand, any production's operating expenses often include variable or flexible costs, such as royalties, that are directly tied to the box office gross income and can only be determined once the actual gross is known. While the following operating budget shows only fixed costs, a method for computing the break-even point that takes variable costs into account is discussed later.

No two production or operating budgets are ever exactly the same, because no two performing arts works are the same. The budget sample that follows might be for a nonmusical, five-character play with one set.

Sample Weekly Operating Budget
(Nonprofit, Professional Theatre: Show #1, Five-Character, One-Set musical)

Salaries:	
Actors (2 × $5,000 & 3 × $1,750)	$15,250
Stage managers	1,700
Crew	4,000
Wardrobe/makeup	800
House staff	1,500
Payroll taxes and benefits	5,813
Royalties	4,000
Local transportation (company)	500
Maintenance of physical production	500
Laundry and cleaning	250
Marketing/promotion	6,000
Printing and postage	100
Playbill printing (commission deal)	0

Box office expenses	500
Contingency	2,000
Sundry	1,087
Total Estimated Weekly Operating Expenses:	$44,000

It is likely that a typical nonprofit company would produce more than one production per season. For example, the company in this case study is planning four major productions, each with a five-week run for the upcoming twenty-week season. The first of these has just been budgeted: a five-character, one-set, nonmusical play.

Assuming that there are no variable costs and that the remaining three productions have been budgeted in detail, the budget summation for this theatre's upcoming season might look something like the following:

	Production Expenses	Weekly Operating Expenses	# of Weeks	Total Operating Expenses	Total Operating + Production Expenses
Show #1	$100,000	$44,000	5	$220,000	$320,000
Show #2	43,000	39,000	5	195,000	238,000
Show #3	83,000	41,000	5	205,000	288,000
Show #4	50,000	35,000	5	175,000	225,000
Totals	$276,000	$159,000		$795,000	$1,071,000
Average Cost	$69,000	$39,750		$198,750	$267,750

One can see at a glance that not all productions are equal in terms of their demands on the budget. The budget of show #1, a five-character play, indicates that two of the parts are being played by high-salaried performers. Perhaps show #2 is a revival of *A Christmas Carol* and will use sets and costumes from storage and have no stars; show #3 could be a contemporary comedy, and show #4 could be a five-character expressionist play with virtually no scenery. But, again, if different scripts mandate different costs, then different artistic approaches to the same play also generate different—even wildly divergent—costs; this underscores an essential principle in regard to theatrical budgeting: the budget figures must reflect the standards and goals of the leading artists involved with the production. This presents a challenge to the manager because it requires translating what a designer or artistic director wants into probable dollar amounts, or the contractual demands of a performer into expected costs. Production plans conceived in the artistic imagination must be translated into dollars in the business office, and this is the point

when artistic-managerial dialogue must become one of give and take in order to meet the artistic goals of the company while retaining overall fiscal responsibility.

With all the production plans and cost estimates set, it might be tempting to hold auditions and begin rehearsals. But the projected costs represent only one side of the budgetary coin. A detailed estimation of all income it can reasonably anticipate during the same season has to be completed. It is essential that total expenses be determined prior to beginning the process of estimating income because it is on the income side that adjustments might be made to compensate for costs through ticket scaling and the development of sponsorship and gift plans.

Estimating the Income

Commercial ventures do not as a rule receive contributions; they rely exclusively on ticket sales to fuel their activities and, hopefully, to distribute as profits as well. The only exceptions might be a merchandising or promotional sponsorship, or perhaps a company might provide advertising in conjunction with its own advertising. For example, American Express sometimes provides advertising for Broadway shows, so that its Gold Card holders can purchase choice tickets.

Nonprofit companies, however, initiate appeals, which they hope will attract grants and contributions, called "unearned income." There are many types of nonmonetary contributions—in-kind services, volunteer labor, donated land, corporate tie-ins—that provide free advertising, free housing for visiting artists, and pro bono services from professional arts support groups such as lawyers and accountants. But this chapter is only concerned with monetary income. What are all the different sources of earned and unearned income that an organization can reasonably count on? In the case of a theatre production or an ongoing performing arts group, the primary source of income is the box office.

Ticket Pricing

Once the total operating costs have been determined, moving the ticket scale up or down can help meet the anticipated expenses. For instance, if a star is used in a production, then a higher ticket price may be necessary and justified. The public is usually willing to pay a higher price for a higher quality product.

If the goal of the company is to maintain standard ticket prices across all productions, then extra effort may be required to secure sponsorships and gift income in order to balance expenses with income.

Ticket prices are often based on intuition, what a producer feels a community will pay. And, in truth, it is difficult to judge whether there will be price resistance until the tickets are actually on sale. Experience has shown that there is virtually no price resistance if the public wants to see a particular production. On the other hand, a not-for-profit company will sometimes have a low-ticket-price policy in order to provide the greatest possible access for its community. Consider for example, free Shakespeare in the Park.

Decisions about ticket pricing generally boil down to an estimation of the elasticity of demand for tickets. What is the top price the consumer will pay? How many consumers will pay it? How much are comparable attractions charging? What is the pricing history in the community? Assigning ticket prices that answer those questions correctly will result in optimum ticket sales for the production being priced.

Scaling the House

The diagrams of different seating arrangements in Chapter 2 suggest that ticket prices might reflect these differences: for example, there could be one price for the orchestra, another for the mezzanine, and another for the balcony. Assigning different prices to different sections of the theatre is known as "scaling the house," and the result is the price scale chart that is usually advertised and posted next to the box office and on relevant ticket-buying websites.

Some theatres have a long stretch of uninterrupted rows of seats; therefore, it may be necessary to select an arbitrary point at which the price changes. If rows of orchestra seats proceed from A to Z, for instance, the producer may decide to cut ticket prices beginning at row N. To make such an arbitrary decision obvious to customers and ushers, different colored seat covers might be used. It is best to avoid row I when designating rows because the letter *I* is easily confused with the number one. Many theatres label the first few rows of the orchestra by using double letters—row AA, row BB—and commence anew with row A farther back in the orchestra. Some theatres and ticketing systems use a zoned numbering system to indicate various sections of the auditorium, such as Zone 1, Zone 2, etc.

If there are fewer than five hundred seats, it makes sense to have a single ticket price. Otherwise, prices should decrease for seats farther from the stage. When sightlines are poor in certain sections of the house—often the case in arena theatres that have elliptical stages—ticket prices should be adjusted accordingly. Tickets for these locations are usually stamped "obstructed view" or "partial view" and scaled downward according to the degree of obstruction. When selling a "partial view" ticket, the buyer typically asks, "How much of the show am I going to miss?" The answer should be, "It's a fine seat and there are just a few unimportant moments that you won't see."

Because auditorium and ticket terminology varies from one theatre to another, it is not surprising that many customers are confused when it comes to ordering tickets. How, then, should the various sections of a theatre be labeled? Some terms are preferred because they sound more elegant than others, i.e. "terrace" instead of "first balcony," "family circle" instead of "second balcony." While the fancy labels may be desirable, more accurate terms are probably better in most cases. Almost any box office treasurer will attest that a surprising number of ticket buyers don't even understand the term "orchestra." Suffice it to say that theatregoing should be made as easy as possible. The following are the most commonly used seating terms:

Front Auditorium	*Middle Auditorium*	*Rear Auditorium*
Orchestra	Mezzanine	Balcony
Stalls (England)	Dress Circle	Rear Orchestra
	Front Balcony	Family Circle
	First Balcony	Second Balcony
	Boxes	Rear Balcony
	Side Terrace	The Gods (England)
	Side Balcony	Second Tier
	Loge	Second Terrace
	Parterre	
	Galleries (England)	
	First Tier	

Estimating Potential Box Office Income

Once the seating arrangement has been determined and the various sections have been labeled, a price is assigned to each seat and the potential gross is determined as follows:

Section	# of Seats	Price Per Ticket	Total
Orchestra and Front Mezzanine	500	$55	$27,500
Mezzanine	200	$45	$9,000
Balcony	100	$20	$2,000
			$38,500

There may be times when the scale is reduced for early-in-the-week evening performances, matinees, or special audiences, such as young people's performances. The following shows the same house as above, but with the price scale,

Section	# of Seats	Price Per Ticket	Total
Orchestra and Front Mezzanine	500	$45	$22,500
Mezzanine	200	$40	$8,000
Balcony	100	$15	$1,500
TOTAL POTENTIAL GROSS FOR A SINGLE MATINEE PERFORMANCE:			$32,000

A common way to create a lower scale is to make the top price of the lower scale ticket equal to the second price level of the higher scale ticket: $55/45/20 would become $45/20/*x*. How should the balcony be priced?

In this case, instead of the mezzanine selling at the balcony price of $20, a $40 mezzanine price was created in order to keep the potential gross high, and a new price of $15 was created for the balcony: $45/40/15. The new price configuration succeeds in that all sections are priced lower than in the first format.

If the production is scheduled for a limited run of less than a week, the total potential gross for the entire run can be computed and then set aside for study once the estimated production costs have been determined. But if the same or different productions are offered as an ongoing policy, then a weekly potential gross can be determined as follows:

	Income	Number	Total
Evening Performances	$38,500	6	$231,000
Matinees	$32,000	2	$64,000
Total Weekly Potential Gross:			$295,000

TOTAL SEASON
POTENTIAL GROSS: 20 weeks: $5,900,000

As well as having different price scales for evening and matinee performances, a theatre may elect to increase its ticket prices for opening night, gala performances, weekend and holiday performances, for musical productions, or for those that feature an especially popular star.

The gross potential is almost never reached because of the following, all of which must be considered when projecting income:

1.) Complimentary tickets
2.) Press seats
3.) Discounted season or subscription tickets
4.) Discounted group sales tickets
5.) Commissions paid to group sales agents and other salespeople
6.) Disputed credit card charges
7.) Difficulty in selling single, scattered seats
8.) Service charges imposed by credit card companies
9.) Ticket printing charges
10.) Ticket mailing costs
11.) Charge backs for bad checks

It is common practice to offset some of these losses by adding a handling charge, which in part will cover the credit card charges, mailing costs, and ticket printing expenses. In some cases, standing room or additional chairs can be sold for a sold-out performance.

In the case of not-for-profit operations, the return of unused tickets for resale can cancel out the complimentary ticket income loss.

The following can diminish ticket sales:

1.) Negative reviews in the media
2.) Poor word of mouth
3.) Adverse general publicity
4.) Illness and/or nonappearance of leading performers
5.) Interruptions in public transportation
6.) Interruptions in media coverage (local disaster)
7.) Severe weather conditions
8.) National emergency or heightened security alerts

Given all of the things that can go wrong to adversely affect box office income, it's prudent to estimate only fifty to sixty percent of the total potential box office gross. In rare instances, with a production with exceptionally wide appeal, the percentage might be raised to eighty percent. If the actual grosses exceed those estimates, pats on the back to all concerned.

In states that impose a sales tax on theatre tickets, price scales and estimates of gross must take this into account by providing "net" and "tax" categories for each price. And the taxable portion of all income should be deposited separately into a special escrow account, until paid to the appropriate tax collector. This practice helps to avoid the temptation of spending those dollars for other purposes.

not in CA.

Tickets are not taxable for for-or nonprofits when food is not included in purchase price in CA.

Income Earned Outside the Box Office

There are countless ways a theatre organization may earn money apart from the sale of tickets. These are discussed in Chapter 12, but it is necessary to show how income that is earned outside the box office might fit into the budget process. Sometimes this income is called "subsidiary" or "concessionary" income.

While it has become increasingly important for the survival of many professional theatres, it is nonetheless unwise to count on such revenue when it is minimal.

Just as capital and operating expenses must be estimated in regard to acquiring and running both a facility and a theatrical production, so they must be estimated in regard to stocking and running a concession—although inexperienced theatre groups are often tempted to anticipate the earnings and forget that there are usually expenses involved. For example, a "simple" little soft drink concession might entail the following costs:

Sample Concession Budget: Soft Drink Bar

Capital Costs:	
Electric 100-cup coffee maker	$95
Double hot plate	50

Four carafes	65
Small refrigerator	215
Large cooler chest	275
Caps and aprons for employees	100
TOTAL CAPITAL COSTS	$800
amortized over 20 operating weeks = $40/wk	
Weekly Operating Costs:	
1000 paper napkins	$10
1 gross stirrers	5
1 gross hot drink cups	20
1 gross cold drink cups	30
2 cases half-&-half cream containers	17
20 pounds of coffee	60
200 tea bags	10
25 cases of cola	250
25 cases other soda & juices	250
12 lemons	5
6 limes	3
AMORTIZED CAPITAL COSTS	$40
2 workers at $125 each + 15% tax	288
Total Estimated Weekly Costs	$988

One can see at a glance that, if both hot and cold drinks are sold for one dollar each, it would take 988 sales each week just to break even—which means that if this 800-seat theatre plays to fifty percent capacity for eight performances, every 2.2 customers would have to buy a drink.

Furthermore, sales for this concession will fluctuate greatly because of such factors as:

1.) Outside weather conditions
2.) Changes in the inside temperature
3.) General age of the audience
4.) General affluence of the audience
5.) The nature of the stage production (with or without an intermission)

If the air-conditioning system breaks down, if the audience includes five hundred children or six hundred senior citizens, if the play is a high-spirited comedy in which champagne is frequently served or a serious drama about alcohol abuse, then certain concessions will suffer a sudden drop in revenues. Spoilage, theft, and embezzlement are also common problems in concession management. And don't forget that any losses may have to come out of the hard-earned box office revenue. So before going into the wet

goods business, theatre managers consider the alternative of leasing concession space to private operators on a flat fee basis. And even in that situation, a percentage deal in which the theatre shares a portion of any profit with the concessionaire requires almost as much surveillance of the operation as if the theatre ran the juice bar itself.

Only when concessions have been in operation over a period of weeks or, better still, seasons, should a theatre feel reasonably confident in estimating the revenue—unless this is purely rental income. For example:

Sample Concession Expense and Income Summary

Concession	Estimated Expense	Estimated Revenue	Differential
Soft drinks	$988	$700	$(288)
Parking	200	1,600	1,400
Coat lockers	50	75	25
Souvenir programs	425	1,200	775
Estimated Totals	$1,663	$3,575	$1,912

PROJECTED SEASON TOTAL ($1,912 × 20 weeks) $38,240

Aside from concessions, there may be other important sources of earned income. Again, any operating expenses must be figured in before profits (or losses) can be projected:

Sample Income Projection Other Than Box Office & Concessions

Other Earned Revenues (Annual)	Est. Income After Expenses
Endowment Fund Interest	$6,000
Savings Account Interest	2,100
Income from Rentals	23,500
Tuition from Acting School	-4,600
Fees from Artists-in-the-Schools Program	-1,500

TOTAL ANNUAL OTHER EARNED REVENUES $25,500

If the above figures cover all sources of potential income, and if the prudent manager of our hypothetical theatre company plans on taking in 50 percent of the potential box office gross, the income summary so far would appear as follows:

Sample Income Summery (All Sources)

Est. season box office income ($295,000 × 20 wks = $5,900,000 @ 50%)	$2,950,000
Est. concessionary income after expenses	38,240
Est. other earned income after expenses	25,500
TOTAL ANNUAL ESTIMATED INCOME	$3,013,740

Let's tally all of the expenses so far:

Annual Operating:	$2,500,000
Preproduction for four shows	276,000
Production Operating (four shows, five weeks each)	795,000
Bonds (Returnable)	55,000
TOTAL PROJECTED ANNUAL EXPENSES	$3,626,000

Comparing the expenses of $3,636,00 to the income of $3,013,74, there is a shortfall of $612,260.

Fortunately, this is a nonprofit company that cannot only sell things to earn money but can also appeal to a variety of sources for grants and contributions.

Estimating Potential Contributed Income

The methods for raising unearned income are covered in Chapter 13. At the moment we are only concerned with illustrating how such revenue figures into the financial planning process. Fundraising expenses have already been addressed: fundraising costs for the capital budget were included in the capital budget, and fundraising costs to offset operating and production expenses were included in the salary and development items in those budgets. It is only necessary to revisit them if costs have risen above the previous estimates.

Fundraising activities are generally conducted well in advance of opening night. In fact, when contributed income is necessary to fund a particular project, work on that project should not begin until such funds are assured. So the fundraiser is likely to begin work at least a year or more prior to the time when it is hoped that the project can be initiated. While there will be many turn-downs, it will eventually become clear whether funding sources are interested in the project and how much money they are willing to promise. The results of a fundraising campaign aimed at numerous individuals for small donations are difficult to predict, although experience with such appeals lends validity to any estimation.

Contributed income estimations—based on past success and careful projection of increases based on new initiatives—can be summarized as follows:

Sample Summary of Projected Annual Contributed Income

Government	
Municipal Agencies	$10,000
City Arts Council	5,000
State Arts Council	8,000
NEA	4,000

Foundations	
Foundation A	6,000
Foundation B	24,000
Foundation C	2,500
Corporations	
Corporation A	125,500
Corporation B	30,000
Individual Donors Subscribers	16,000
Trustee Donations	75,000
Friends Campaign	10,000
Major Benefactors	15,000
TOTAL ANNUAL PROJECTED UNEARNED INCOME	$331,000

A sizable portion of contributed income is likely to be earmarked for specific purposes, such as commissioning a new work or a particular production or a tour. Similarly, budget allocations from a parent institution, such as a civic center, a university or a municipal agency, are usually limited to specific types of expenditures, such as office supplies, full-time salaries, part-time wages, and equipment. Such encumbrances, which limit the manner in which an organization can spend its money, are discussed in the "cash flow" section of the next chapter.

Projecting Profit or (Loss)

Commercial managers talk in terms of profit and loss, while nonprofit managers use the terms surplus and deficit. From a bookkeeping standpoint, such distinctions mean little. The bottom line in a budget shows whether a given company or project is expected to come out with a profit or a loss, and the bottom line in a financial statement shows whether or not it did. The following budget summation for our hypothetical theatre company projects a troublesome, though hardly gigantic, deficit for an operation of its size.

Sample Projection of Income and Expense
(Nonprofit Professional Theatre, 20-Week Season)

Protected Expenses	
Annual Operating Budget (Including Amortized Capital Costs)	$2,500,000
Preproduction Expenses (4 shows)	276,000
Production Operating Expenses (4 shows, 5 weeks each)	795,000
Total Bonds (returnable)	55,000

Total Projected Annual Expense	$3,626,000
Projected Income	
Total Box Office Income	
(50% of $5,900,000)	$2,950,000
Total Concessionary Income After Expenses	38,240
Total Earned Income from Other Sources	25,500
Total Grants and Contributions	331,000
TOTAL PROJECTED ANNUAL INCOME	$3,344,740
Income Less Expenses	-281,260
Plus Refundable Bonds	55,000
Differential (Shortfall)	-226,260

The bottom line for this company—-$226,260—doesn't look too bad, providing that the board of trustees and the management have faith in the planning process. Still, no company should start a season with a projected deficit. The goal should always be to have a balance between income and expenses. Alternative plans should be explored, and proposed revisions should be studied in terms of their impact on production standards and goals. In other words, back to the drawing board.

Budget Balancing Alternatives

The basic alternatives to a projected deficit are very simple:

1.) Increase income—earned or contributed
2.) Decrease expenses

Balancing a budget can be tricky, largely because it is tempting to make false assumptions. For example, it is easy to assume that if ticket prices are raised, the theatre will continue to draw fifty percent of its capacity. This may not be the result. Or perhaps the decision is made to produce three rather than four productions over the twenty-week season, thereby lowering production costs. But this makes the dangerous assumption that more ticket buyers can be found to support the additional performances of the remaining three productions and thereby maintain revenue at the level estimated from four shows.

Most budgeting involves a certain amount of robbing from Peter to pay Paul. Money is borrowed from one item to pay for another. But realism must be brought to bear. For instance, if it is decided to hire only two box office treasurers rather than three, can the box office still service customers without a loss in ticket sales? If the set designer is

told not to construct a revolving stage unit, will additional stagehands have to be hired to move scenery manually?

Substantial revisions of estimated expenses or income almost always translate into substantial revisions of policies and priorities. Managers and boards must be mindful of this fact when looking at the budget-balancing alternatives. How much financial compromise is possible before the artistic mission and integrity of the project are threatened?

Increasing the Earned Income

The first budget-balancing alternative to consider is increasing ticket prices. A simple raise of ticket income by only ten percent would bring in another $295,000, which would wipe out the deficit. This is a slippery slope, however, because at this point in the process these are only numbers on a page. What is the real impact of a ten percent ticket price increase? Will the ticket-buying community go along with it? Will there be a drop off in sales? Or what if the board is simply adamant about holding prices at the current level? Some alternatives would be to:

1.) Increase prices or sales in relation to other sources of earned income—i.e., charge $2.00 for a soda or add a T-shirt concession.

2.) Increase the number of performances for the planned production(s). This would also increase expenses, but the marginal revenue could be worth it. Additionally performances might be given at the home theatre, at another theatre, or on tour.

3.) Increase the number of productions and performances. This would usually entail the most extra costs, unless the productions were revivals that could use costumes and scenery from storage and, perhaps, actors already rehearsed in their roles.

Some alternatives obviously carry a higher degree of risk than others. Experimenting with alternatives can provide valuable lessons for future planning.

Increasing the Contributed Income

While the fundraising director may already feel overburdened, necessity may inspire increased productivity from this person's efforts. Present donors, from board members to subscribers, could be asked to donate more. Funding agencies could also be asked for additional money, although many of them are locked into annual budgets themselves, which they cannot exceed. New funding sources could always be approached. However, at this point, it may be too late to start looking for new sources of donated funds. While new sources are always an option, the company would have to be certain that the potential sources are real and not fantasy.

Factors such as urgency and merit are important in seeking additional or new funding. But as with the business of increasing sales, the business of increasing contributed income will also entail added expenses.

Decreasing Expenses

Nobody likes to have to economize, much less produce in impoverished circumstances. Unfortunately, most arts organizations, and the dedicated people who work for them, frequently must function under such circumstances. Many companies never rise above them. Doing more with less is a well-known exercise for theatres.

If we look at the production budgets and the programming plans for our hypothetical theatre company, it's clear that many cost-saving measures could be adopted. What remains the big point of conjecture is how such measures will affect production activities and results. Artistic considerations aside, let's make a few cuts, and see how they affect the bottom line.

Merely by not using stars in the first production and thereby reducing actors' salaries to $7,500 per playing week—saving $9,300 in weekly salaries plus payroll taxes—and by substituting two plays that don't carry royalty payments for two that do, the season's costs are reduced by $69,300. Any number of changes and combinations of cost reductions can be fed into the computer and the results seen instantly. Each new set of results will stimulate new discussions between the artistic and managerial leadership, or at least this is how it should be. Each new budget cut will threaten somebody's territory, each will affect the quality and standards of the operation in some way, each will alter the navigational direction of the operation—even if this is perceptible only to the keenest observer.

One option might be to look at the entire season and question each play or production choice. Might some be substituted with less expensive works, without compromising artistic integrity? Perhaps selecting pieces with smaller casts or less scenery might help.

Another idea might be to co-produce with another company and thereby reduce the expense of the productions.

The Free Admission Policy

Ironically enough, the policy of eliminating box office revenue is sometimes the best way to balance the budget. Of course this policy could only be adopted by a nonprofit organization because it is based on the theory that if audience size can be substantially increased by giving all tickets away, contributed income will be increased proportionately. From a per capita standpoint, free tickets may actually reduce losses—a good argument to use in grants applications. For example, if the weekly operating costs for a production are $10,000 a week, and 1,000 people per week are paying two dollars and fifty cents each to see that production, then each person is being subsidized seven dollars and fifty cents. But if no admission is charged and, as a result of this policy, the production plays to 5,000 people weekly, each person is then being subsidized by only two dollars. This

is a logical rationale, providing that the goal is not to make money. Also, the larger the audience served by a theatre group—regardless of ticket policy—the more favorably that group is likely to be regarded by potential funders. If some libraries, parks, and museums are free to the public, why shouldn't free theatre also be made available? Experiments with this policy, such as The New York Shakespeare Festival's Shakespeare in the Park productions each summer in New York, show that free theatre attracts hundreds of thousands of first-time theatregoers. This is a phenomenon that makes politicians, as well as government and corporate funders, sit up and take notice.

However, this is an extreme example, requiring substantial financial commitments from funding sources. The danger in an ongoing operating policy of this nature is that when the economy takes a downturn, government grants, sponsorships, and major gifts tend to either dry up or shrink substantially, putting the company at risk.

Two Special Equations

Setting the Stop Clause in a Commercial Theatre License

Most tenants who rent spaces typically negotiate leases that allow occupancy for a specific length of time at a specific rental. A Broadway theatre license, however, frequently calls for a percentage of the box office gross against a minimum guaranteed usage—rental or license—fee. Rarely is there a specified date when the production must vacate the theatre, unless the attraction is booked for a specific limited engagement. The date when the production will actually vacate the theatre is usually determined by the so-called stop clause—or a mutually agreed closing date, typically because of poor sales.

The stop clause is a provision in the theatre license stipulating that when weekly box office revenue falls below a certain negotiated figure—usually for two consecutive weeks—either the landlord or the producer may serve notice on the other in order to terminate the lease. Termination notice must be given within a preagreed number of days after the gross has dropped below that predetermined figure.

What box office figure should be used in the stop clause? If the weekly break-even point is projected at $273,973, perhaps that figure should be used because the producer doesn't wish to lose money. On the other hand, what if bad weather or illness of the star or some other occurrence results in business that is only temporarily bad? The producer obviously doesn't wish to give the theatre owner the right to close the production. In most cases, the Broadway producer selects a figure slightly below the break-even point. The reasoning is that if business is going to be permanently bad, it will probably get worse quickly. If receipts fall to $200,000 one week, for example, they will probably fall much lower the following week. But the producer who must sustain a continuing weekly loss that is above the stop clause figure is in serious trouble. After the capitalization has been exhausted and previous profits spent, further losses probably have to come out of the producer's own pocket. Hence, it is important to set the right stop clause amount. (See Chapter 4, Commercial Theatre.)

Computing the Break-Even Point When There Are Variable Costs

When all operating costs are fixed, it is a simple matter to estimate the revenue dollar amount at which there will be neither profit nor loss, the so-called break-even point. But what if there are also variable costs in the form of percentages, the dollar costs of which can only be determined by the exact revenue earned? In this case, the point at which the fixed and variable costs equal the gross income is the break-even point. Furthermore, if revenue exceeds the break-even point, expenses will increase because of the percentage payments. If revenue is less than the break-even point, then the actual operating cost will be lower than the break-even point. How then can a break-even point be determined without first knowing the actual revenue? To illustrate the equation that provides the answer, isolate the items in a Broadway production weekly operating budget that involve both fixed and variable costs.

The formula below provides a way to compute the actual operating cost, the break-even point. It divides the fixed cost by what may be called the marginal income ratio—the margin of profit that can be gained after variable costs are paid. In this example, the producer has given away twenty-three percent of every dollar that will be taken in at the box office, leaving seventy-seven percent of marginal income.

The fixed cost—$249,500—divided by the marginal income ratio—seventy-seven percent equals the break-even point, or $249,500 divided by 77% = 324,026.

For the sake of clarity, the following figures have been lowered and rounded off:

	Fixed	Variable
Theatre Rent	$12,500	6%
Star	$25,000	5%
Authors	$6,000	6%
Director	$2,000	2%
Choreographer	$2,000	2%
Prior Production	$2,000	2%
Other Fixed Costs	$200,000	
Total Fixed Costs	$249,500 plus 23% of NAGBOR	

$$\frac{\text{Fixed Cost}}{\text{Marginal Income Ratio}} \quad \frac{\$249{,}500}{1-23\%}$$

$$\frac{\$249{,}500}{0.77} = \$\,324{,}026$$

This budget shows fixed weekly operating costs at $249,500. But the producing company would have to take in well over that amount in weekly revenue in order to show a profit because of the twenty-three percent variable cost.

Gross Income	$324,026
Less:	
Variable Cost (23%)	$74,526 (23% of $324,026)
Fixed Costs	$249,500
Total Costs	$324,026
Profit or Loss	$0

If the total potential weekly gross at the theatre where this show is playing is $500,000, then at capacity business it can earn a $135,500 weekly profit, as follows:

Gross Income:	$500,000
Less:	
Variable Cost	$115,000 (23% of $500,000)
Fixed Costs	$249,500
Total Costs	$364,500
Profit	$135,500 ($500,000 minus $364,500)

But the profit exists only after the capitalization, or preproduction expenses, have been paid off.

If this preproduction amount is $6,000,000, then the show must play at capacity for over forty-four weeks before any true profit can be realized:

$6,000,000/$135,500 = 45 weeks

Under this scheme the producer and backers must wait until the capitalization is repaid before they earn a profit even though the theatre landlord, the star, and others earn their percentages from the first ticket sold. Under the Dramatists Guild Approved Production Contract, percentage payments to the creative team are lower before the capital costs are recouped so that the investors can be paid back sooner and begin to share in profits earlier. Notice that actual operating costs of a production vary according to the actual box office income.

If the total weekly potential gross is $500,000 but the actual weekly gross is seventy-five percent of $500,000, or $375,000, then the actual cost for that week will be:

Gross Income	$375,000
Less:	
Variable Costs	$ 86,250 (23% of $375,000)
Fixed Costs	$249,500
Total Costs	$335,750
Profit	$ 39,250 ($375,000 less $335,750)

If the show opens at and maintains this $375,000 weekly gross, it will take over 152 weeks to pay off a $6,000,000 capitalization.

To reflect these figures in terms of profit dividends—assuming that the producer is sharing profits equally with the limited partners at a $375,000 weekly gross—the producer can earn no more than $19,625 per week after 153 weeks or just under three years of waiting, plus all the time spent before the show went into rehearsal. And the person who bought a ten percent investment in that show—$600,000 of the total $6,000,000 capitalization—will earn $1,963 per week, ten percent of $19,625. (See Chapter 4.)

Stepped Percentage Costs

The above example uses a simple twenty-three percent variable cost. However, there is a scenario in which the percentages change with the amount of money taken in.

Rent:	Five percent over $12,000, ten percent over $15,000
Royalties:	Seven percent plus ten percent over $24,000

In this case the rent is free until the gross hits $12,000, then five percent is charged. Once the gross reaches $15,000, the percentage charged jumps to ten percent.

Royalties begin at seven percent and then increase to ten percent at $24,000 of income.

The following example starts with the production budget and includes that of the operating budget:

Sample Production Budget

PHYSICAL PRODUCTION:		
Scenery	$50,000	
Costumes	$20,000	
Props	$2,500	
Electric and sound	$15,000	
Instrument rental	$1,100	
Sub Total		$88,600
FEES:		
Authors	$6,000	
Director	$8,000	
Scenic designer	$5,000	
Costume designer	$5,000	
Lighting designer	$5,000	
Choreographer	$6,500	
Casting	$3,500	
General manager	$15,000	

Orchestration	$4,000	
Sub Total		$58,000
SALARIES:		
Equity	$21,400	
Crew/wardrobe	$4,000	
Musical director	$5,000	
Musicians	$6,000	
Press agent	$4,200	
Sub Total		$40,600
REHEARSAL EXPENSES:		
Audition/rehearsal hall	$4,000	
Scripts and scores	$500	
Departmental	$500	
PREOPENING:		
Hauling	$3,000	
Take-in and out	$25,000	
Box office	$1,000	
Opening night party	$10,000	
Sub Total		$ 44,000
ADVERTISING:		
Newspaper and radio	$120,000	
Posters, printing, etc.	$12,000	
Radio spot	$10,000	
Sub Total		$142,000
ADMINISTRATION:		
Office fee	$2,400	
Legal	$15,000	
Accounting	$4,500	
Payroll/fringes	$10,700	
Insurance	$500	
Sub Total		$33,100
TOTAL PRODUCTION COSTS:		$406,300
BONDS/DEPOSITS:		$40,000
CONTINGENCY:		$48,700
CLOSING COSTS:		$5,000
TOTAL CAPITALIZATION:		$500,000

FIXED COSTS

SALARIES:		
Cast	$4,400	
Stage manager and ASM	$1,480	
General manager	$1,500	
Press agent	$1,100	
Stagehands	$1,500	
Wardrobe/makeup	$700	
Musicians	$3,600	
Company manager	$1,100	
Total Salaries		$ 15,380
PHYSICAL PRODUCTION:		
Light/sound rental	$2,000	
Physical production maintenance	$400	
Instrument rental	$1,100	
		$ 3,500
ADVERTISING:		
Print and radio	$15,000	
		$ 15,000
ADMINISTRATION:		
Office	$250	
Legal	$250	
Accounting	$250	
Insurance	$300	
Payroll taxes, etc.	$2,100	
		$3,150
THEATRE OPERATING:		
Rent	$6,000	
House staff	$4,000	
		$10,000
TOTAL FIXED COSTS:		$47,030

Fixed Costs: $ 47,030

VARIABLE COSTS

Rent: 5% over $12,000, 10% over $15,000
Royalties: 7% plus 10% over $24,000

Break-even point = S = Sales at break-even

Fixed Costs + Variable Costs

$47,030 + .05(S-12,000) + .05 (S-15,000) + .07S + .03(S-24,000)

$47,030 -(600 + 750 + 720)/1.0-.2

$47,030 2070/1.0-.2

$44,960/1.0-.2

$44,960/.8

$56,200

Gross income			$56,200		
Expenses					
Fixed:					$47,030
Variable:					
Rent					
Gross income			$56,000		
less		×	$12,000		
	0.05		$44,200	=	$2,210
Gross income			$56,200		
less			$15,000		
	0.05	×	$41,200	=	$2,060
Royalties	0.07	×	$56,200	=	$3,934
less			$24,000		
	0.03	×	$32,200	=	$966
			Total Expenses		$56,200

Note: Total Expenses: $56,200 is equal to Gross Income: $56,200

Both the rent and royalties are calculated in two formula steps:

Rent: Five percent of all income (sales) over $12,000 plus an additional five percent, or ten percent, on all income above $15,000. In this case, the first $12,000 is exempt—the free rent.

Royalties: Seven percent from the first dollar of income, plus an additional three percent, or ten percent, on all income above $24,000.

After computing the break-even point, one should be certain that none of the sales levels at which a percentage begins are higher than that break-even figure. If that is the case, the break-even figure will be inaccurate. For instance, if the above example were changed to add an additional ten percent royalty for all sales over $24,000, this would invalidate the break-even figure. Many contractual percentages or increases are negotiated after the break-even point has been figured so it is important to remember this.

With a $45 average ticket price, at fifty percent capacity, the producer, unenviably, will need to dig into her or his own pocket to meet that week's expenses. All of the box office proceeds, $53,820, are not enough to meet the expenses of $56,200.

Sample Gross Potentials
(For an 8-performance week in a 299-seat house
with a $56,200 weekly break-even point)

Capacity: 299
Weekly Break-even Point: $56,200

Average Ticket Price	% Capacity	Gross Expenses	Total Weekly Expenses	Weekly Profit (Loss)	# of weeks to pay off Capitol of $500.000	Weekly Break-even as % of Gross Potential at different Capacities
$55.00	100	$131,560	$71,272	$60,288	8	43%
	65	$85,514	$62,063	$23,451	21	66%
	50	$65,780	$58,116	$7,664	65	85%
$50.00	100	$119,600	$68,880	$50,720	10	47%
	65	$77,740	$60,508	$17,232	29	72%
	50	$59,800	$56,920	$2,880	74	4%
$45.00	100	$107,640	$66,488	$41,152	12	52%
	65	$69,966	$58,953	$11,013	45	80%
	50	$53,820	$55,724	($1,904)	N/A	104%

Summary

A great deal of time and effort must be invested in financial planning if the final budget is to bear a reasonable resemblance to the final financial report. Happily, spreadsheet programs make the mechanics much easier than in the past. Financial scenarios are merely financial exercises and "what ifs," but the adopted budget will be a document with a great deal of importance.

Variances between estimated and actual figures will directly affect the tenure of employees, which productions will be produced, and ultimately whether or not the organization will succeed or fail. Hence, it is important to think long and hard when making budgets and financial plans.

When projected income doesn't meet the necessary expense threshold, a particularly seductive trap is to raise ticket prices. It's very easy to change a few numbers (ticket prices) in a spreadsheet. It's not so easy to sell a ticket, however, at any price.

Measured against realistic income and expense projections, decisions should be judged as safe, reasonable, or risky. But still there is no accounting for luck: good or bad. All one can do is make the best choices based on the best information available at the time.