Advanced Financial Planning E-Guide for MSMEs

Future-Tourism in the Eastern Caribbean

#FUTURETOURISM
Acknowledgements

This guide will enable you to develop a financial plan to REFLECT, RESTART or to REVITALISE your business, and to adapt your business performance to the new market conditions.

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1. What is a Sales Forecast?

A sales forecast is a plan to work from and is about predicting the future as accurately as possible, given all of the information available, including historical and current data and knowledge of any future events that might impact the forecasts.

A sales forecast is an estimate of the quantity of goods and services you can realistically sell over the forecast period, the cost of the goods and services, and the estimated profit.
WHY A SALES FORECAST WILL BENEFIT YOU AND YOUR BUSINESS?

Sales forecasts will influence the goals you set for your business and help to determine the resources you will need for the future. Looking ahead and planning set the stage for decision making such as:

• From where can I expect revenue?
• Will I have sufficient funds for operations, expansions, etc.?
• Will I need to discontinue or scale back on certain services?
• Will I need to hire more people or reduce staff?

WHAT IS A SALES GOAL?

• What you would like to have happen
• Should be guided by your sales forecasts
There are many reputable sources for tourism sales forecasts for the region and for your country/Island available for free. Here is an initial list.

- Caribbean Tourism Organisation
- Local Tourism Industry Associations and Hotel Associations
- Central Banks
- Ministry of Tourism
- Chamber of Commerce
- Inter-American Development Bank
- UNDP
- CARICOM

A bit of research on websites and telephone calls to public entities and tourism associations in your country will provide you with ample information and forecasts.
HOW TO USE SALES FORECAST TO SET BUSINESS GOALS OR QUOTAS?

1. What percentage of visitors are expected in your country?

2. What percentage of monies will visitors spend in your country?

3. Are there any future events that can affect your business?

4. What percentage of visitors will you provide service to? (Use your historical data: what percentage of total visitors did you serve in the past? Use your best judgement to determine how current and future events could affect your service delivery. Can you serve more, less, or the same number of visitors?)

5. What type of service will you provide and at what price per unit? (After assessing all the information gathered, consider if there are opportunities to provide additional or new services, and at what price per unit)
When you compare the forecast with the sales goals and the sales goals against the actuals, you can see early on if something might not be right.
2. How to use accounting software as a sales forecasting tool

Each sale in the software can be assigned to sales staff, customer types or other parameters that do not necessarily have to appear on the invoice itself.

The reporting function can display reports of sales by different parameters, for example, analysing by salesperson performance, or by customer type to identify revenue sources.

The sales data from your accounts can help you identify trends that will help make your decisions about how to sell and market more effectively.
A financial plan is an integral part of a business plan because it projects the financial resources needed to back up everything described in a business plan. If you are seeking financing or starting a new business, it is a must. A Business Plan allows you to eliminate impulsivity, because you have developed a strategy growth after care and informed consideration. It is a strategic blueprint that shows where you want to be in the future and how you expect to get there.

The objective is to put your business in a good position to develop all components of your business plan. It includes conservative projections of your profit and loss statements, balance sheet, and your cash flow statements for the next three years. These are forward-looking projections, not your current accounting outputs.
REMEMBER THE ELEMENTS OF A BUSINESS PLAN:

1. Executive summary
   Can be done last. Overview and summary of the entire plan, including your mission statement and the who, what, why, when and where.

2. Business description and structure
   Goals, customers, products and services

3. Market research and strategies
   What is the market for your service/product

4. SWOT Analysis
   Be honest and objective

5. Management team and personnel
   Skills and responsibilities

6. Financial Plan
   Financial projections for the next 3 years

A FINANCIAL PLAN IS COMPRISED OF PROJECTED FINANCIAL STATEMENTS¹:

1. Profit and Loss/Income Statement
2. Cash Flow Statement
3. Balance Sheet

¹ see Fundamentals Financial Planning e-guide for MSMEs to get introduced to these three statements and sheets.
The sales goals you develop will be used in the income statement.

Even with the best possible forecasting method, and your best judgement, no one can predict the future 100% accurately. There might be disruptions that you did not foresee (remember March 2020 when the WHO announced the COVID-19 outbreak as a pandemic), or things might turn out much better than expected. In scenario analysis you examine and evaluate possible events or scenarios that could take place in the future and you predict the various feasible results or possible outcomes. This helps you to assess and minimise potential risks.

4. Use your Sales Goals for the Financial Plan
Especially for a start-up or if you are already in business but want to launch a new product or service, they lack historical data. This is not a cause for concern. Predicting demand for new products or services is not a science and relies on judgement rather than statistical methods. The key to success is collaboration, using all available quantitative and qualitative data, and reforecasting once your own data is available. The following tips will help you develop smart sales goals.

• Collaborate with a team

• Use results of market research and customer surveys to establish agreed assumptions about:

1. Number of consumers in the target market
2. Percentage that is expected to buy the product
3. Timing of their purchase
4. Purchase patterns (repeat/replacement purchase etc.)

• Incorporate effects of internal factors

• Generate a range (Best case, worse case, most likely case) of forecast

• Keep track of actual sales so the forecast can be tweaked
Just as we look at sales targets (your sales forecast) for the first year, we act the same way for years 2 and 3. To set your sales targets for years 2 and 3,

- Be realistic
- Break the figures into components by sales channel or target market segment
- Project monthly for the first year
- Project monthly or quarterly for second and third years
- Use your best judgement and all relevant information that might be available
- Keep track of actual sales, compare against goals and revise

As time moves forward, sit down with the financial plan once a month or at least quarterly, enter the actual figures in the profit and loss account and compare these figures with the forecasts. On the basis of these comparisons, you can then correct the forecast thus gaining experience needed when developing future forecasts.
Many factors play a role in predicting the unit price. For an existing business, you can use your current price and match it with the results of your market research and analysis. You may have found that your price is much higher or lower than your competitors, or you may be planning to add a feature to your product that increases the value to your customers and for which they would be willing to pay more. Or the cost of producing your product has increased and you will pass it on to customers.

When starting up or launching a new product, your findings from market research and analysis play a big role: use the information you’ve gathered to get started and create a budget using different price points until you settle on one you can work with. You can apply the same tips we mentioned above for developing smart sales goals.
The next step in preparing your financial plan is to identify direct costs, also known as cost of goods sold. The two main categories are labour costs and input costs (e.g. material costs). In a product-based business, it is easy to identify the wages associated with the production of the goods. Not so in a service-based business.

An example of direct labour costs in a service-based business would be a company paying consultants who are not employed by it for a specific job they do.

Similar to setting the unit price for different products, the cost of goods sold or cost of sales should also be projected for each type of product. For example, if you run a hotel and a restaurant, you would plan the costs for both products separately.

**HOW TO FORECAST YOUR DIRECT COSTS?**

<table>
<thead>
<tr>
<th><strong>EXISTING BUSINESS/EXISTING PRODUCT &amp; SERVICES</strong></th>
<th><strong>NEW BUSINESS/NEW PRODUCT &amp; SERVICES</strong></th>
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<tbody>
<tr>
<td>· Historical data</td>
<td>· Be guided by your market research and analysis</td>
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<tr>
<td>· Use percentage of salee but adjust according to results of market research and analysis</td>
<td>· Use percentage of sales</td>
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Direct costs give you an indication of how much it costs to produce your products and services. It is important to keep an eye on the actual direct costs. If they increase more than expected, you should take a look at the cost of materials and other direct costs such as overtime. It could also be an indication of waste or theft. Whatever the reason, it is important to identify inefficiencies that are driving up your direct costs and eliminate them quickly.
The lower your direct costs, the higher your gross profit. A higher gross profit is a sign of efficiency. It also gives you the opportunity to pass on benefits such as discounts to your customers. Gross profit margin is what is left over from every dollar of sales you make to pay operating costs, interest and taxes and contribute to net profit.
WHAT IS THE DIFFERENCE BETWEEN FIXED AND VARIABLE COST?

When business activities and sales volume change, this can affect costs. Some fluctuate, some are static. One therefore speaks of fixed and variable costs.

**FIXED COSTS** do not change when the quantity of goods or services produced or sold increases or decreases. Fixed costs are expenses that have to be paid by a company regardless of specific business activities, such as the rent of the shop, salaries, insurance, lease fee for equipment or vehicles.

**VARIABLE COSTS** are expenses that change directly and proportionately to changes in the level or volume of business activity, such as direct labour, taxes and operating costs. They are dependent on the production volumes of the business. When business activities increase, variable costs increase. Conversely, when activities decrease, variable costs decrease.

Labour costs are usually fixed (operating) costs, but labour costs directly related to the production of goods or services are variable. Supplies directly related to the production of units are also variable. Commission paid based on units sold is a variable cost. Credit card fees are calculated as a percentage of turnover.
6. Operating Expense Budgets

An expense budget helps businesses track purchases and keep operating costs to the lowest possible amount. Through careful planning and analysis, business owners can coordinate their spending with tax strategies and cash flows. Without spending budgets, there is a risk of overspending and reducing profit margins or not making any at all. An expense budget can be also used for monitoring the monetary performance of the actual sales.
The Operating Expense budget for your business plan is the lower part of the Profit and Loss (P&L) statement. It makes up the largest part of the P&L and captures the information from your business plan. It also feeds critical information to your projected cash flow statement. There are certain items that are **Not** to be included in your projected Operating Expense budget.

Cost of Goods sold/Costs of Sales/Direct costs are not included in the Expense budget, neither is what you spend on the purchase of assets or interest on loans. They are included in the income part of the income statement instead.

The purchase of assets is not included in the expense budget. Assets are capitalised, which means their cost is added to the balance sheet, and their “usage” for a particular period is accounted for in the income statement as depreciation. Assets purchase affects the Balance Sheet and your cash flow statement, but not the profit and loss or income statement. The purchase of assets also affect your liquidity.

Proceeds from a loan would not be recorded as income. It increases your cash flow and your bank balance and increases your liability. When its repaid the reverse is true. It decreases your liability and your cash flow. Both your liability and bank balances are recorded in the balance sheet, and not in the P&L statement.
What you include in your expense budget section of your financial plan depends on your type of business and your business plan. It can include the following:

- Rent for your business/shop
- Utilities
  - water
  - electricity
- Telephone and internet
- Salaries and benefits
- Insurance
  - Property
  - Liability
- Marketing

Margins\(^2\) can be used to compare businesses within the same industry. A good margin depends on the type of business. A general rule of thumb, a 10% net profit margin is considered average, a 20% margin is considered high (or “good”), and a 5% margin is low.

\(^2\) see Fundamentals Financial Planning e-guide for MSMEs to learn how to calculate the three main profit margins: gross profit margin, net profit margin and expense margin
A break-even analysis is a financial tool that helps you determine at what stage your business, service or product will be profitable. It is a financial calculation that determines the number of products or services a business needs to sell to cover its expenses, especially fixed costs. It helps you understand your business’s revenue, expenses and cash flow - which is critical to keeping your business profitable and subsequently your business doors open.
The goal of your business is to become profitable as early as possible after start-up and then to stay that way. To make sure you are on the right track, you need to look at your numbers upfront. If you don’t calculate the break-even point for your products or services, you run the risk of not making a profit (or not making as much profit) as you thought you would. It ensures that you properly price a product or service by including all costs (direct, variable and fixed costs). With the analysis you will know where you need to set your margins to generate the right amount of revenue to break even and begin your product or service turning to a profitable product or service.

It tells you what you need to do to recover your initial investment and is therefore an important financial ratio for any entrepreneur. After reaching the break-even point, the turnover of your business is pure profit. It is important to determine your break-even point because the viability of your business depends on staying above this number.

\[ \text{IF YOU KNOW WHERE YOUR BREAK-EVEN POINT IS, YOU CAN DETERMINE} \]

- the profitability of a product line or service
- how far sales can decline before you start making losses
- how many units you need to sell to make a profit
- how a reduction in price or sales volume will affect your profits
- how much you need to increase the price or volume of sales to compensate for an increase in fixed costs.
The formula to assess your profitability and price your product or service is the following:

\[
\text{BEP (Unit)} = \frac{\text{FIXED COST}}{\text{SALES PRICE - VARIABLE COSTS}}
\]

\[
\text{BEP (Unit)} = \frac{\text{FIXED COST}}{\text{CONTRIBUTION MARGIN}}
\]

The BEP provides you with the information you need to implement the best strategy for the future.

The Break-Even Analysis can assist you to determine ways to speed up the BEP such as reducing overall fixed costs and variable costs, improving a sales mix or increasing the sales price. The Break-Even Analysis can be used to develop direct cost structures and to identify opportunities for promotions and discounts.

**REMEMBER:**

If your Variable Cost is increasing and your Sales Price remains unchanged you would have to sell more units to break even. If your Fixed Costs are increasing whilst your Sales Price remain unchanged, your BEP would increase, meaning you would have to produce more to turn a profit.
The Break-Even Analysis can also be used as a tool in the following situations:

- When you are starting a new business, as it helps you to decide whether the idea is viable, and it provides information for your pricing strategy.

- When you are creating a new product and you want to set a price which would allow you to reach break-even point within a reasonable time. Break-even point for Cost intensive new products may be different from existing products, so you would need to know how many sales are needed before a profit is made.

- When you are making any kind of adjustment to your business that has cost implications to product or service such as adding a new sales channel or switching your distribution model. Fixed and variable costs are an important metric in the analysis, so whenever there are changes in the cost, it’s always a good idea to do a break-even analysis.

- When you are planning promotion, it helps you to identify products with high contribution margins that can be promoted for more sales or offered as discounts while still making a profit.
• When you are presenting your Business Plan for funding, potential investors can use the Break-Even analysis to get an idea of when you will start making a profit and when the investor expects a return on their investment.

• If you are expanding your business to a new location, the break-even analysis can provide a reality check on how long it will take for planned investments or changes in your business to become profitable.

• If you need to lower your pricing, e.g. due to competition, determine how many more units you need to sell to compensate for a price reduction

• If you want to narrow down your options, with a break-even analysis, you can base your decisions on scenarios with simple yes-or-no questions, such as “Can we do better than the minimum required to succeed?”
Sample questions that a break-even analysis can provide in the development of a business plan:

- How much of my product or service do I need to sell per month?
- How much volume do I expect to sell?
- At what price do these figures match my break-even calculation?
- At what price can I make a reasonable profit?

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<th>ADVANTAGES</th>
<th>CONSIDERATIONS</th>
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<tr>
<td>Enables a more solid basis for pricing your products.</td>
<td>No prediction of demand</td>
</tr>
<tr>
<td>Setting concrete sales and revenue targets</td>
<td>Predictive power depends on the reliability and accuracy of your financial data</td>
</tr>
<tr>
<td>Minimising risk - avoiding investments, product lines and other expansions that are not profitable or difficult to make.</td>
<td>Only useful for simple and few products</td>
</tr>
<tr>
<td>Essential for financing</td>
<td>Competitor behaviour is not included in the equation</td>
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All in all, it’s best to do a break-even analysis along with other profitability metrics, such as net profit margin, to ensure you get the best overview of your business’s financial health.
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