

Northern  
Ireland  
Embrace  
a Giant  
Spirit



# Introduction to Financial Planning / Models For Tourism Businesses with more than 25 Staff Webinar

Feargal McCormack & Ashok Thomas  
PKF-FPM Accountants (pkffpm.com)

TED

Tourism  
Enterprise Development  
Programme



tourism  
northernireland

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# Presentation context

- Webinar is being delivered as part of Tourism NI's new Tourism Enterprise Development (TED) Programme. Slides will be an Aide Memoire
- Designed to help businesses with more than 25 staff operating within the NI tourism industry survive and recover from the unprecedented events of 2020.
- Will endeavour to offer a comprehensive overview and refresher 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;**

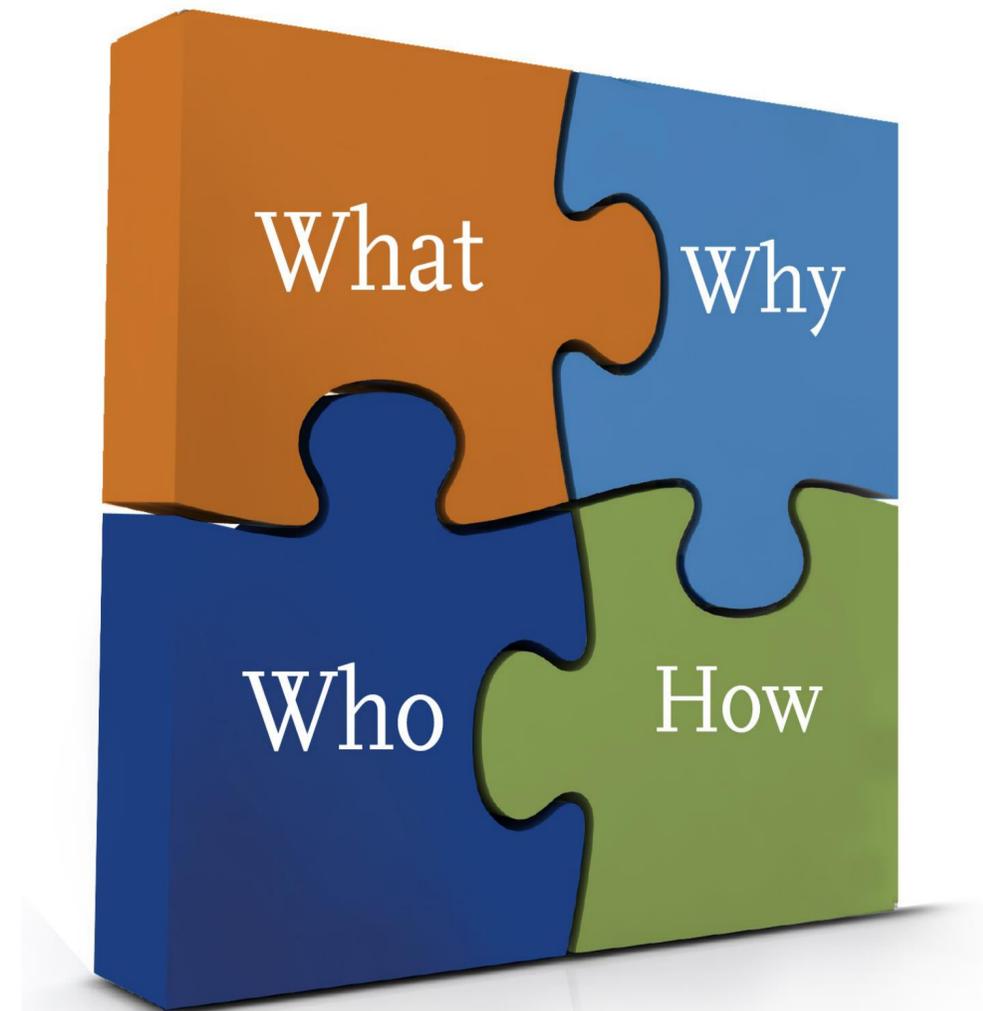
THEY MERELY DETERMINE  
**WHERE WE  
START”**



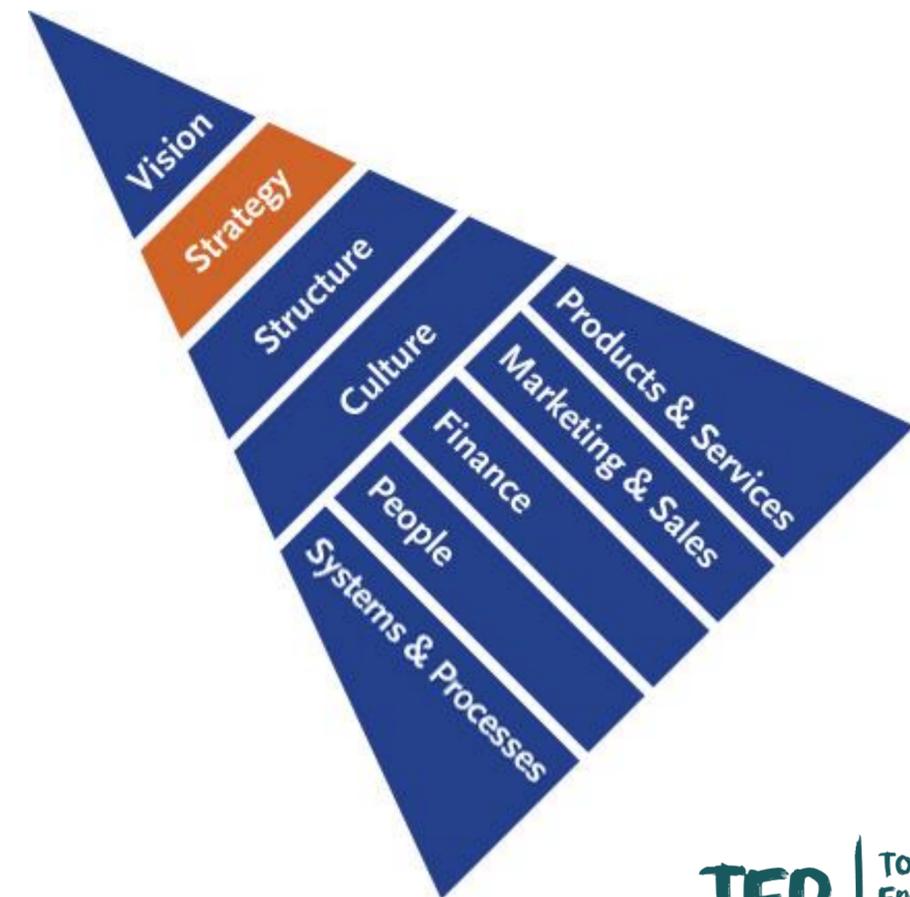
# 5 Key Strategies to Consider to Survive in the Current Climate

- 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?

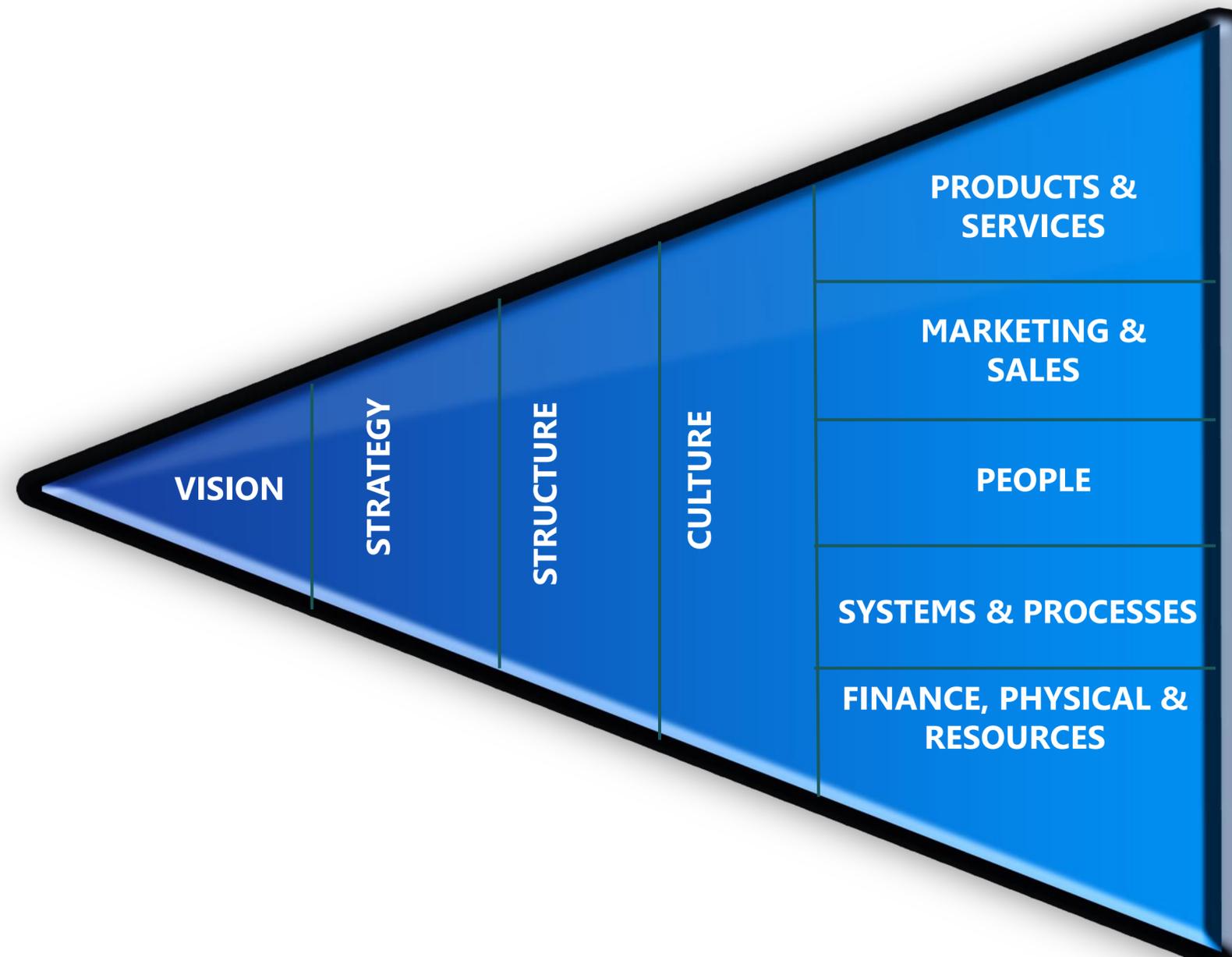
# WHY?

- 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.

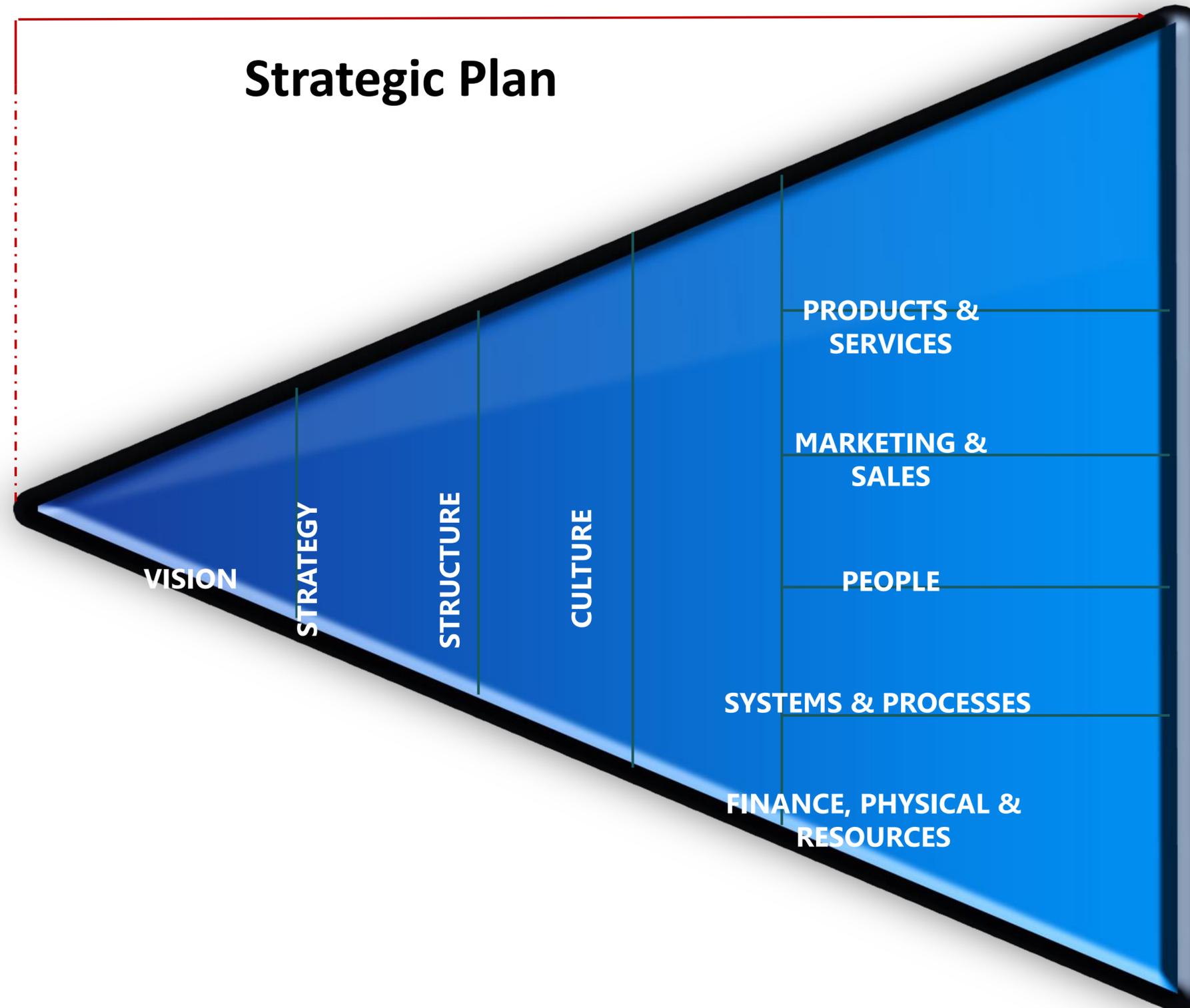


# A Business Needs Direction

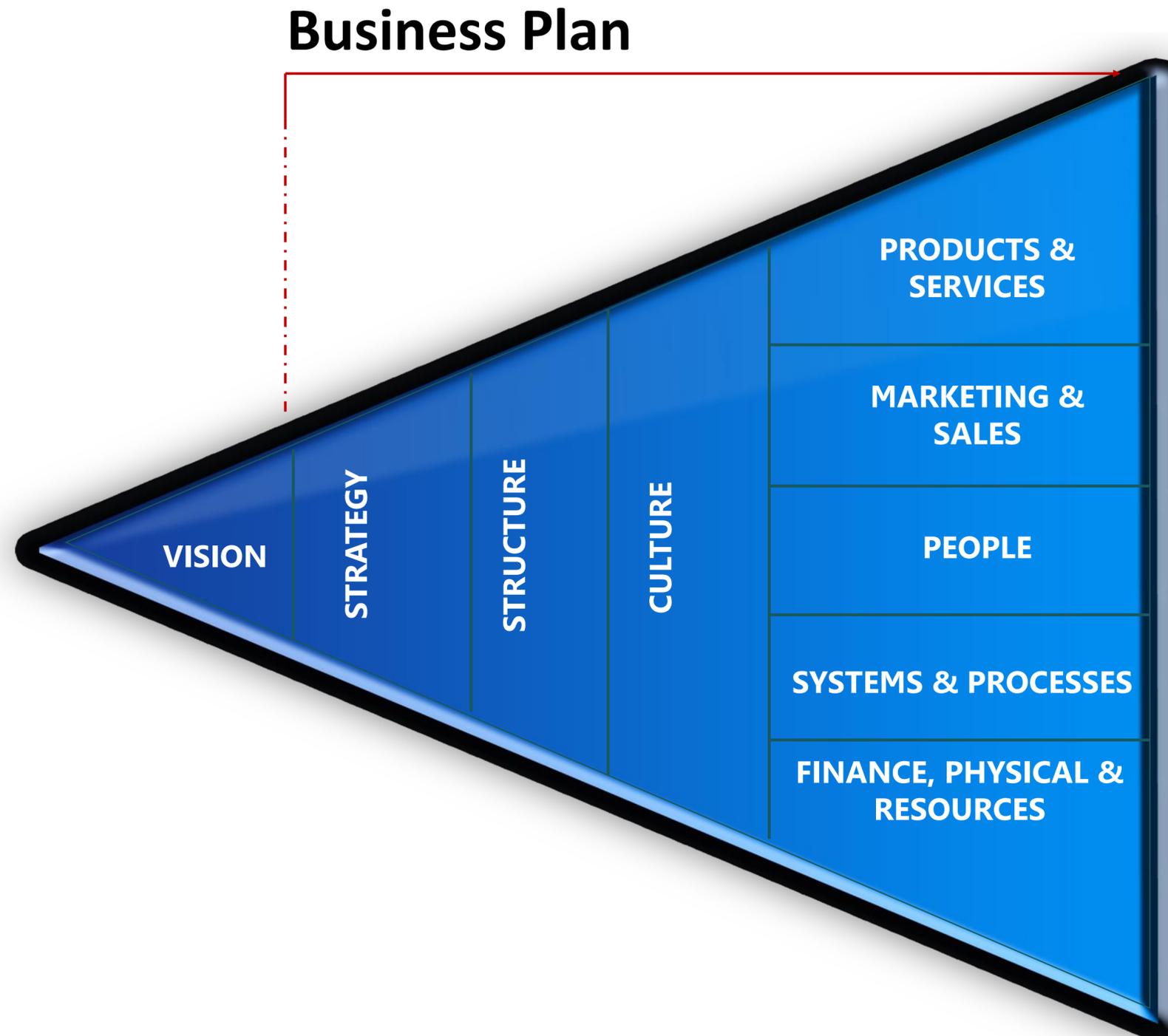
- A business needs direction, structure and processes. To facilitate Business Planning, we have developed a strategic management holistic framework for PKF-FPM, which we call the PKF-FPM Rocket.



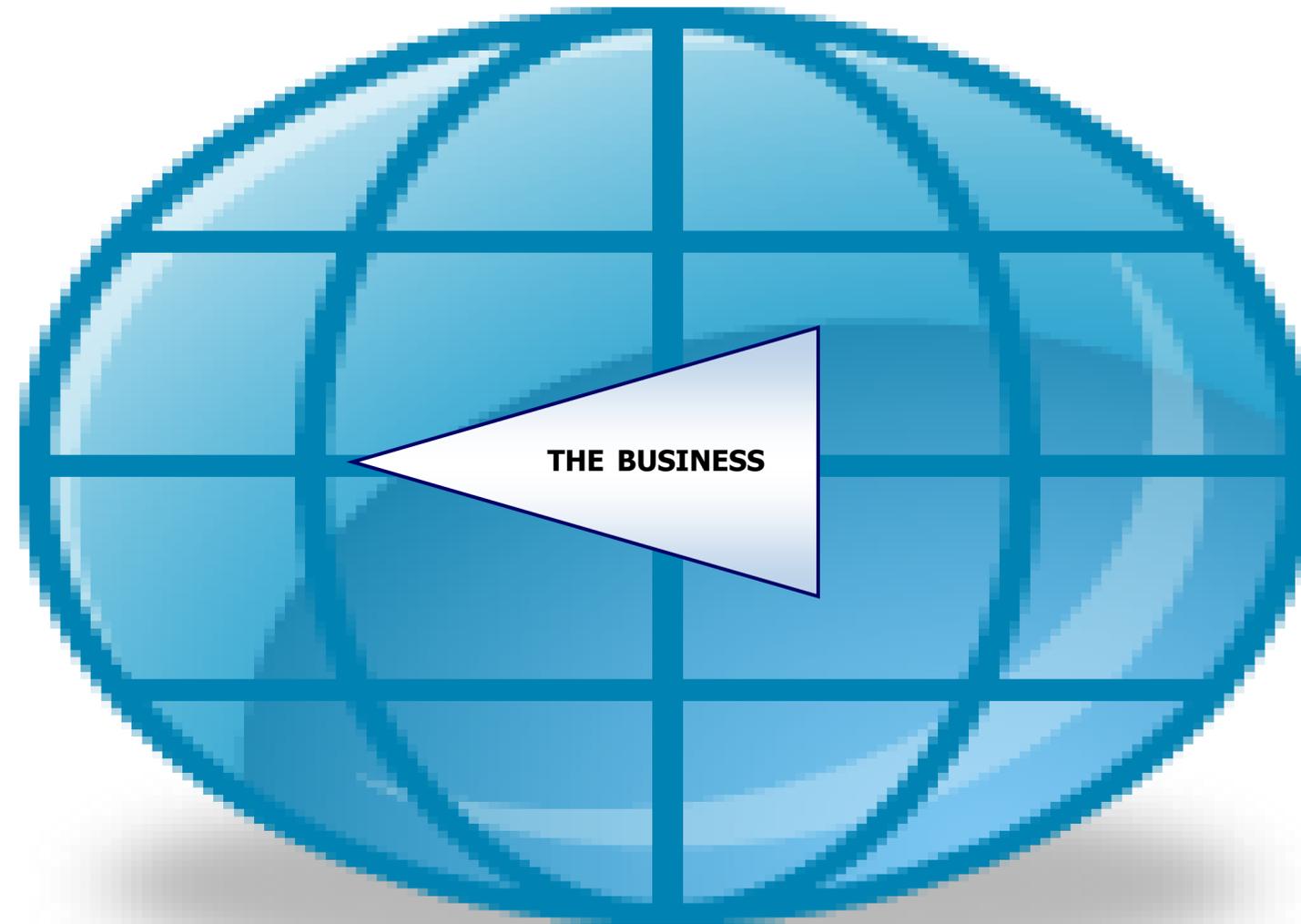
# Strategic Plan Determines the Vision



# 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

# A Refresher on 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.
- An understanding of these can aid and enhance decision making.



# Understanding Profit & Loss and Key Terms

- The Profit & Loss Account / Statement (P&L) summarises the revenues, costs and expenses incurred during a specified period e.g. a year or a month.
- **Sales / turnover** – income from the sales of products / services during the period (excluding VAT if business is VAT registered). Suggested you split sales among key product / service areas, rather than use a single bucket sales account.
- **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).

# 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	70.0	44,000	73.3	12,000
Administrative expenses	(44,000)	55.0	(34,000)	56.7	10,000
Operating profit	12,000		10,000		2,000
		15.0		16.7	
Tax on profit	(3,000)		(2,000)		1,000
NET PROFIT	9,000	11.3	8,000	13.3	1,000

**Discussion: How did they do?**

**Calculate gross profit & net profit margins**

# 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 mainly for the next accounting period – prepayment in this accounting period for 2 of 3 months (£4,000) and only £2000 for the month of March is included in P&L Account for year ending 31 March.

# 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 net value of your business at a specific point in time, meaning the amount that would be returned to shareholders, if all the company's assets were liquidated.
- 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	£
<b>Fixed Assets</b>	
Equipment	4,500
Buildings	9,500
	<b>14,000</b>
<b>Current Assets</b>	
Stock and Work in Progress	1,000
Trade debtors	2,000
Cash at bank	500
	<b>3,500</b>
<b>Current liabilities</b>	
Trade creditors	1,700
Other creditors	500
Loans	1,000
	<b>3,200</b>
<b>Net current assets</b>	<b>300</b>
Total assets less current liabilities	14,300
<b>Long-term liabilities</b>	<b>(10,000)</b>
<b>Net Assets</b>	<b>4,300</b>
<b>Capital and reserves</b>	
Owner's capital	3,000
Retained profit	1,300
<b>Net Worth</b>	<b>4,300</b>

# 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
<b>INCOME</b>													
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
<b>TOTAL</b>	<b>0</b>	<b>17,625</b>	<b>23,500</b>	<b>29,375</b>	<b>35,250</b>	<b>41,125</b>	<b>41,066</b>	<b>41,066</b>	<b>41,066</b>	<b>41,066</b>	<b>41,066</b>	<b>41,066</b>	<b>393,273</b>
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)
<b>OVERHEADS</b>													
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
<b>TOTAL</b>	<b>33,294</b>	<b>33,294</b>	<b>33,294</b>	<b>33,294</b>	<b>33,299</b>	<b>33,299</b>	<b>33,221</b>	<b>33,221</b>	<b>33,223</b>	<b>33,223</b>	<b>33,223</b>	<b>33,223</b>	<b>399,108</b>
<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>	
<b>CAPITAL INTRODUCED</b>													
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
<b>TOTAL</b>	<b>131,458</b>	<b>1,458</b>	<b>1,458</b>	<b>147,496</b>									
<b>CAPITAL EXPENDITURE</b>													
Plant, machinery & Equipment	11,750	0	0	0	0	0	0	0	0	0	0	0	11,750
<b>TOTAL</b>	<b>11,750</b>	<b>0</b>	<b>0</b>	<b>11,750</b>									
<b>MONTHLY CASH BALANCE</b>	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
<b>OPENING CASH POSITION</b>	0	87,883	72,516	62,149	56,782	56,411	61,924	67,444	72,964	78,482	84,000	89,518	-
<b>CLOSING CASH POSITION</b>	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
<b>Receipts</b>				
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.
<b>TOTAL RECEIPTS</b>	<b>12,000</b>	<b>15,500</b>	<b>3,500</b>	
<b>Payments</b>				
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.
<b>TOTAL PAYMENTS</b>	<b>15,000</b>	<b>19,800</b>		
<b>Net Cash Balance</b>	<b>(3,000)</b>	<b>(4,300)</b>	<b>(1,300)</b>	
<b>Opening Cash Balance</b>	<b>0</b>	<b>0</b>	<b>0</b>	
<b>CLOSING CASH BALANCE</b>	<b>(3,000)</b>	<b>(4,300)</b>	<b>(1,300)</b>	

# 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.

# 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 six 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
<b>Variable Costs</b>	<b>X</b>
Indirect Overheads as % of Direct Labour	X
Add Mark Up	X
<b>DESIRABLE SALES PRICE</b>	<b>X</b>

# 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
	<b>24,460</b>

# 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  $\frac{\pounds 20,000}{1,950} = \pounds 10.26$

1,950

## 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)
<b>NET PROFIT</b>		<b>42,000 (8.4%)</b>

# 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
<b>TOTAL OVERHEADS</b>	<b>108,000</b>

# 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  
$$= 72\% \times \pounds 14.86$$
$$= \pounds 10.70$$

# 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
<b>DESIRED SELLING PRICE</b>	<b>41.47</b>

# Cost Behaviour

## (Understanding and Analysing Costs)

- Costs are a major contributing factor, to net profit, cashflow and return on investment.
- Specifically, we need 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.
- Activity drive costs.
- Traditional accounting systems monitor consequences rather than causes of cost changes.

# 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 / SERVICE			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 / SERVICE			
	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	40
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

Assuming 30% GP%

Volume Increase to Give Same GP

Price Decrease

*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 x £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.

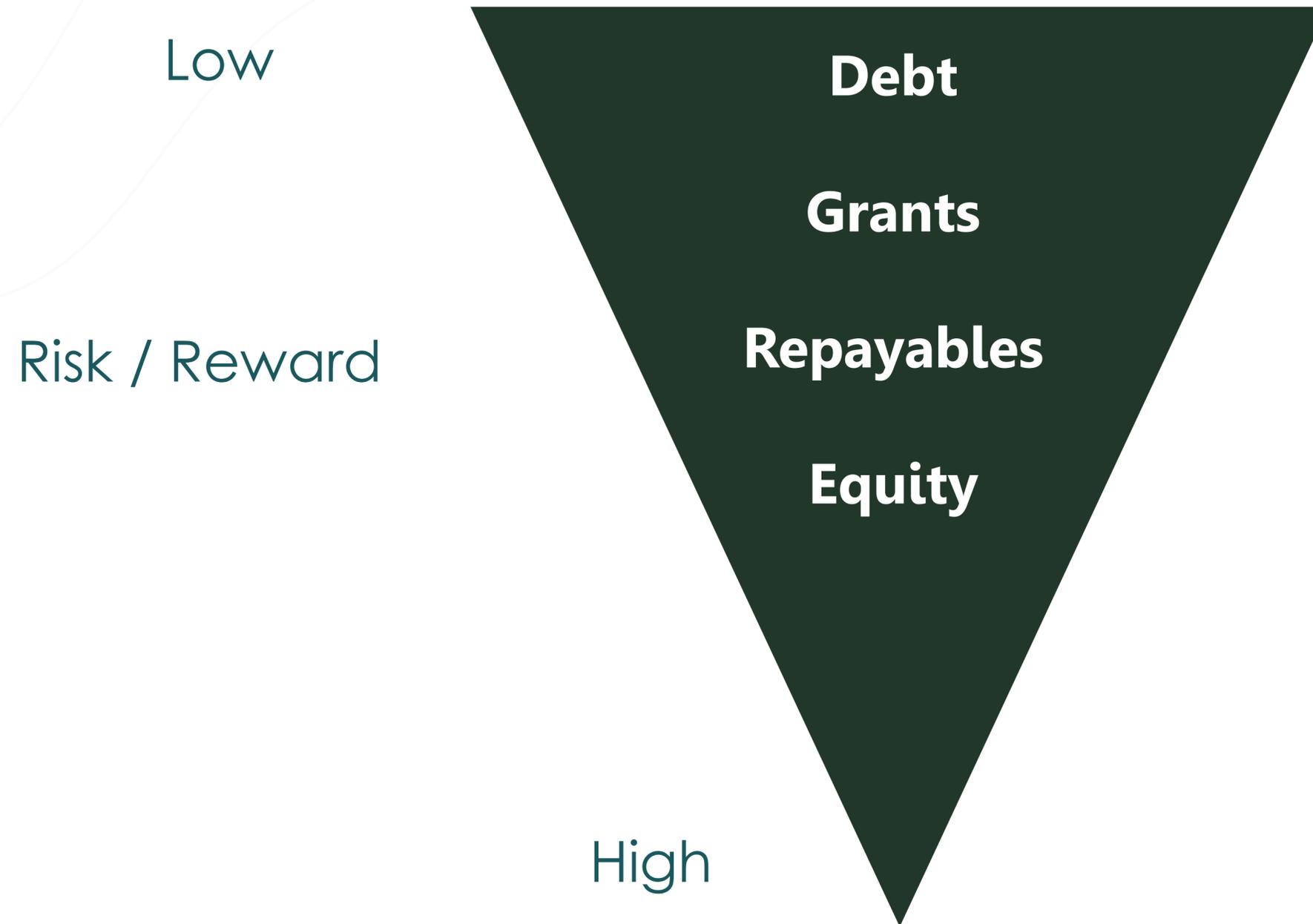
# Cause of Funding Requirement

- 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 19<sup>th</sup> October 2020)
- New Job Support Scheme (from 1<sup>st</sup> November 2020 for 6 months)
- Coronavirus Job Retention Scheme (CJRS) – furlough workers (ends 31<sup>st</sup> 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 31<sup>st</sup> January 2021)
- Eat Out to Help Out Scheme (3<sup>rd</sup> – 31<sup>st</sup> 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
- Senior Management / Board Information Pack and Rocks
- Ethics – “Should I” culture

# 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
- Consider forming a Group

# Tax Management: Consider Forming a Group

6 possible reasons why in some circumstances a Group may be more beneficial than direct ownership:

- 1. Tax Free Dividend:** Dividends paid by trading companies to the parent company are tax free divided, thus trading company can transfer all profits to holding company, with no tax impact.
- 2. Transfer of Cash & Assets:** Both cash and assets for the trading company can be transferred to holding company with no tax implications, if you have a 75% group relationship – thus opportunity to protect trading company assets.
- 3. Creditor Protection:** If trading company has excess earnings each year and transfers this access via dividend to holding company, this protects earnings from creditors of trading company.
- 4. Relief for Losses:** A group of companies allow losses to be surrendered to each other, to facilitate maximum tax planning, if there is a 75% group relationship.

# Tax Management: Consider Forming a Group

- 5. Efficient Reinvestment:** If the surplus earnings from the trading company are paid via tax free dividends to the holding company, the holding company can reinvest some of these earnings into other assets or investments to diversify its holdings. This comprises favourably with the situation, where the individual shareholders would have to extract these monies from the company at a tax cost (up to 38.1% on dividends extracted) if they wanted to make these investments personally.
- 6. Sale of Subsidiaries by a UK Holding Company:** A UK holding company may wish to sell its shares in its subsidiaries and pass the money on to these shareholders by way of a dividend. On the disposal of the shares by the holding company, this typically triggers a capital gain, on which corporation tax would be payable. However the UK holding company may benefit from a relief called substantial shareholding exemption on disposals of its trading subsidiaries, which would have the effect of making the entire gain exempt from capital gains tax (note various conditions must be met)

# 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

# Senior Management / Board Information Pack and Rocks

- Trading Performance / Business Update
- Monthly / Quarterly Accounts & KPIs (to include variance analysis against budget)
- Market conditions / competitor news
- Staffing / training cost issues
- Health & Safety
- Financial Incentives / R&D update
- Current and proposed capital expenditure
- Business Development / Marketing
- Progress with Key Initiatives
- Rocks – 90 days clock

# 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
Sales growth	20%	10%	→	15%	15%	15%
Cost of Sales	167	165		202	233	268
Cost of Sales %	42%	38%	→	40%	40%	40%
<b>Gross Profit</b>	<b>233</b>	<b>275</b>		<b>304</b>	<b>349</b>	<b>402</b>
Gross Profit %	58%	63%		60%	60%	60%
Wages & Salaries	50	52	→	55	60	65
Overheads	80	85	→	90	100	110
<b>Net Profit</b>	<b>103</b>	<b>138</b>		<b>159</b>	<b>189</b>	<b>227</b>
Net Profit %	26%	31%		31%	33%	34% <i>Sense check</i>

# HOW?

## Forecasting Balance Sheet

	ACTUAL 30-Sep-19	ACTUAL 30-Sep-20
Fixed Assets	1,000	950
Trade Debtors	35	36
<i>Debtor days</i>	32	30
Trade Creditor	37	45
<i>Creditor days</i>	55	65
Loan	600	550
Bank	63	197
<b>Net Assets</b>	<b>461</b>	<b>589</b>

# 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)
<b>Net Cash Flow</b>	<b>53</b>	<b>144</b>	<b>82</b>	<b>73</b>	<b>187</b>
Opening bank balance	10	63	207	289	361
<b>Closing bank balance</b>	<b>63</b>	<b>207</b>	<b>289</b>	<b>361</b>	<b>549</b>

# 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  <b>Financial loss incurred - £25,000</b>
Tapering off of Government supports/schemes	Full amount of support received each month - £25,000  <b>Loss of support - £25,000</b>
Supplier issues – not able to secure goods on time, withdrawal of supplier credit and price escalation	Cash to be paid upfront - £30,000  <b>Additional working capital funding needed - £30,000</b>
Issues with debtor collection	Debtor balance to be written off - £25,000  <b>Additional working capital funding needed - £25,000</b>

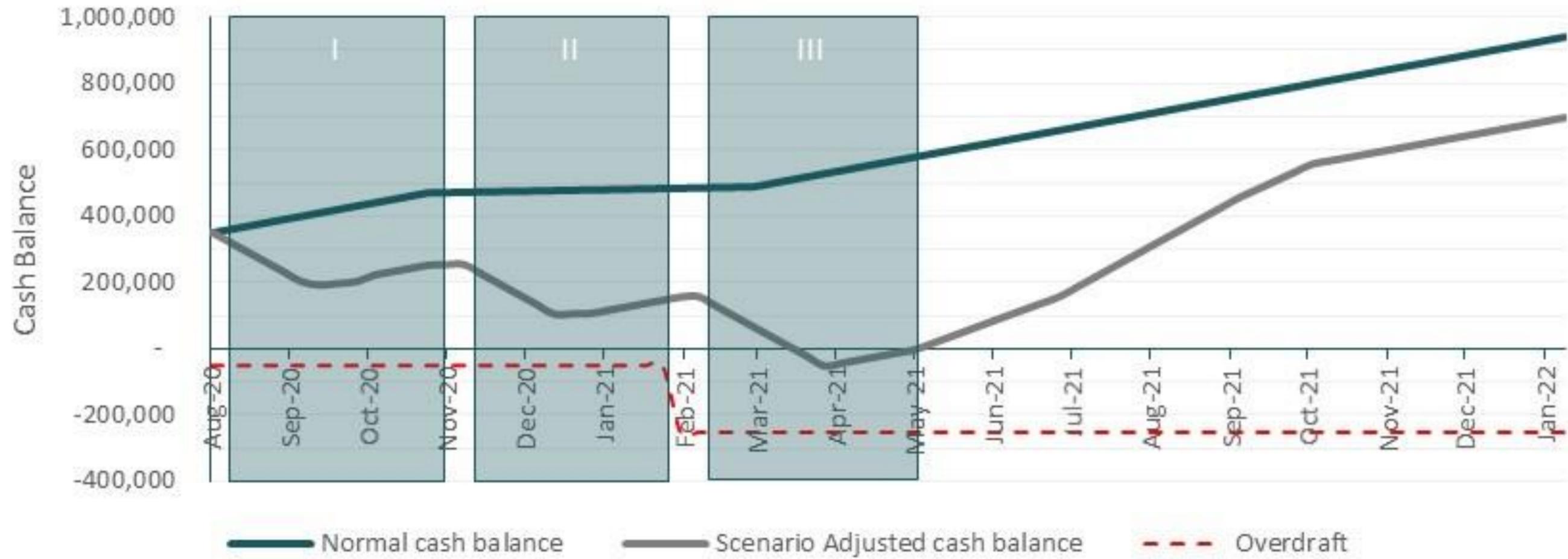
# Scenario Planning

## 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)
<b>Net Cash Flow</b>	<b>50,000</b>	<b>(40,000)</b>

# 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 and Refresher on key matters affecting the financial needs of 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](mailto: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



**TED** | Tourism  
Enterprise Development  
Programme

 tourism  
northernireland