

Introduction to Financial Planning / Models For Micro / Small Tourism Businesses Webinar

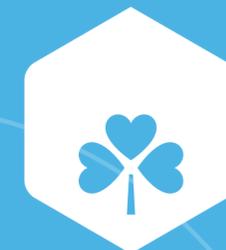
Northern
Ireland
Embrace
a Giant
Spirit



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TED

Tourism
Enterprise Development
Programme



tourism
northernireland

20th & 22nd October 2020

Presentation Context

- Webinar is being delivered as part of Tourism NI's new Tourism Enterprise Development (TED) Programme
- Designed to help micro and small businesses operating within the NI tourism industry survive and recover from the unprecedented events of 2020.
- Will endeavour to offer a comprehensive overview of the key areas that businesses should be considering, while planning and managing the financial needs of their business.
- Provide practical tips and advice on how to navigate uncertain times through smart financial planning.
- Provide an introduction to financial modelling.
- Acknowledged that one to one mentoring may be available to enhance knowledge and understanding of specific elements of financial management.

Covid-19

- The evolving Coronavirus pandemic, means that we are currently living in unprecedented and extraordinary times and as we all know, the current second wave is creating further challenges for the Tourism & Hospitality sectors in terms of uncertainty re Public Health guidelines and government restrictions leading to volatility in economic activity.
- It is acknowledged that the UK Government, the NI Executive and government agencies such as Tourism NI and Invest NI have endeavoured to bring in business supports to help businesses, employers and employees. But the truth is, the Covid-19 pandemic is hurting the tourism sector, and it is very difficult to predict the future market dynamics, because, we are now faced with triple uncertainty: firstly around the Coronavirus itself; secondly, its economic impact; and thirdly, the ways in which the pandemic has, and will affect people's behaviour.
- The reality is that the pandemic will come to an end, but that timescale is currently unknown. Therefore in the short-term, from a business perspective, we must financially plan for living with, and post Covid-19. Things will be different, some behaviours and attitudes will have changed. There will be a greater need for business model agility and to understand key issues concerning the financial management of businesses. There will be a demand to accelerate digitalisation. Health will become a fixation and environmental / green / sustainability issues will come to the fore.

Webinar outputs

Understanding of:

- Business Model
- Legal Status
- Financial Statements
- Commercial Profitability (Pricing, Costing, GP Analysis and Break-even Analysis)
- Funding
- Working Capital
- Practical Tips on Key Performance Indicators, Taxation and Asset Protection
- Financial Modelling

**“OUR PRESENT
CIRCUMSTANCES
DON'T DETERMINE
WHERE WE CAN GO;**

THEY MERELY DETERMINE
**WHERE WE
START”**



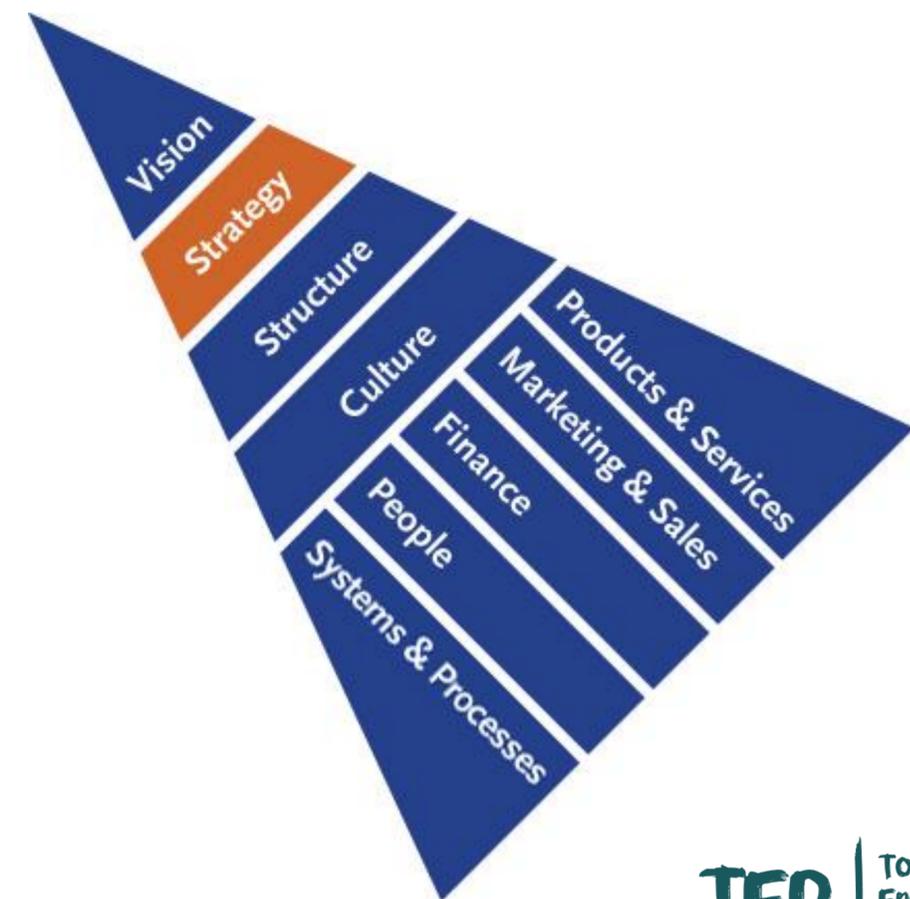
5 Key Strategies to Consider to Survive in the Current Climate

- Embrace lateral thinking, adapt a risk management strategy including Scenario Planning, recognising that failing to plan, is planning to fail
- Emphasis on cash flow management (Receipts and Payments)
- Cost reduction strategies (including labour resources)
- Reflect on current and anticipated market dynamics (including collapse of out of state visitors in the short term and growth in staycations) and take a holistic view of our businesses to reflect on what we did before, what we did during Covid to date (non trading and trading, when permitted), what we could do better and what we didn't do before that we should go for in the future in terms of products / services, sales mix, processes etc.
- Profit Maximisation (Pricing and Costing)

Business Model



- The success of a business is dependent on its business model
- Good business models are based on a Valuable Formula



The most important thing is Purpose
– that is, the WHY?

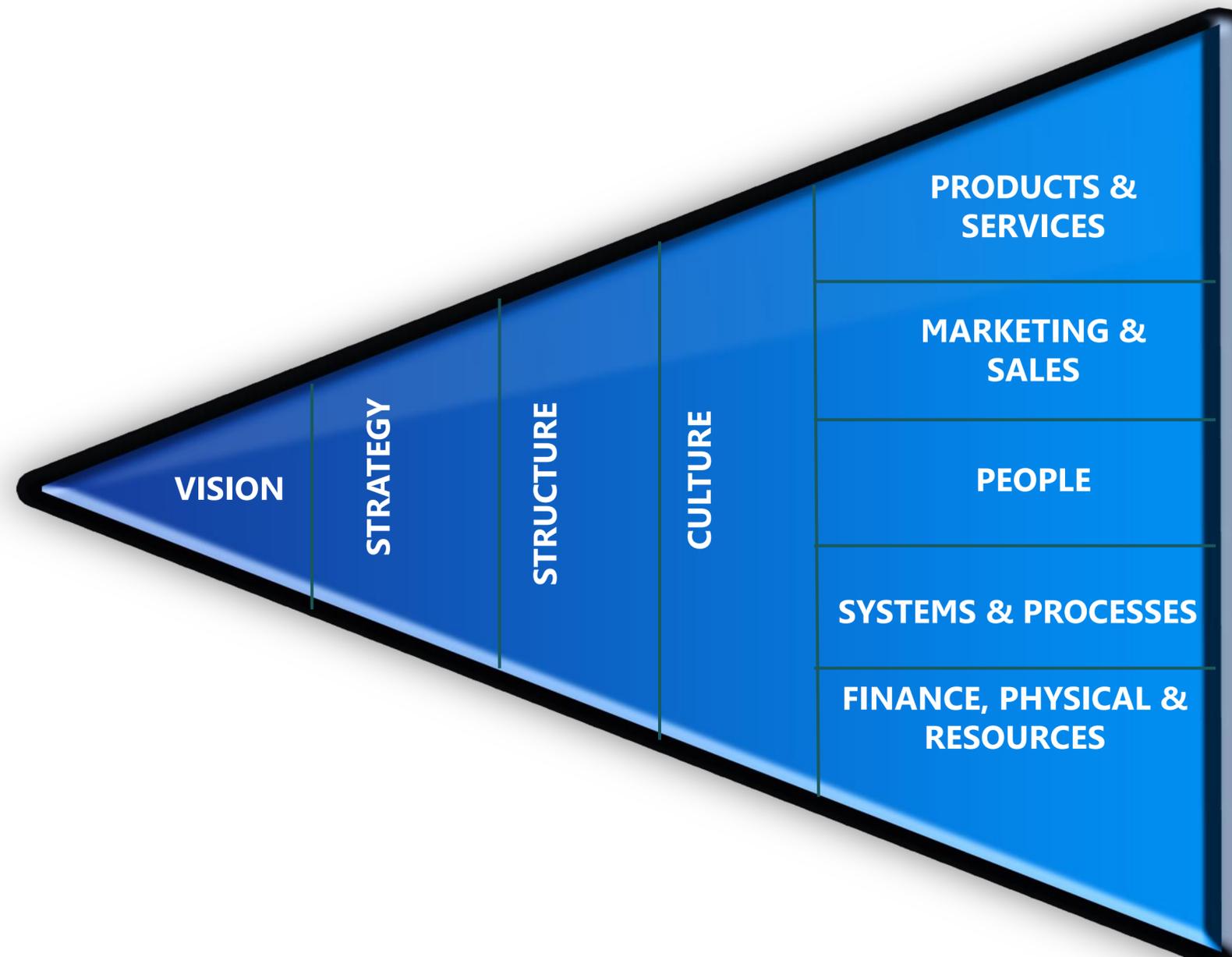
WHY?

- Customers will not purchase our tourism products / services because they understand what we do, and how we do it, but rather they will buy our products / services on the basis of the results they perceive our tourism products / services will bring them. When their **WHY** and our **WHY** are the same, we have a sale.

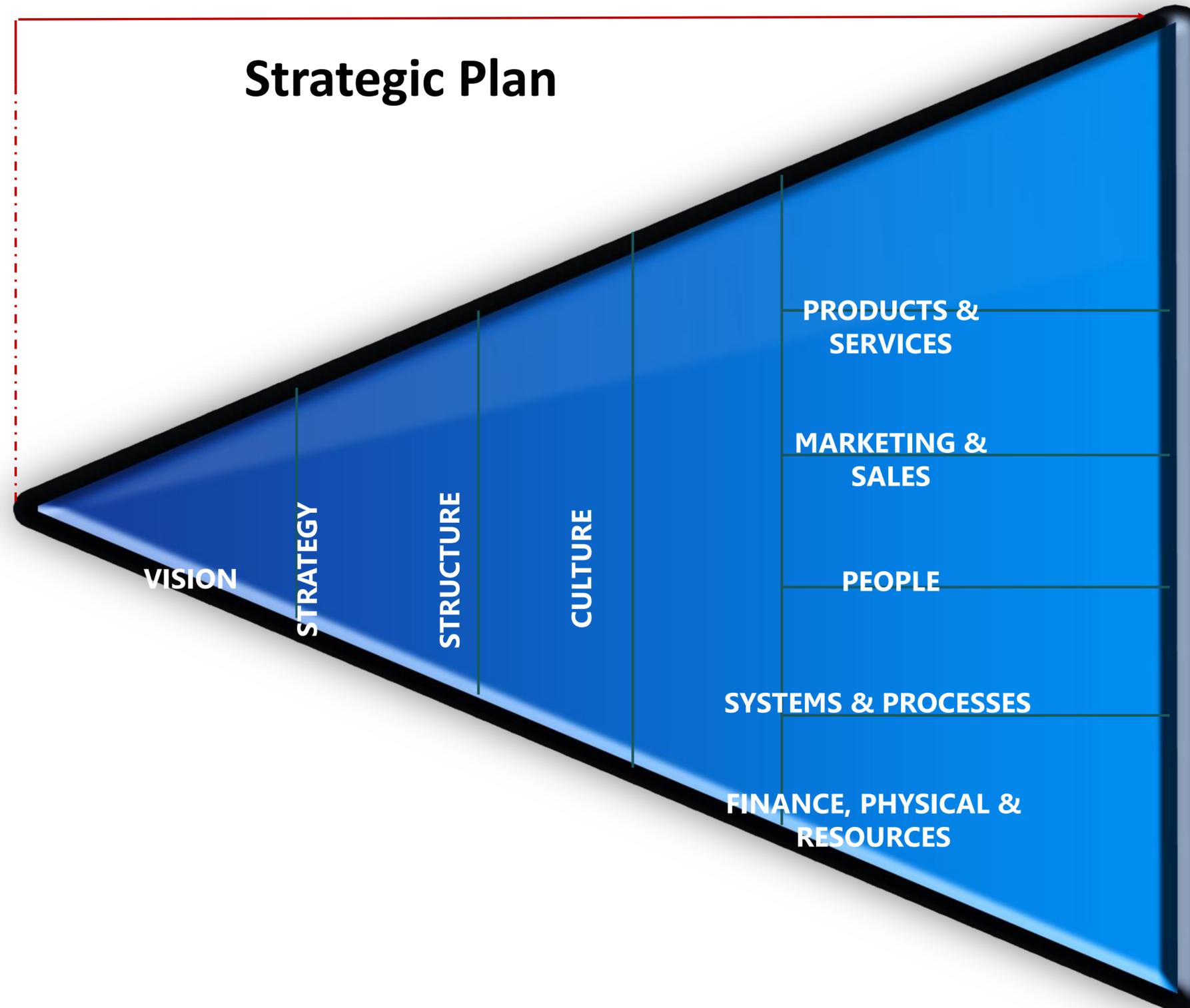


A Business Needs Direction

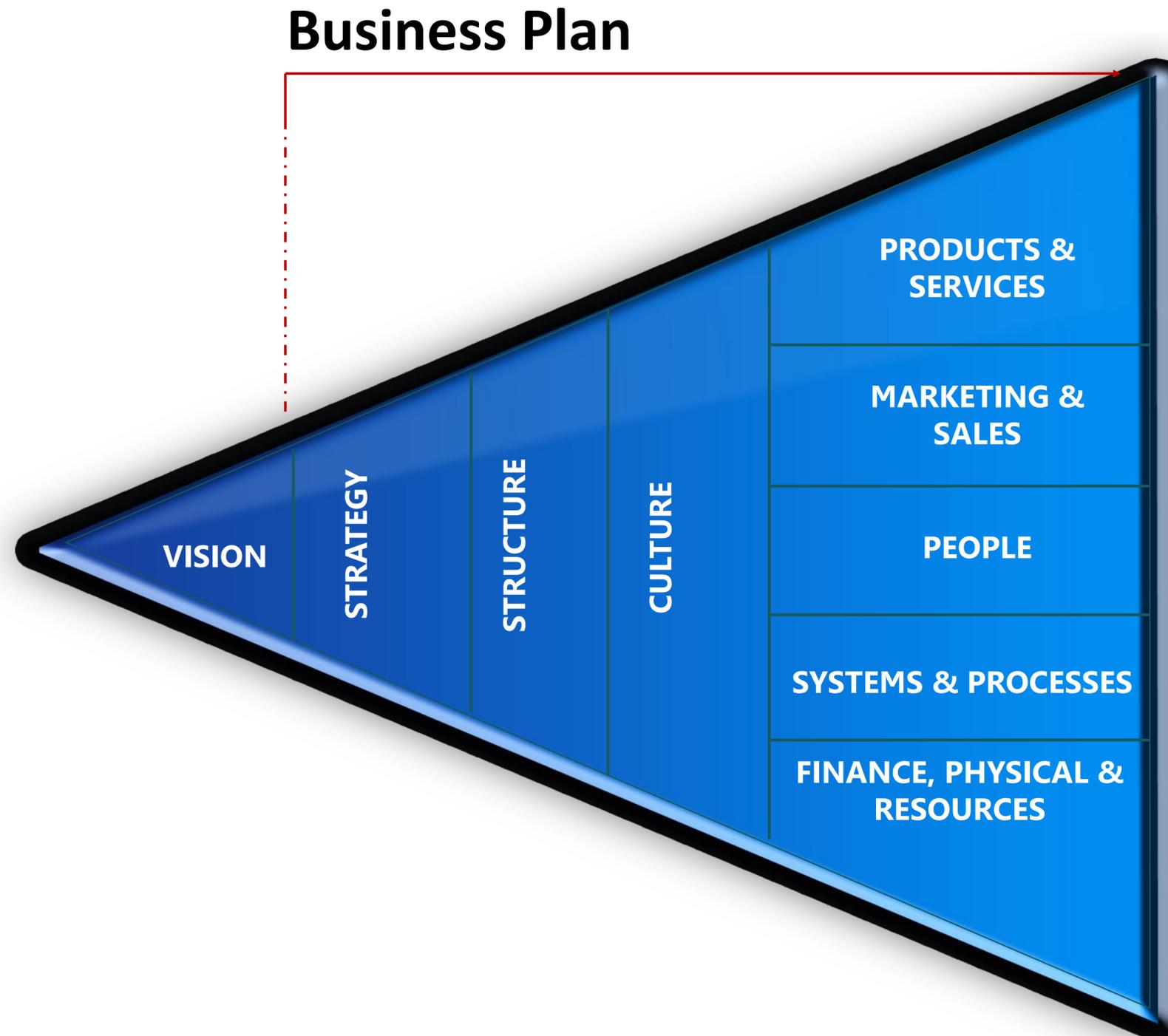
- A business needs direction, structure and processes. To facilitate Business Planning, we have developed a strategic management holistic framework for PKF-FPM, which we call the PKF-FPM Rocket.



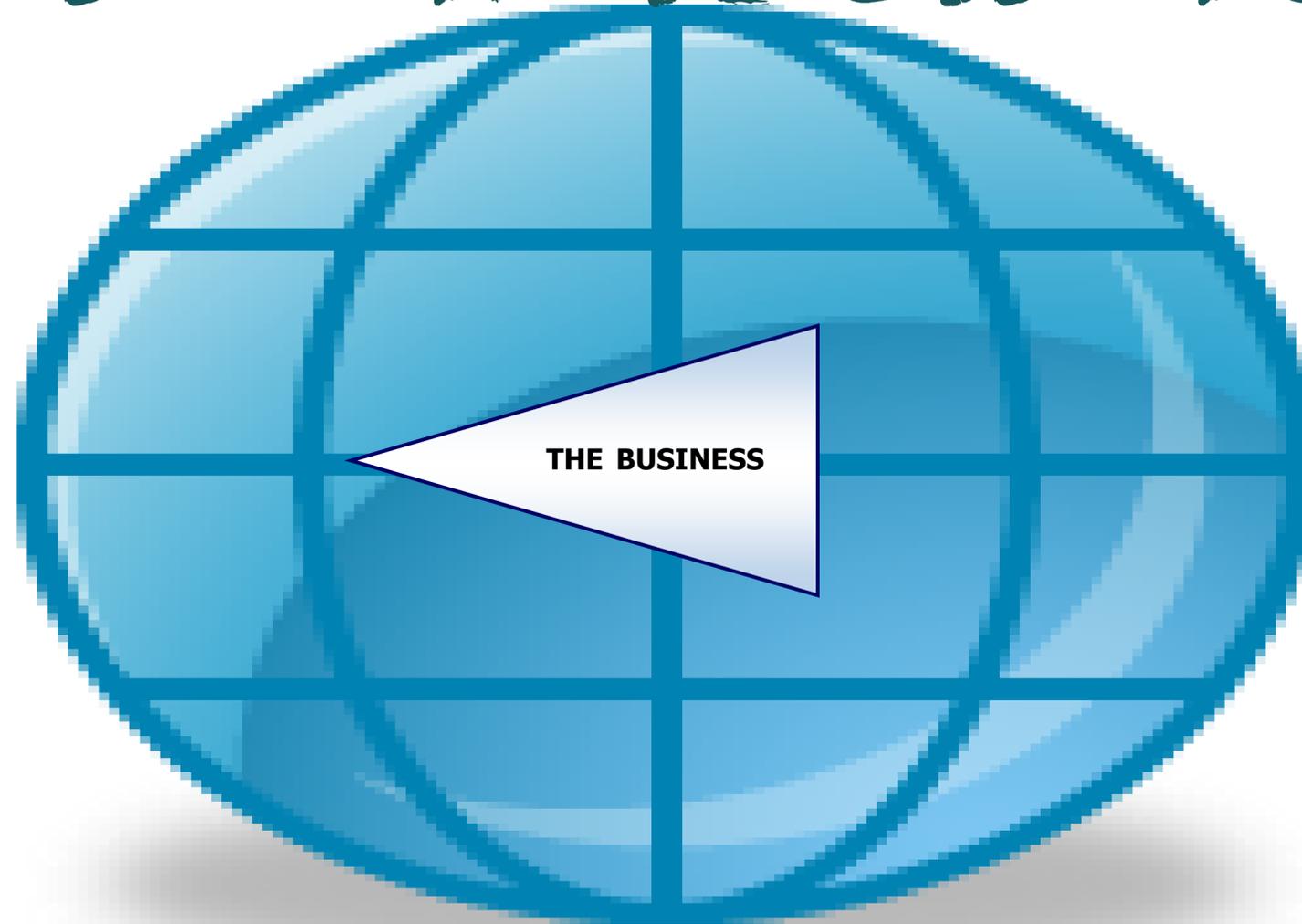
Strategic Plan Determines the Vision



Business Plan Accepts the Vision as it is and Revisits the Best Way to Achieve it



The Business does not operate in Isolation



Every business is subject to pressures and influences from the external environment. These are ignored at your peril.

Effectiveness & Efficiency

- Business thrives when both effectiveness and efficiency are aligned and complement each other.
- By **EFFECTIVENESS**, we mean doing the right things (i.e. strategic working on the business).
- By **EFFICIENCY**, we mean doing things right (i.e. operational and tactics, working in the business).



Legal Status of Businesses Operating in the Tourism Sector

(Legal status of business, has financial implications for business)

- Main forms of legal status:

- Sole trader

- Partnership

- Limited company

} Note owners remuneration / withdrawal
reflected differently

- Others:

- Not for Profit Company (Limited by Guarantee)

- Limited liability partnership

- Social enterprise

- Franchise

Understanding the Basics of Financial Statements

(Key to planning and managing the financial needs of your business)

- Three key Financial Statements:
 - The Profit and Loss Account.
 - The Balance Sheet.
 - The Cashflow Statement.



Profit & Loss Account

ABC Business

Profit & Loss Account

Year Ended 31 March 2019	£	%
Sales Turnover	80,000	
Less cost of Sales	(24,000)	
<i>Gross Profit</i>	<i>56,000</i>	<i>70</i>
Administrative Expenses	(44,000)	
OPERATING PROFIT	12,000	15

Profit & Loss Terms

- **Sales / turnover** – income from the sales of products / services during the period (excluding VAT if business is VAT registered).
- **Cost of sales / direct costs / variable costs** – costs that can be directly attributed to the production of a particular product / service or sale of an item. These variable costs move in line with activity.
- **Gross profit / contribution** – difference between sales income (turnover) and the cost of sales.
- **Administrative expenses / overheads / fixed costs** – covers all operating costs not directly linked to producing a product / service e.g. rent, utilities, insurance and indirect staff costs (not included in cost of sales).
- **Profit** – difference between the income of your business and its expenses.
- **Other Income (grants, rent etc.)** – do not include loans or capital introduced in your P&L.
- Understand the difference between Revenue Expenditure (included in P&L) and Capital Expenditure (included in Balance Sheet).

Why Use a Profit & Loss Account?

- Keep an eye on how business is performing.
- Useful to produce a forecast Profit and Loss for each month/year.
- Use to compare actual figures against what you had planned to achieve.



More Detailed Profit & Loss Account

- Split sales turnover by showing income for each of your product / service lines and show the split of their cost of sales (Little management information benefit from using a single bucket sales account).
- Understanding the variable and fixed nature of costs is vital.
- Separate labour costs between direct and indirect labour costs.
- Divide administrative expenses into a number of categories such as staff, premises, marketing, finance costs, etc.
- Can aid decision making.
- Modern accounting software.



Comparing Profit & Loss Accounts

Sample Profit & Loss Account

	2019 £	2018 £	Change £
Sales turnover	80,000	60,000	20,000
Less cost of sales	(24,000)	(16,000)	8,000
Gross profit	56,000	44,000	12,000
Administrative expenses	(44,000)	(34,000)	10,000
Operating profit	12,000	10,000	2,000
Tax on profit	(3,000)	(2,000)	1,000
NET PROFIT	9,000	8,000	1,000

Discussion: How did they do?

Calculate gross profit & net profit margins

Figures as a Percentage of Turnover

	2019	2018	Change
Gross profit	70%	73%	(3%)
Overheads	55%	57%	(2%)
Operating profit	15%	17%	(2%)
Net profit	11%	13%	(2%)



Questions

- Are selling prices under pressure from competitors?
- Have direct labour costs % increased?
- Are raw material prices increasing faster than selling prices?
- Why have overhead costs (in value terms) increased so fast?



Accrual Accounting

- **Deferred Income** – payment in advance (before product / service is made / provided) e.g. gift vouchers, advance deposits for accommodation or weddings etc.
- **Expense accrual** e.g. Accountants fees are typically charged and invoiced after the year end. Accrued provision for this cost should be included in the business' expenses for this year.
- **Expense prepayment** – some costs, e.g. rent, are invoiced and paid in advance e.g. rent invoice £6,000 is dated 1 March and covers period 1 April to 30 June. The period covered by the invoice is for the next accounting period – prepayment in this accounting period.

Limitations of Profit & Loss Account

- Does not show the solvency of a business.
- Prepared on an accruals basis does not show cash position.
- Some businesses may find it difficult to fully reflect the “matching principle” – i.e. every revenue item must be matched with a corresponding expenditure item and vice-versa.

Understanding a Balance Sheet

- Balance Sheet is a financial snapshot that summarises the value of your business at a specific point in time.
- Limited companies must prepare as part of annual accounts.
- Balance Sheet is good indication of whether your business is solvent (i.e. can meet its financial obligations as they fall due).
- Shows all the assets (anything owned by or owed to it), less its liabilities (all the money owed by the business to its creditors).
- Useful for benchmarking.

Sample Balance Sheet

Balance Sheet	£
Fixed Assets	
Equipment	4,500
Buildings	9,500
	14,000
Current Assets	
Stock and Work in Progress	1,000
Trade debtors	2,000
Cash at bank	500
	3,500
Current liabilities	
Trade creditors	1,700
Other creditors	500
Loans	1,000
	3,200
Net current assets	300
Total assets less current liabilities	14,300
Long-term liabilities	(10,000)
Net Assets	4,300
Capital and reserves	
Owner's capital	3,000
Retained profit	1,300
Net Worth	4,300

Key Balance Sheet Terms

- **Fixed Assets** – assets usually with a life longer than one year. Can be split between tangible (e.g. buildings and equipment) and intangible (intellectual property or goodwill). Cost of tangible fixed assets is depreciated over their expected lifetimes.
- **Current assets** – usually have a life of less than one year, examples:
 - **Stock and work in progress** : usually at cost rather than market value.
 - **Trade debtors**: money owed to your business by your customers. Includes VAT (if your business is registered).
 - **Cash** : money in your bank account and in hand. Figure may be adjusted for outstanding cheques.
- **Current liabilities** - money which your business owes that is due to be paid within one year, examples:
 - **Trade creditors**: money owed to suppliers. Includes VAT.
 - **Other creditors**: money your business owes for taxes (VAT, PAYE, corporation tax), accruals, etc.

Key Balance Sheet Terms (cont...)

- **Net current assets** – shows business' ability to meet current cash needs.
- **Long-term liabilities** – balance of any bank loans or hire purchase payments due later than one year.
- **Capital** – money introduced by you (and your shareholders if a company).
- **Reserves** – retained profits.

Limitations of a Balance Sheet

- Does not show profitability.
- Assets mainly recorded at historical cost. Does not reflect the true market value of your assets (albeit your property assets may be reflected based on recent formal valuations or at most recent balance sheet date).
- Use of estimates (e.g. stock, depreciation, etc.)
- Omission of valuable non-monetary or non-acquired assets.

Cash Flow Forecasting / Budgeting

- Cash is the life blood of any business.
- Cashflow forecasts are a pre-requisite for business success.
- Cash flow forecasting enables you to plan for:
 - How much cash your business will need to keep trading
 - When it will be needed
 - Applying for financing if there is going to be a shortfall
 - Managing excess funds
 - Regulate spending
 - Draw attention to waste/inefficiency



How to Set up the Forecast

- Manual preparation.
- Spreadsheets (e.g. excel).
- Accounting Software.



Cash Flow Forecasting

Sample Cash flow Projection

CASHFLOW FORECAST													
ABC													
31 December 2019	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	TOTAL
INCOME													
Cash sales	0	0	0	0	0	0	0	0	0	0	0	0	-
Credit sales		17,625	23,500	29,375	35,250	41,125	41,066	41,066	41,066	41,066	41,066	41,066	393,273
TOTAL	0	17,625	23,500	29,375	35,250	41,125	41,066	41,066	41,066	41,066	41,066	41,066	393,273
VAT -(payments)/receipts	1,469	(1,156)	(2,031)	(2,906)	(3,780)	(3,772)	(3,783)	(3,783)	(3,783)	(3,783)	(3,783)	(3,785)	(34,877)
OVERHEADS													
Staff salaries & wages	17,390	17,390	17,390	17,390	17,390	17,390	17,390	17,390	17,390	17,390	17,390	17,390	208,680
Staff training	489	489	489	489	490	490	490	490	490	490	490	490	5,875
Marketing & advertising	7,344	7,344	7,344	7,344	7,344	7,344	7,344	7,344	7,344	7,344	7,344	7,344	88,125
Postage & packaging	235	235	235	235	235	235	157	157	156	156	156	156	2,350
Motor running costs	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	17,625
Accountancy	391	391	391	391	391	391	391	391	392	392	392	392	4,700
Bank Charges and fees	83	83	83	83	83	83	83	83	84	84	84	84	1,000
Insurance	83	83	83	83	83	83	83	83	84	84	84	84	1,000
Telephone, fax & internet	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350	28,200
Bank Interest	783	783	783	783	784	784	784	784	784	784	784	784	9,400
Website	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	1,469	17,625
Trade Fairs	489	489	489	489	490	490	490	490	490	490	490	490	5,875
Legal Fees	489	489	489	489	490	490	490	490	490	490	490	490	5,875
Loan Interest	231	231	231	231	231	231	231	231	231	231	231	231	2,778
TOTAL	33,294	33,294	33,294	33,294	33,299	33,299	33,221	33,221	33,223	33,223	33,223	33,223	399,108
<i>Monthly working capital</i>	<i>(33,294)</i>	<i>(15,669)</i>	<i>(9,794)</i>	<i>(3,919)</i>	<i>1,951</i>	<i>7,826</i>	<i>7,845</i>	<i>7,845</i>	<i>7,843</i>	<i>7,843</i>	<i>7,843</i>	<i>7,843</i>	
<i>Cumulative working capital</i>	<i>(33,294)</i>	<i>(48,963)</i>	<i>(58,757)</i>	<i>(62,676)</i>	<i>(60,724)</i>	<i>(52,898)</i>	<i>(45,053)</i>	<i>(37,208)</i>	<i>(29,365)</i>	<i>(21,522)</i>	<i>(13,678)</i>	<i>(5,835)</i>	
CAPITAL INTRODUCED													
Investment	100,000	0	0	0	0	0	0	0	0	0	0	0	100,000
Directors Loan	30,000	0	0	0	0	0	0	0	0	0	0	0	30,000
Grant assistance	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	17,496
TOTAL	131,458	1,458	1,458	147,496									
CAPITAL EXPENDITURE													
Plant, machinery & Equipment	11,750	0	0	0	0	0	0	0	0	0	0	0	11,750
TOTAL	11,750	0	0	11,750									
MONTHLY CASH BALANCE	87,883	(15,367)	(10,367)	(5,367)	(371)	5,513	5,520	5,520	5,518	5,518	5,518	5,516	95,034
OPENING CASH POSITION	0	87,883	72,516	62,149	56,782	56,411	61,924	67,444	72,964	78,482	84,000	89,518	-
CLOSING CASH POSITION	87,883	72,516	62,149	56,782	56,411	61,924	67,444	72,964	78,482	84,000	89,518	95,034	95,034

Key Steps

1. Produce a **sales forecast** for next 12 months.
2. Split **credit** and cash sales; consider credit period.
3. Establish whether any **other cash** will be received (e.g. loans, grants, furlough payments etc.).
4. Identify any cost holidays (e.g. rates) or deferral of payment opportunities (VAT, taxes etc.)
5. Determine goods/**stock** you need to buy to reach your sales forecast. Consider credit terms.
6. Identify other regular months cash **payments** (e.g. salaries, marketing costs, operating costs, vehicle costs, etc.).
7. Identify any **one-off expenditure** (e.g. fixed assets).
8. Set out cashflow forecast **month by month** for full year.
9. Ensure figures correspond to when you expect payments will be made.
10. List your **assumptions** as a reminder of how you reached your figures (e.g. payment terms).

Using Your Forecast in Practice

- Use it to compare with what happens in reality (e.g. month end).
- By comparing your actual cashflow with the forecast figures, you can see whether your assumption remain valid.
- Re-forecast with revised assumptions.

Using Your Forecast in Practice

Cashflow Forecast	Forecast £	Actual £	Variance £	Notes
Receipts				
Cash sales	2,000	1,500	(500)	Started trading a week later than expected.
Credit sales	0	4,000	4,000	Early payment discount offered to customers.
Other income	10,000	10,000	0	Start up capital.
TOTAL RECEIPTS	12,000	15,500	3,500	
Payments				
Purchases	7,000	11,000	(4,000)	Credit terms slow to establish with suppliers.
Wages	3,000	3,000	0	
Office expenses	2,000	3,000	(1,000)	More sundry items needed than expected (e.g. Covid 19 costs).
Finance & tax	0	300	(300)	Overdraft arrangement fee from bank.
Capital expenditure	3,000	2,500	500	Negotiated better deal on equipment.
TOTAL PAYMENTS	15,000	19,800		
Net Cash Balance	(3,000)	(4,300)	(1,300)	
Opening Cash Balance	0	0	0	
CLOSING CASH BALANCE	(3,000)	(4,300)	(1,300)	

Hints & Tips

- Aim to have a contingency reserve of cash to cover unexpected costs or a sudden shortfall of cash
- Be cautious about how quickly your customer will pay you.
- My colleague Ashok, will return to the theme of scenario planning.
- In context of Covid-19, agreeing deferral terms for loans, asset finance agreements, taxes etc.
- Unfortunately, if redundancies are required, need to provide for these.
- Use 'what if' scenarios.



Cash is NOT Profit

- **Profit** is the difference between the total amount your business earns and all of its costs, usually assessed over a year or other trading period
- **Cash** is the amount you have on hand to pay debts
- You can be showing a good profit on the books and still be strapped for cash to cover immediate debt
- Working capital management will impact cashflow
- Risk of over trading – i.e. when the business expands too quickly without having the financial resources to support such a quick expansion. If suitable sources of finance are not obtained, overtrading a problem of rapid growth, can lead to business failure



Freeing up Profits

Business A

	P&L (£)	Paid (£)
Sales	100,000	40,000
CoS	80,000	30,000
Profit	20,000	
Net Assets	20,000	

Business B

	P&L (£)	Paid (£)
Sales	100,000	20,000
CoS	80,000	50,000
Profit	20,000	
Net Assets	20,000	

From a cash flow perspective:

Company A: Trade Debtors £60,000, Trade Creditors £50,000, positive cashflow £10,000 (Bank £10,000)

Company B: Trade Debtors £80,000, Trade Creditors £30,000, negative cashflow of £30,000 (Bank overdraft (£30,000))

Note Net Profit and Net Assets are the same for Company A & Company B

Cashflow Management – Concluding Comments

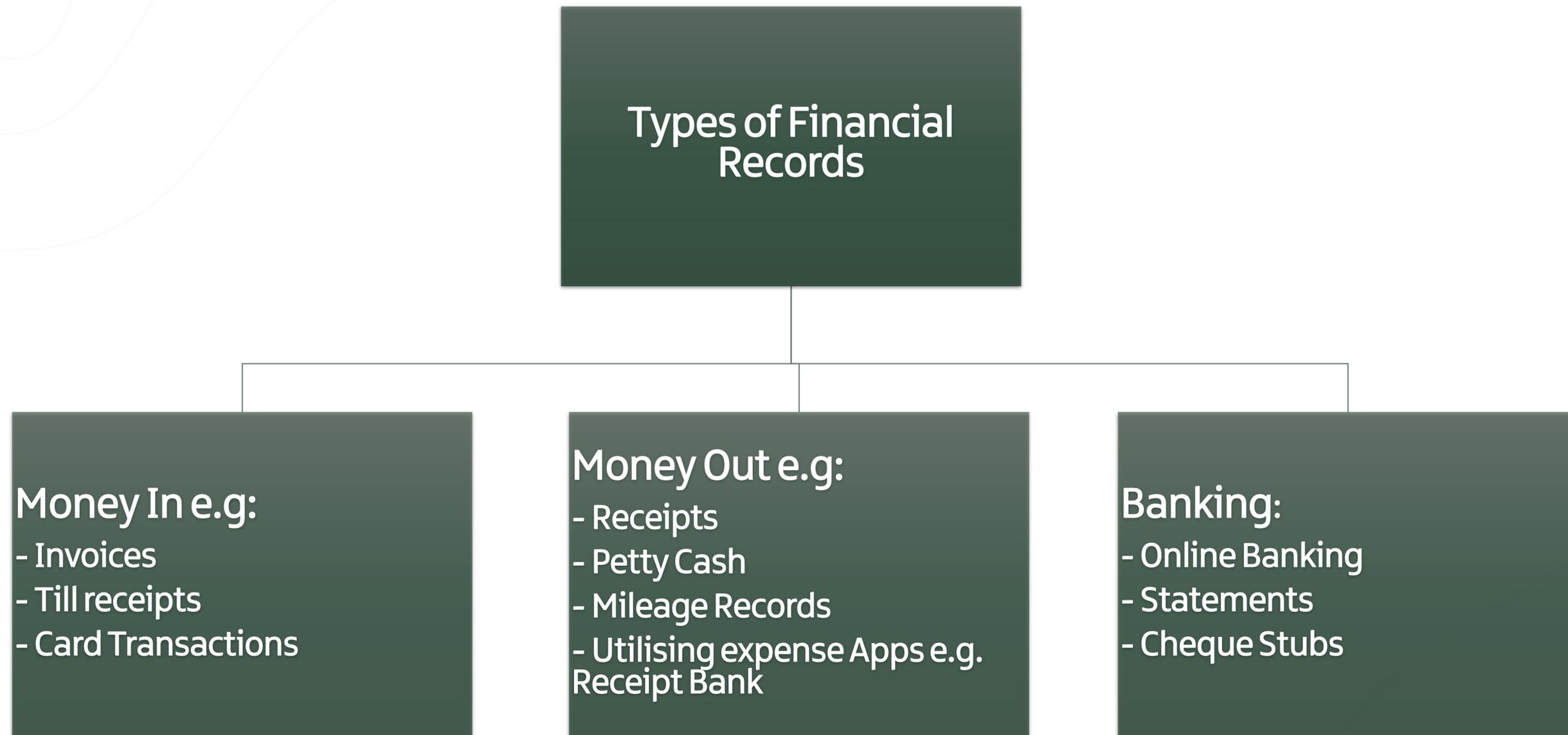
- Golden rule: Turnover is vanity, profit is sanity, **CASH is KING**
- Seek Help early – face up to any problems before they become insurmountable
- Explore possibility of restructuring your debt
- Consider if a discussion with an Insolvency Practitioner is required (CVA or IVA arrangements)



Limitations of Cash Flow Statement

- Fails to present net income or assess profitability and ignores non-cash items, which are considered by the Profit & Loss Account.
- Fails to assess the liquidity and solvency position.
- Not a substitute of Funds Flow Statement.

Types of Financial Records to Keep



Reasons for Keeping Financial Records

- Provision of quality management information to facilitate financial planning and the decision making process.
- Financial monitoring and control.
- Requirements of HMRC
- Tax, VAT and PAYE returns.
- Accountancy.
- Credit control.
- Cost control.
- Refinancing.



Keeping on Top of your Business Accounts

Do's:

- Keep simple records of earnings and expenditure.
- Get into the habit.
- Keep your paperwork safe.
- Give each invoice a unique number.
- Keep petty cash records.
- Monitor turnover.
- Monitor online banking and check your bank statements.
- Invest in accounting software.
- Real time accounting should be a priority.
- Explore paperless office (consider apps like Receipt Bank for expenses).



Keeping on Top of your Business Accounts

Dont's:

- Make paperwork complicated or look suspicious.
- Mistake your limited company's money for 'your' money.
- Get behind with your book-keeping.
- Mix personal and business expenditure.
- Throw anything away.



Commercial Profitability

- Price / Revenue - (Market Driven)
- COST OF SALES - (Controllable/Internal)

Thus establishing the correct price and determining whether it is possible to make the sale at a profit requires an undertaking of cost behaviour and careful analysis of:-

- Sales Price
- Cost of Sales

Pricing Products / Services

- Cost Pricing
- Products & Services

Cost Plus Pricing

- In **practice**, many companies operate a 'cost-plus' pricing system, which provides a useful rule of thumb to setting the base price.
- Essentially five steps:
 1. Calculate labour cost.
 2. Add in direct material cost (Normally relatively easy to calculate).
 3. Establish the total variable cost. (Direct labour, material and variable overheads)
 4. Calculate overhead recovery rate, to facilitate establishing total cost.
 5. Add mark up.
 6. Desirable sales price.

Sales Price Calculation

	£
Materials	X
Direct Labour	X
Direct Costs	X
Variable Costs	X
Indirect Overheads as % of Direct Labour	X
Add Mark Up	X
DESIRABLE SALES PRICE	X

Step 1 – Calculation of Direct Labour Cost

	£
Gross salary	20,000
Employers' NIC 13.8%	2,760
<u>Benefits in Kind</u>	
Pension Contributions (including Auto Enrolment)	1,200
Other	300
Sundry	200
	24,460

Direct Labour Cost - Solution

Total hours paid	1,950 hrs (52 wks x 37.5 hrs)
Actual hours worked	1,650 hrs (44 wks x 37.5 hrs)
Actual cost per workable hours	$\frac{\pounds 24,460}{1,650} = \pounds 14.82$ per hour

Note 1:

Above calculations make no provision for overtime rates

Note 2:

Cost per hour is NOT $\frac{\pounds 20,000}{1,950} = \pounds 10.26$

Note 3:

Utilise time records to establish actual time spend on product / service, if relevant

Step 2 – Calculate Direct Material Cost

- Identify the units of material required for each unit of sales product
- May require you to prepare list of material ingredients
- Allow for wastage
- Normally relatively easy to calculate

Step 4 – Overhead Recovery Rate – Case Study

X Ltd – Trading, Profit & Loss Account

For Year Ended 31 Dec xx	£	£
Sales		500,000
Materials	175,000	
Direct Labour [10 staff @ £15k]	150,000	
Subcontractors (outsourced services)	25,000	
<i>Variable Costs</i>		<i>(350,000)</i>
Gross Profit		150,000 (30%)
Overheads (Appendix 1)		(108,000)
NET PROFIT		42,000 (8.4%)

Overhead Recovery Rate — Case Study

X Ltd – Appendix 1 - Overheads

	£
Indirect labour	70,000
Postage, stationery & advertising	3,700
Insurance	4,000
Light & heat	5,000
Telephone fees	2,200
Repairs & maintenance	1,500
Rent & rates	3,000
Travel & subsistence	4,000
Bank interest & charges	4,600
Sundry expenses	10,000
TOTAL OVERHEADS	108,000

Calculate Overhead Recovery Rate

Overhead Recovery Rate:

- $$\text{OHR} = \frac{\pounds 108,000}{\pounds 150,000}$$

= 72% of Direct Labour Cost

- Thus OHR per labour hour

= 72% x £14.86

= £10.70

Steps 3, 5 & 6 Cost & Price Summary – Product X

	£
Direct labour (assume 1 hr)	14.86
Overhead recovery (assume 1 hr)	10.70
	<i>25.56</i>
Add direct materials for product (assume £9)	9.00
Add direct variable costs (£nil in this example)	0.00
	<i>34.56</i>
Add 20% Mark-up (assumption)	6.91
DESIRED SELLING PRICE	41.47

Cost Behaviour

- Costs are a major contributing factor, to net profit, cashflow and return on investment.
- Specifically, we're going to look at what causes costs to rise or fall and what you can do to influence results.
- Costs are your investment in revenue generating activities – without costs you have no business. Thus while it is important to focus on business growth and revenue generating activities, there should at the same time be a constant review of costs and business processes, with the goal being to get the best possible return on your investment.
- Cost creep (i.e. costs creeping up) is at the bottom of many business failures, so a knowledge of cost behaviour is a good protection.

Understanding and Analysing Costs

- Activities drive costs
- Traditional accounting systems monitor consequences rather than causes
- It's important to know where each particular cost arises in the business process
- Does the activity provided by incurring that cost contribute to the objective of making money?

Working on Costs

- Working Definitions, as previously highlighted
 - **Variable Costs:** *These costs vary directly with sales revenue, in other words when sales rise or fall, they rise and fall.*
 - **Fixed Costs:** *These are those costs that are incurred irrespective of whether or not any sales are made. They are usually associated with the physical capacity of the business to provide its service to customers.*

Important note: fixed costs are only fixed within a certain timeframe.

ALL costs are subject to change over the long term.



*Gross Margin Analysis:
What You Need To Do To
Hit Your Profit Target*

Gross Profit Analysis

All costs and revenues are ultimately driven by two things

- *Products or services provided*
- *Customers*

You should conduct a *Gross Profit Analysis* to determine which of your products/services are the most profitable, and which of your customers are the most profitable to deal with



Product Profitability Analysis

	PRODUCT			TOTAL
	A	B	C	
Price (£)	12	6	15	
Cost (£)	8	3	12	
Annual Sales (£)	144,000	180,000	250,000	574,000

- Typical conclusion: Product C is the best as it has the highest sales revenue
- Question: is that conclusion necessarily the correct one?

Analyzing the Numbers

		PRODUCT			
	Formula	A	B	C	Total
Sales (£)	a	144,000	180,000	250,000	574,000
% of Total		25%	31%	44%	100%
GM%	b	33%	50%	20%	
Gross Profit (GP) (£)	$c = a \times b$	48,000	90,000	50,000	188,000
% of total		25%	48%	27%	100%
Average price per item (£)	d	12	6	15	9.78
#. of items	$e = a / d$	12,000	30,000	16,667	58,667
GP per item sold (£)	$f = c / e$	4.00	3.00	3.00	3.20

Interpreting the Analysis

- Although product B sales represents 31% of total sales, it has an individual Gross Margin % of 50% and thus contributing £90,000 (48%) of total company Gross Profit of £188,000.
- Although Product B has the highest GM% (50%) and contributes the most to GP (£90,000), you need to sell 30,000 units to achieve this. Product A generates a GP per unit of £4 relative to £3 for a unit of Product B and Product C.
- Thus for every £100,000 of sales revenue of Product B, the Gross Profit is £50,000, compared to £100,000 sales revenue of Product A creating Gross Profit of £33,000.
- Thus, if we have limited resources, our emphasis should be to try and grow sales of Product B relative to products A & C.
- However, as highlighted by the individual GP per unit figures, never black and white and these matters need to be considered in the round.

Cost – Volume – Price – Profit Analysis

- Without doing an analysis, you will never know.
- Cost – Value – Price – Profit Analysis - An analysis which allows us to examine the effect on profit of changes in prices, costs and sales volume.

Working on Price

- You can increase profit by **increasing price**
 - *provided that any reduction in volume does not offset the effect of the price increase on the margin*
- *OR*
- You can increase profit by **decreasing price**
 - *provided that the increase in volume is sufficient to offset the reduction in margin caused by the reduction in price*

How Much Additional Volume do I need if I cut my Price?

	Gross Margin				
	%	20	25	30	35
4	25	19	15	13	11
6	43	32	25	21	18
8	67	47	36	30	25
10	100	67	50	40	33
12	150	92	67	52	43

Price Decrease

Assuming 30% GP%

Volume Increase to Give Same GP

Example: 10 items of £100 each with a Gross Profit of 30% results in turnover of £1,000 and Gross Profit of £300. If a price decrease of 10% to £90, then volume would have to increase by 50% to 150 units to create a Gross Profit of £300 i.e. $15 \times £20 = £300$

What Volume can I Afford to Lose if I Increase my Price?

	Gross Margin				
	%	20	25	30	35
4	17	14	12	10	9
6	23	19	17	15	13
8	29	24	21	19	17
10	33	29	25	22	20
12	38	32	29	26	23

Assuming 30% GP%

Price Increase →

Volume Decrease to Give Same GP

Using the same example, if price increased to £108, volume could fall by 21% to 7.9 units to give a Gross Profit of £300 (7.9 x £38)

Working on Volume of Transactions

- You can increase profit by increasing volume of sales
 - Provided that price remains constant so that the increase in volume translates in higher gross profit

Or

- You can increase profit by decreasing volume of sales
 - Provided that the resultant saving in costs outweighs the reduction in gross profit arising from the decrease in volume

Working on Variable costs

- You can increase profit by **decreasing** variable or activity related expenses
 - *provided that there is no change in product or service quality that could have a consequential effect on sales volume*

OR

- You can increase profit by **increasing** variable or activity related expenses
 - *provided that the improvement in product or service quality allows you to win greater market share or premium price*

Working on Fixed costs

- You can increase profit by **reducing** fixed expenses
 - *provided that sales revenue does not decline or if it does, the reduction in revenue is less than the saving in fixed expenses*

OR

- You can increase profit by **increasing** fixed expenses
 - *provided that there is a resulting increase in gross profit from greater market share or higher gross margin*

Cost Reduction Strategies

It is Easier to Reduce
Costs than to Achieve a
Price Increase

Benchmark your costs

- Assess costs against industry benchmarks
- Industry analysis to establish benchmarks
- Find ways to meet or beat benchmarks

Break-even Analysis

- The point at which income matches expenditure. Anything beyond this will return a profit.

COMPANY A	
Fixed Costs	£500,000
Gross Profit %	35%
Break-even Point	£1,428,571

COMPANY B	
Fixed Costs	£500,000
Gross Margin	60%
Break-even Point	£833,333

If you know your Fixed Costs and your Gross Margin, you can then work out the level of sales you must generate to at least cover your fixed costs (overheads) by dividing Fixed Costs by the Gross Margin % e.g. For Company A: $\frac{£500,000}{0.35} = £1,428,571$

Funding

- Cause of funding requirement.
- Sources of Funding.
- Types of Funding.
- Bank Funding.
- Covid 19 Supports & Unsecured Loan Assistance.
- Grant Assistance.
- Accessing Funding.

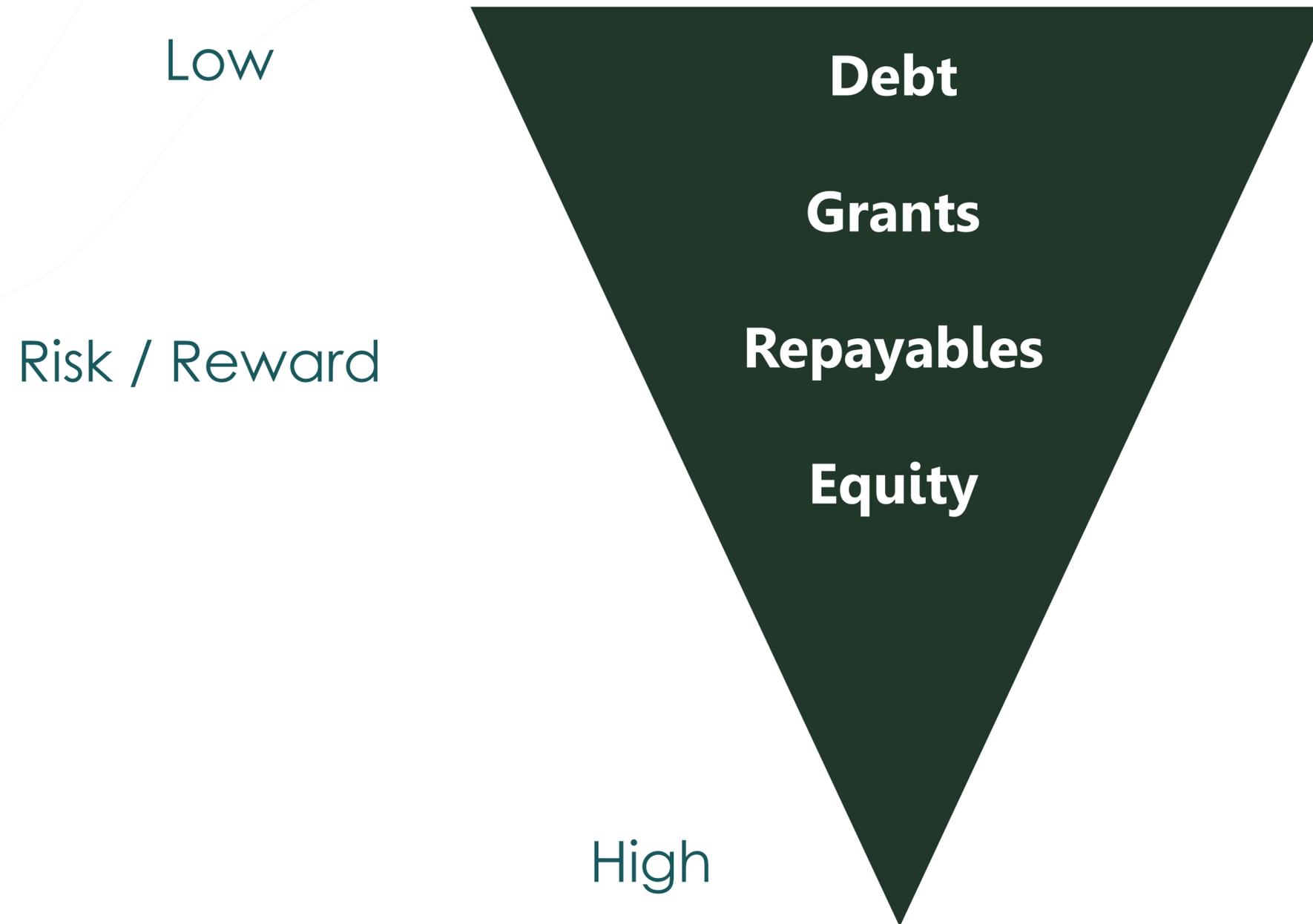
Cause of Funding Requirement

- Identify the cause of the funding requirement:
 - Funding cash losses
 - Working Capital
 - Capital Investment
 - Research & Development
 - International Trade

Sources of Funds

- Cashflow within business can be supported by seeking an extension from creditors or negotiating reductions on outstanding debts
- Refinancing of existing unencumbered Assets or sell assets that you do not need (surplus assets)
- Bank Debt – overdraft, loans, invoice discounting, and Asset Finance e.g. hire purchase / leasing / lease hire
- Promoters Equity (Ordinary Shares, Preference Shares, Quasi Loans)
- Working Capital Finance
- Grants / Financial Incentives
- Loan Funds
- Other alternative funding sources including Venture Capital, Business Angels, Private Investors, Enterprise Investment Scheme (EIS)
- P2P Loans and Crowdfunding

Types of Funding



Bank Funding

- Working capital funding – overdraft, invoice discounting, stocking facility
- Asset backed funding – hire purchase, lease facilities, Chattels Mortgages
- Business growth/expansion – commercial loans
- Specialist funding – small business loans, EIB



Covid-19 Supports & Unsecured Loan Assistance

- NI Executive Localised Restrictions Support Scheme (effective from 19th October 2020)
- New Job Support Scheme (from 1st November 2020 for 6 months)
- Coronavirus Job Retention Scheme (CJRS) – furlough workers (ends 31st October 2020)
- Job Retention Bonus Scheme
- Self Employment Income Support Scheme (SEISS) – extended to April 2021
- Reduction in VAT rates for Hospitality & Tourism Sector (from 20% to 5% for 6 months to 31st January 2021)
- Eat Out to Help Out Scheme (3rd – 31st August 2020)
- Rates Relief
- Deferral of VAT / PAYE / Tax Payments and HMRC Time to Pay arrangements
- Bounce Back Loan Scheme
- Coronavirus Business Interruption Loan Scheme (CBILS)

Grant Assistance (Other than COVID-19 Supports)

- Tourism NI
- Invest NI
- Local District Councils
- Local Enterprise Agencies
- DAERA (Rural Business Development Grant Scheme & the Rural Micro Business Grant Scheme currently closed)
- Arts Council, Big Lottery, Community Foundation, Heritage Lottery Fund & NI Screen
- Cross Border Assistance (InterTradeIreland)

Accessing Funding

Basic Debt Finance Principles

- Borrow for long term needs with long term debt
- Borrow for short term needs with short term debt
- Match term of Loan/Lease/HP Agreement with expected useful economic life of asset
- Difficult economic climate but Banks (albeit with Covid-19 assistance from government) are funding businesses that they consider to be viable post Covid-19 pandemic



Working Capital Management

3 Core elements of Working Capital Cycle which will absorb cash requirements:



Other Practical Tips

- Key Performance Indicators
- Taxation
- Protection of Assets / Wealth Management

Key Performance Indicators

Utilise Ratios to assess Key Performance Indicators in:

- Turnover
- Profitability
- Productivity
- Gearing
- Liquidity
- Working Capital

Taxation

- Effective management of the business taxation affairs can reduce costs and enhance cash flow
- Sole Traders & Partnership pay income tax
- Limited Companies pay Corporation Tax
- Be aware of 4 minimum wage rates re various categories of employees
- Consideration of Dividends v Salaries for emoluments of business owners – significant potential cost and cash flow savings
- Consider tax effective pension contribution
- Explore opportunity to employ family members and exploit Personal Tax Allowances
- Research & Development Tax Credits

Protection of Assets / Wealth Management

- Business Owners may wish to explore how they can protect their assets from a risk perspective and not put all their assets / eggs in one basket (their business)
- Consider legal entity for Business
- Consider keeping key assets out of business e.g. property
- Consider owning business property via SIPP or SASS
- Death & Illness do not respect age, to protect sustainability of business consider Key Man, Income Protection Insurance Policies and Private Health Schemes
- Consider Partnership and Shareholder Agreements

Financiála Modeling

TED

Tourism
Enterprise Development
Programme

Introduction to
**Financial
Modelling**

1 The What?

2 The Why?

3 The How?

4 Scenario Planning

What is a Financial Model?

*A Financial Model combines
accounting, finance and business inputs
to create financial projections for the future*

Why is Financial modelling important?

- Fundamental in helping businesses make decisions
- Helps evaluate investment decisions
- Assess pricing and profitability
- Estimate funding need/borrowing requirement
- Scenario Planning

HOW?

Forecasting P&L

	ACTUAL FY 2019	ACTUAL FY 2020		FORECAST Year 1	FORECAST Year 2	FORECAST Year 3
Sales	400	440		506	582	669
<i>Sales growth</i>	20%	10%	→	15%	15%	15%
Cost of Sales	167	165		202	233	268
<i>Cost of Sales %</i>	42%	38%	→	40%	40%	40%
Gross Profit	233	275		304	349	402
<i>Gross Profit %</i>	58%	63%		60%	60%	60%
Wages & Salaries	50	52	→	55	60	65
Overheads	80	85	→	90	100	110
Net Profit	103	138		159	189	227
Net Profit %	26%	31%		31%	33%	34% <i>Sense check</i>

HOW?

Forecasting Balance Sheet

	ACTUAL 30-Sep-19	ACTUAL 30-Sep-20		FORECAST 30-Sep-21	FORECAST 30-Sep-22	FORECAST 30-Sep-23
Fixed Assets	1,000	950	→	975	1,050	1,050
Trade Debtors	35	36		42	40	37
<i>Debtor days</i>	32	30	→	30	25	20
Trade Creditor	37	45		48	55	62
<i>Creditor days</i>	55	65	→	60	60	60
Loan	600	550	→	500	450	400
Bank	63	197		284	356	544
Net Assets	461	589		752	942	1,168

HOW?

Forecasting Cash Flow

	ACTUAL 30-Sep-19	ACTUAL 30-Sep-20	FORECAST 30-Sep-21	FORECAST 30-Sep-22	FORECAST 30-Sep-23
Net Profit	103	138	159	189	227
Purchase of Fixed assets	0	50	(25)	(75)	0
Change in WC	0	6	(2)	8	11
Repayment of loan	(50)	(50)	(50)	(50)	(50)
Change in WC	0	(10)	5	0	0
Net Cash Flow	53	134	87	73	187
Opening bank balance	10	63	197	284	356
Closing bank balance	63	197	284	356	544

Scenario Planning

Scenario Planning

The first step in scenario planning is to create a customisable financial model

Scenario Planning

Some examples:

- A Belfast restaurant recently re-opened bringing over 20 staff out of furlough following a £1m investment in refit and refurbishment making the restaurant COVID compliant - only to be hit with a 4-week circuit breaker closure.
- A 131 bed 4-star hotel had to temporarily close after two of its staff tested positive for Covid-19, resulting in 100's of employees being sent home for several days.
- A local entertainment company which does live shows had to cancel a fully booked event and faced the daunting prospect of refunding thousands to customers and not being able to recover deposits paid on advance booking of the venue.

Scenario Planning

How can businesses prepare to overcome a specific set of uncertainties, so that the core business survives the short-term impact of COVID?

- What are the specific set of uncertainties that the business needs to prepare for?
- How can businesses prepare?

Scenario Planning

Step 1: List likely uncertainties to business

- A 4 week lockdown
- Local COVID outbreak
- Tapering off of Government supports/schemes
- Supplier issues
- Debtor collection issues

Scenario Planning

Step 2: Quantify financial impact

Scenario	Financial Impact
4-week lockdown / Local COVID outbreak	Loss of sales - £50,000 Direct costs foregone - £15,000 Fixed overheads/salaries - £20,000 Deep cleaning costs/rescheduling/Others - £5,000 Financial loss incurred - £25,000
Tapering off of Government supports/schemes	Full amount of support received each month - £25,000 Loss of support - £25,000
Supplier issues – not able to secure goods on time, withdrawal of supplier credit and price escalation	Cash to be paid upfront - £30,000 Additional working capital funding needed - £30,000
Issues with debtor collection	Debtor balance to be written off - £25,000 Additional working capital funding needed - £25,000

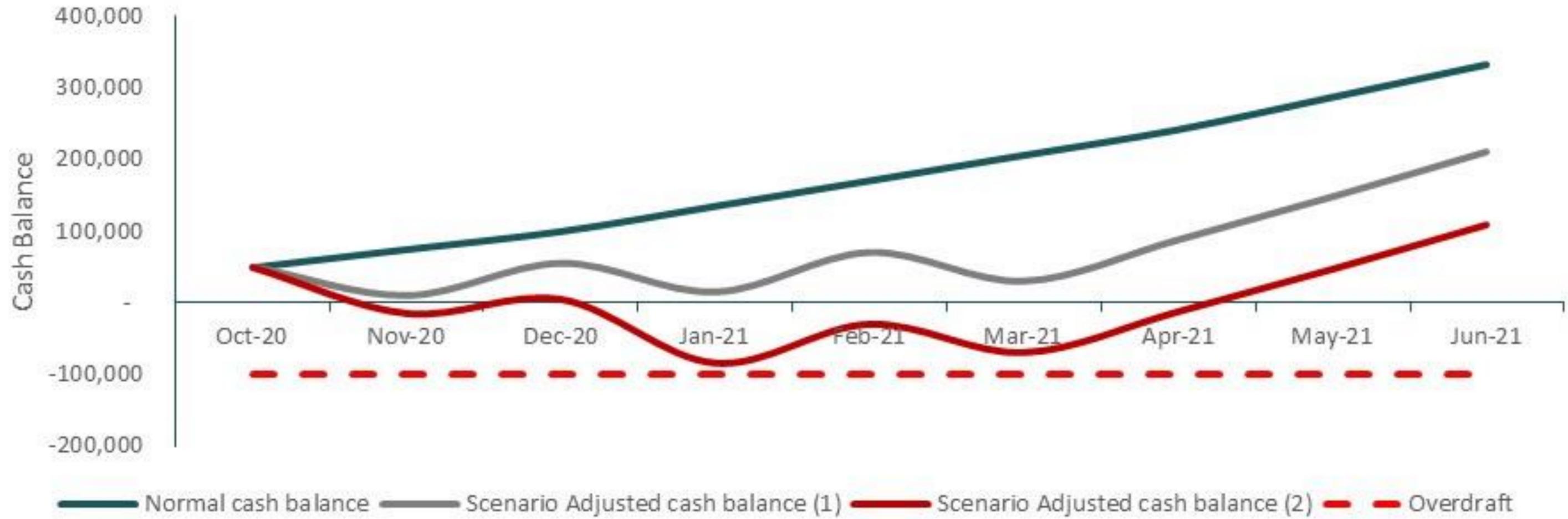
Scenario Planning

Step 3: Assess cash flow impact on adjusted scenarios

	Normal Trading Cash Flow	Scenario Adjusted Cash Flow
Debtor collection– prior period sales	25,000	0
Customer Receipts – current period sales	50,000	0
Payments to suppliers	(35,000)	(25,000)
Support received from Government schemes	25,000	0
Loan repayment	(15,000)	(15,000)
Net Cash Flow	50,000	(40,000)

Triple Dip Financial Model

Scenario Adjusted Financial Model



Source: PKF-FPM Modeller Analysis Tool

Final Tips

- Get the balance right between simplicity and complexity
- You would rather be broadly correct than precisely wrong!
- Use the experience gained from the last 6 months and plan for all likely scenarios
- Financial Modelling is not a one-time exercise – embed to your management culture

Conclusion

- Overview of key matters affecting the financial needs of micro/small businesses operating within the NI Tourism sector.
- Looking forward to participating in a Q&A Session now.
- If today's webinar has raised an issue or question that you would like to discuss in private, you can get in touch via e-mail to industry.development@tourismni.com and Tourism NI will organise for you to get a call from a finance expert tomorrow.
- Thank you.

Questions & Answers

Thank
you

Northern
Ireland
Embrace
a Giant
Spirit



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