COURSE GUIDE

TSM 342
CONCEPT, DESIGN AND FEASIBILITY

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CONTENT

INTRODUCTION

TSM 342 – Tourism Design and Feasibility is a course developed to suit every 300-level undergraduate student studying for a Bachelor of Science (B.Sc.) degree in Tourism Studies at the Faculty of Social Sciences. The primary concern of the course is a detailed estimate of the cost, the technical, management, and financial aspects of tourism and other related businesses. This course, therefore, provides learners with fundamental knowledge of new trends and innovations in tourism business investment decisions and profitability.

CONTENTS OF THE COURSE

During this course, you will learn about Tourism, Entrepreneurship and Innovation, Tourism Business Feasibility Study, Tourism Business Feasibility Report, Tourism Project Funding, and Tourism Business Simple Cash Flow Forecasts. The course further entails Tourism Business Plan and Planning, Tourism Project Cycle, Tourism Project Planning and Control, Tourism Business Financing and Objectives, and Tourism Business Financing and Related Risks. Others include Tourism Business Financial Cost and Benefits Analysis, Tourism Business Breakeven Analysis, Tourism Project Financial Statements, Tourism Project Budgeting Techniques and Techniques and Tools of Evaluating and Analyzing Tourism Business Investment.

COURSE AIM

The major aim of this course focuses on exposing learners to various methods and techniques of tourism design and feasibility study. The course aids the learners in gaining knowledge and the ability to develop tourism business plans, and control cash inflow and outflow.

COURSE OBJECTIVES

The course objectives, among others|, include:

- ✓ Comprehending how to start a tourism business
- ✓ Understanding the techniques of writing a feasibility report
- ✓ Listing key considerations when writing a tourism business plan
- ✓ Developing and writing an acceptable tourism business plan
- ✓ Understanding simple cash flow forecasts for tourism business
- ✓ Knowing tourism project financing and related risks
- ✓ Describing tourism business budgeting technique
- ✓ Ascertaining effective techniques and tools for analyzing tourism investment Decisions

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WORKING THROUGH THIS COURSE

For you to complete this course successfully, you are required to attend online facilitation classes, and read the course material, reference books, and other resources that are related to each unit. Each unit of the course contains Self-Assessment Exercises (SAEs).

The Tutor-Marked Assignment (TMA) is to be done as scheduled and submitted through the approved assessment platform. This course is a 2-credit course; as such, you are expected to spend a minimum of two hours every week studying the course. You are expected to complete the entire course outline within 18-25 weeks.

ACADEMIC PERFORMANCE EVALUATION

Every unit of this course has SAEs attached to it. You are required to keep the SAEs file. Tutor Marked Assignments (TMAs) should be done. At the end of the course, the evaluation shall be as follows:

Tutor Marked Assignments (TMAs)	–	30 %
Examination	–	70%
Total	**=**	**100%**

All the continuous assessments will be 30%, while the examination at the end of the course shall cover all aspects.

COURSE MODULES AND UNITS

This course is categorized into three (3) modules and fifteen (15) units having
different topics as presented below.

Module 1

Unit 1	Tourism, Entrepreneurship and Innovation
Unit 2	Tourism Business Feasibility Study
Unit 3	Tourism Project Feasibility Report
Unit 4	Tourism Project Funding
Unit 5	Tourism Business Plan and Planning

Module 2

Unit 1 Tourism Business Simple Cash Flow Forecasts
Unit 2 Tourism Project Cycle Management and Application
Unit 3 Tourism Project Planning and Control
Unit 4 Tourism Business Financing and Objectives
Unit 5 Tourism Business Financing and Related Risks

Module 3

Unit 1 Tourism Business Financial Cost and Benefits Analysis
Unit 2 Tourism Business Breakeven Analysis
Unit 3 Tourism Project Financial Statements
Unit 4 Tourism Project Budgeting Techniques
Unit 5 Tourism Business Investment Evaluation: Techniques and Tools of Analysis

The logical link exists in the arrangement, and the units must be treated sequentially. Every previous unit remains a foundation for the succeeding units. A maximum period of one week is required for every unit.

LEARNING RESOURCES

Learning references recommended for this course are presented below. The resources are not limited to only the recommended ones; you can lay your hands-on other materials, including texts, videos, and images.

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PRESENTATION SCHEDULE

Specific dates for specific activities, such as online facilitation schedules, submission of assignment, and examination dates shall be made available to you at a later date. This will enable you to plan your activities in the same line. The method of submitting your assignment and receiving other course materials shall be agreed upon at a later date. You should endeavor to keep every schedule that might be communicated to you and try as much as possible to be punctual.

CONCLUSION

At the end of this course, you must have been equipped with fundamental knowledge of new trends and innovations in tourism business investment decisions and profitability. Also, conduct tourism business feasibility studies and conversate with a business plan and planning processes.

MAIN COURSE

CONTENT PAGE

MODULE 1

UNIT 1 TOURISM, ENTREPRENEURSHIP AND INNOVATION

1.1 Introduction

Globally, tourism depends on the abilities of entrepreneurs to identify investment opportunities and convert their innovation and creativity into business ventures. This process is a driver of new tourism business development. The success in tourism business investment depends on tourism entrepreneurs' entrepreneurial skills, innovation, and creativity abilities to meet customers' demands.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- Identify the nature of tourism
- Understand tourism innovation and creativity.
- Differentiate between tourism entrepreneurship and entrepreneur
- Comprehend qualities of tourism entrepreneurs

1.3 Nature of Tourism

Tourism is the movement of people from generating area to destination engaging in activities unconnected to remuneration for not less than 24 hours and not more than 365 consecutive days. It has become a source of employment and revenue generation. Why is it important to understand the nature of tourism while studying tourism design and feasibility study? Since it has been recognized as a business, it requires innovation and creativity on the part of entrepreneurs to establish a successful tourism business. The skill is significant to designing and offering tourism products to tourists. Tourism products are different from one region to the other comprising:

- ✓ Conference and business-based tourism
- ✓ Wildlife tourism
- ✓ Ecotourism
- ✓ Resort-based tourism
- ✓ Cultural tourism
- ✓ Community-based tourism and so on.

The products listed above are often accompanied by niche products for local, domestic or international tourism. It is important to know that the nature of tourism propagates some factors of variation, especially in developing nations. The factors are highlighted below:

- ✓ Influence and power
- ✓ Issues of underdevelopment
- ✓ Inability to meet international tourist demands

1. Influence and power

Tourism is usually controlled by foreign firms.

2. Issues of underdevelopment

The direction of tourism development and growth is often influenced by a lack of proper structuring.

3. Inability to meet international tourist demands

Sometimes, the service operators do lack the capacity to meet tourism demands by foreign tourists.

1.3.1 Tourism Demand

The term tourism demand is a complex charge. It is referred to as the relationship between persons' motivation to embark on a journey and ability to accomplish it. Issues affecting tourism demand include:

- ✓ Cost and Time Determinants
- ✓ Security, Safety, and Health Considerations
- ✓ Seasonal Differences
- ✓ Promotional Ability and Efforts of the Destination
- ✓ Political Factors

1. Cost and Time Determinants

Cost and time in the tourism element are very significant. The cost of travel from the generating area to the destination can affect demand. The popularity of any destination relies on affordability and how quickly individuals can travel to such destinations.

2. Security, Safety, and Health Considerations

Security, safety, and health issues are affecting tourism demand negatively.

The problems are recognized by the government of every nation, policymakers, decision-makers, and the tourism industry. They are affecting destination design and development. Their impacts are also significant to the willingness of tourists to alter their travel plans from one destination to the other.

3. Seasonal Differences

Seasonal variations in tourism demand are majorly in three (3) categories. First, one peak with a particular season, such as dry season. Next, two-peak, which may comprise rain and dry seasons. Third, non-peak often takes place in urban centers involving all-year-round usage, but demand is seasonal, involving both domestic and foreign tourists.

4. Promotional Ability and Efforts of the Destination

The intangibility nature of tourism products differentiates the kind of tourism promotion in the industry from other industries. Promotional efforts are influenced by the destination, imagery, and receipt of such tourism promotional efforts. Consumers, while making decisions, can access information using the internet for availability and online booking regardless of intermediaries. However, note that the success of

promotional efforts can affect tourism demand but is uncontrollable by the suppliers at a particular destination.

5. Political Factors

Tax policies and controls on visitors' spending and at the destination influence tourist's demand. The issues usually monitored include exchange control, visa regulations, currency export, and taxation of visitors.

1.3.2. Types of Tourism Demand

It is crucial to know different forms of tourism demand. They are as follows:

- ✓ Actual Demand
- ✓ No Demand
- ✓ Suppressed Demand
- ✓ Substitution of Demand

1. Actual Demand

This form of demand is the total number of visitors recorded at a specific time in a particular destination. It is also referred to as effective or aggregate demand. It forms part of a statistical record that shows the total number of persons, purpose of traveling, and raveling from one local, domestic, or international destination to the other.

2. No Demand

This type of demand means that no proportion of the population participates in tourism. This situation may result from an unwillingness, lack of money, ignorance of the benefits of tourism, or lack of time.

3. Suppressed Demand

This exists when persons do not travel at all due to some reasons. Suppressed demand entails deferred and potential. The deferred demand is connected to challenges emanating from the supply side, such as climate change, shortage of accommodation, and transport issues that prevent individuals or groups of people from traveling to the destinations of their choice. Meanwhile, potential demand refers to those who cannot travel for personal reasons, such as holiday entitlement, extra income, and health-related issues. This type of demand can become an actual demand in the future as circumstances change.

4. Substitution of Demand

As the name implies, this occurs when demand for a particular tourism activity is taken over by another type of tourism.

1.3.3 Tourism Supply

Tourism supply is the outcome of all productive activities involving providing services and goods needed to meet tourism demand and expressed in sightseeing consumption. Tourism supply has three categories. First, descriptions, operations, management, and marketing of the tourism industry. Next, the geographical development and connections distinguish the sector on a local, national and foreign scale. Last, impacts result from the development of the tourism industry. In supply terms, tourism is a composite product that embraces the following:

- ✓ Attraction and activities
- ✓ Transportation
- ✓ Accommodation
- ✓ Entertainment
- ✓ Tour operators
- ✓ Travel agents
- ✓ Other tourist services and facilities such as catering, banks, and shops.

The nature of tourism supply is complex, wide, and broad, and mainly three types of tourism businesses exist in tourism supply.

- ✓ The voluntary
- ✓ The Private Sector
- ✓ The Public Sector

1. The Voluntary

This is a sector also called not-for-profit. The industry is involved in tourism for many reasons. For instance, it serves as a volunteering sector to maintain historic facilities. Some of them can access grants from the public sector to for acting as custodians of state resources.

2. The Public Sector

This sector makes provision for infrastructure, facilities, and services to manage and facilitate tourism activities. It ensures that tourist attractions are readily accessible and provides adequate information on sightseeing and events. It ensures high-quality environmental care and proper security measures for the host and visitors.

3. The Private Sector

The sector is profit-driven. Globally, small and medium-scale businesses dominate this sector. It is designed by tourism entrepreneurs considering innovation and creativity to meet social, group, and family tourism needs and to maintain marginal profitability.

Self-Assessment Exercise: 1

How can you define tourism?

1.4 Tourism Entrepreneur and Entrepreneurship

Tourism depends on entrepreneurs that usually identify tourism business opportunities and turn ideas into profitable businesses. Success relies on entrepreneurs' creativity, innovation, vision, and business skills. As such, tourism is a sector constantly experiencing change and innovation. Thereby providing diverse products that can absorb tourism consumption and its changing patterns. Why is the study of tourism entrepreneurs and innovation important in tourism design and feasibility study?

1.4.1 Tourism Innovation and Creativity

Innovation is the most term now in different contexts, including the tourism sector. It is used to explain the behavior of enterprises in the tourism sector. The term does not connote only the ability to create; it further entails the ability to comprehend all the forces in the work environment. The list below showcases kinds of tourism innovation.

- ✓ Introduction of a new product
- ✓ Discovering the new source of supply of semi-finished products or raw materials
- ✓ Opening of a new market
- ✓ Improvement in the standard of an existing product
- ✓ Introduction of a new production method
- ✓ Creation of a new type of industrial tourism firms

Tourism innovation is to be examined in tourism entrepreneurship. The innovator has to acquire the skills and knowledge and develop the ability to use them.

1.4.2 Tourism Entrepreneurship

Entrepreneurship emerged in the late 19th century. Tourism entrepreneurship is the capacity and attitude of a person or group to undertake tourism ventures with the probability of success or failure. It is also the willingness and ability of an individual to seek out tourism investment opportunities, establish and run a tourism enterprise successfully. It can also be defined as the capacity for tourism innovation, investment, and activist expansion in new markets, products, and techniques. Tourism entrepreneurship may reflect superior information and imagination, vital for reducing risks and uncertainties of new opportunities rejected or ignored by other tourism investors. The general features of tourism entrepreneurship include:

- ✓ Social alertness
- ✓ Fair education
- ✓ Past experiences
- ✓ The need for achievement

The government is encouraging tourism entrepreneurship across the globe.

1.4.3 Tourism Entrepreneur

A tourism entrepreneur is a distinct factor of production and that individual who coordinates the other factors of production (land, labor, and capital) by assuming the associated risks and investing their resources in a tourism business venture. The entrepreneur is that person who begins or organizes a commercial tourism enterprise, especially a tourism business involving financial risk. They plan, recruit human resources, manage, direct, and control tourism business to attain set goals.

There are two types of tourism entrepreneurs, namely;

- ✓ Pure tourism entrepreneurs
- ✓ Other tourism entrepreneurs

1. Pure tourism entrepreneurs

They innovate, create, organize, take risks and manage tourism enterprises.

2. Other tourism entrepreneurs

This category of tourism entrepreneurs takes over ongoing tourism business concerns and manages them, including franchise operators.
Tourism entrepreneurs should always examine and query the following areas when starting a new business or when a successful business begins to show signs of distress:

- ✓ Is inventory balanced or unbalanced?
- ✓ Are sales growing, stagnant, or declining?
- ✓ Are credit sales normal or over-extension?
- ✓ Are cash sales growing, stagnant, or declining?
- ✓ Is cash flow liquid or Illiquid?
- ✓ Is profit growing, stagnant, or declining?

Self-Assessment Exercises: 2

Identify two major types of tourism entrepreneurs.

1.5 Summary

From our discussion, we have discussed the nature of tourism, tourism demand, and supply. This section has exposed you to differentiating between tourism innovation, creativity, entrepreneurship, and entrepreneur. We have learnt the basic categories and functions of a tourism entrepreneur and discussed the nature of tourism and demand and supply from tourism perspectives. Also, the unit showcased relevant issues regarding tourism innovation, creativity, entrepreneurship, and entrepreneur.

1.6 References/Further Readings

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1.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

Tourism is the movement of people from generating area to destination engaging in activities unconnected to remuneration for not less than 24 hours and not more than 365 consecutive days.

Self-Assessment Exercise: 2

Two types of tourism entrepreneurs are;
i. Pure tourism entrepreneurs
ii. Other tourism entrepreneurs

UNIT 2 TOURISM BUSINESS FEASIBILITY STUDY

2.1 Introduction

The fundamental aspect of any tourism investment decision is profitability. Before embarking on any significant tourism business project, a study should be undertaken to determine the feasibility of such a project with the degree of risk associated with such an investment.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- Understand what feasibility studies entail.
- Conduct good feasibility studies for the success of tourism businesses.

2.3 Uses of Tourism Business Feasibility Study

Before exploring the uses of a tourism feasibility study, we can think of the effort to define tourism business feasibility study. So, what is a tourism business feasibility study? A tourism business feasibility study is a study conducted to establish both the feasibility and viability of a tourism project. It is a comprehensive proposed venture for setting up a tourism business. A tourism business feasibility study is helpful in the following ways:

- ✓ It does not only help one to decide whether to invest or not but also it helps you to raise much capital for your business.
- ✓ A feasibility report also serves as a basis for measuring the performance of your new business.
- ✓ It helps to ascertain whether or not a project is worth undertaking.
- ✓ It usually is required to support an application for financial assistance.
- ✓ It serves as an implementation guide to the project to which it relates.

It is critical to note that a tourism project feasibility study does not eliminate business failure. Still, without it, a tourism entrepreneur is like an individual in a tunnel without a touch light, and he will just be moving and meddling around without any idea where he is going and how he will reach there.

2.3.1 Key Segments in a Tourism Investment Feasibility Study

The following are the significant kinds of information a person determining the feasibility of a tourism project will need:

1. **Site Selection**

The most significant factor in determining the success or failure of a proposed tourism venture, for instance, an accommodation outfit, is site location. The issues to consider include:

- ✓ The economic environment of the area
- ✓ Size the project
- ✓ The physical location
- ✓ Nearness to the visitors
- ✓ Road accessibility
- ✓ Source and access to the required utilities
- ✓ Natural advantages
- ✓ Availability of labor
- ✓ Availability of niche products such as transport, catering, and so on.

The list above shows that site location is the first area of consideration in any tourism feasibility study. Here you will be concerned with identifying the forms of transport available and their cost. You should also think about possible locations for your business and the comparative costs of the alternative locations. Are there any duties or taxes to be paid?

It is important to note that location selection is vital in the tourism industry and businesses. For example, some of the factors you consider when trying to decide where to locate tourism business are the following:

You have to consider each factor concerning your proposed location and determine to what extent it will affect your operation's cost. Suppose the consumers of the products are concentrated in a certain geographical area or areas. In that case, you should weigh the financial implications of each factor and compare the costs of alternative locations.

Then, site your project at the location which gives you maximum comparative advantage. Remember that you are in business to make a

profit. Therefore, site your project in an area that will enable you to make the desired profit.

You should consider the age group of the population in the area where the business is to be located, the group's income level, and the group's buying habits. It would be best if you tried to match the business's products, image, price class, and mode of operation.

You have to determine whether visits by customers or clients are necessary. If so, you must ensure that facilities for customer comfort are adequate. The location must also be consistent with the type of customers or clients you want and its habits in buying the tourism service and have a memorable experience. You have to consider the need for efficient public utilities. We have discussed location at length because of its importance. Location is significant for success and can make or mar a business.

2. Market Information

You should try to answer the following questions and many more as business unfolds:

- ✓ Who are the major consumers of your product?
- ✓ Where are they?
- ✓ What is their purchasing power?

What is the competition?

- ✓ How many competitive businesses are in the market?
- ✓ Where are they located?
- ✓ What are their practices and policies?
- ✓ What is the total known or estimated volume of competitive business within the geographical area in which you want to do the business?
- ✓ What are the channels of distribution?
- ✓ What kind of advertising and sales promotion do the competitors adopt?

It would be best to study business directories, industrial directories, telephone directories, and other relevant directories to find out who your competitors are and where they are. You can also get information on your competitors from different public sources you can think of.

3. Supply and Demand

It is significant to discover the existing supply and future supply. Suppose it is for the existing supply, the names of the current sites, chains, or any

other brands and packages. Then, based on the statistical analysis of arrivals and nights, a forecast can be made for future demand for the project.

4. Facilities

The market analysis should be able to provide adequate information regarding the types of visitors that may be expected, comprising their ethnic background, income level, country of origin, cultural preference, and religion. The information can also extend to the category of the tourists such as business travelers, tourists, educationists, etc. The information will guide in deciding the class and type of facilities available to the customers**.**

5. Information on Labour Requirements and Situation

Human resources contribute to a tourism venture's major success or failure. You should gather information on the kind, source, grade, and quality of employees the business may require and their benefits, including the possible union they may wish to join.

6. Legal Requirements

You will need a lawyer if you want to operate the business as a proprietorship, partnership, or limited liability company. You will have to complete registration formalities if you want to operate the business under a business name other than your own personal name. For example, the business must be registered with Corporate Affairs Commission (CAC) in Nigeria.

7. Information on Capital Requirements and Financial Projections

This is the last but not the least. This is the most critical aspect of the information that must be considered during a feasibility study. The kind of machines and equipment are needed? Is any superstructure necessary? Is any land acquisition necessary, and what is the cost?
The accumulation of the information gathered in the above sections will lead to the preparation of financial projections. You must get in touch with the bank, financial institution, or ministry you may intend to approach for a loan with or without interest to finance the business. You have to find out their loan requirements so that you can present your loan request in the form acceptable to them using a bankable business plan. It is also possible to seek a business grant.

Self-Assessment Exercise: 1

1.	What is a tourism business feasibility study?

2.3.2 Information Collection Methods

You can collect the information you need by a combination of the following methods:

1. Observation

Observation involves recognizing and noting people, objects, and events rather than asking people to give you information. For example, if you want to know what kind of people patronize certain hotels and restaurants, you visit the hotel and restaurants and observe things for yourself.
Visit the places where your existing or prospective competitors are doing business and collect as much information as possible by observation. You can go there as an ordinary customer, which is perfectly alright. Make as many mental notes as possible and put your observation in writing as soon as you leave the scene.

2. Questions

This is called the questionnaire method. It would help if you learned to ask questions to get information on the market for the product, logistics, workforce requirements, and capital requirements. Depending on the situation, you can put these questions either verbally or in writing. You must determine who you will ask the questions from, customers, suppliers, competitors, government officials, etc. For example, if you cannot visit the machine supplier you need, you can write him and ask him to give a quotation covering the cost of the machines, and their transportation to the intended site.
All these mean you must come out and visit places and offices where you can get information in all the areas where information is needed. In this area, you must demonstrate your creativity and ingenuity, for research is, after all, a creative task.

3. Library Research

To the uninitiated, going to the library is intimidating. Library research is easy, and I will show you how.

Before going into the library, ensure you know what you are looking for. There are librarians and clerks always ready to help you in any suitable and well-managed library. If you are looking for information on tourist inflow in this country, request the librarian to help you locate any publication which will give you information on the subject matter in this country. The librarian can collect some copies of the annual abstract of statistics and Nigeria Trade Summary. Go through them patiently and painstakingly and gather the information you need. You can do the same on any other issues about which you want to do any additional research. Be humble and tell the librarian you are new to the library and need help on how to use the library.

4. Research on the Internet

You can also research on the internet. The internet is the world's most extensive library, and you can collect information on any subject on the internet. All you need to do is know what you are looking for and how to browse the internet.

Once you have collected all the information needed through observation, questionnaires, and reading publications in the library, the internet, or elsewhere, you are ready to begin writing your report. Before you start writing, however, you must ensure that you have organized the information you collected and arranged them in a file or two, as the case may be.

Self-Assessment Exercise: 2

How can you collect information in the course of conducting a tourism project feasibility study?

2.4 Summary

A tourism business feasibility study is significant to the success or failure of a proposed tourism venture. As a result, information collection can be easy or complicated depending on how you handle it and your professional capability. It is essential to get the correct information. In case of any complication, contacting a tourism feasibility expert or consultant might be necessary. This unit discussed the meaning of a tourism business feasibility study. It further presents the uses of the feasibility study and how to gather relevant information in conducting a feasibility study for a particular tourism project.

2.5 References/Further Readings

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2.6 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1
A tourism business feasibility study is a study conducted to be able to establish both the feasibility and viability of a tourism project. It is a comprehensive proposed venture for establishing a tourism business.

Self-Assessment Exercise: 2
You can collect the information you need by a combination of the following methods:
1. Observation
2. Questions
3. Library Research
4. Research on the Internet

UNIT 3 TOURISM PROJECT FEASIBILITY REPORT

Unit structure

3.1 Introduction

Whenever a feasibility study is conducted, it must be presented in a report to aid tourism investment decisions. The report must contain certain features that will showcase the feasibility and viability of the tourism project.

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- Understand what a tourism business feasibility report is all about and
- Write an adept feasibility report for the success of a particular tourism business venture.

3.3 Tourism Project Feasibility Report Defined

Put in a straightforward language, a tourism project feasibility report tells you whether a tourism business plan will succeed or fail. In other words, the information concerns itself with determining whether the business you plan to do will be profitable or not. If the report indicates that the business cannot succeed, you must think of another business plan.

No matter how elementary, such a report is critical and should be prepared by anybody who wants to start a new business or expand an existing one. Suppose you happen to go to any bank or any institution giving loans to business people. In that case, you would probably hear the loan officer telling you to either go and bring a feasibility report or business plan. The information will show him whether there is a market for your product, whether you can manage the business and ethical implications of the proposal, and w,

3.3.1 Possible Contents of a Tourism Project Feasibility Report

The contents of the tourism business feasibility report vary, but essential ones include:

- ✓ A brief description of the project
- ✓ The project objective
- ✓ The economic and social justification for the project
- ✓ Organization and management
- ✓ Technical and production considerations
- ✓ Demand and supply outlook
- ✓ Marketing strategies
- ✓ Financial projections and profitability
- ✓ Cost of project
- ✓ Financing plan
- ✓ Risk analysis
- ✓ Balance sheet

However, collecting information can be challenging and sometimes frustrating when there is poor record-keeping and poor dissemination or publication of data. But you should not be intimidated by this challenge. Without information (or data, to use a technical jargon), it will be challenging to determine what kind of information you need to prevent you from collecting useless material.

Self-Assessment Exercise: 1

1. What do you understand about the tourism project feasibility report?

3.3.2 Features of a Tourism Project Feasibility Report

The significant features or parts of a tourism project feasibility report can be outlined as follows:

- ✓ The product
- ✓ The market for the product
- ✓ The management team
- ✓ The production process and the production plan
- ✓ The marketing plan
- ✓ Manpower requirements
- ✓ Estimated capital expenditure
- ✓ Estimated working capital
- ✓ Cash budget
- ✓ Projected income statement
- ✓ Projected balance sheet
- ✓ Profitability analysis and evaluation of the project

1. The Product

Gives a brief and precise description of the nature of the tourism product you are discussing. For example, if it is accommodation, there is a need to identify a clear description of what exactly it is. It could be serviced or non-serviced. The serviced sector provides accommodation with facilities and services which can be included in the bill for the product. Accommodation is usually the only product supplied in the non-serviced sector.

2. The Market

Here you give an account of the nature and size of the target market for the proposed tourism product. You must indicate here how you did the market study. You can now make your forecast with the information you collected about the market. The market forecast is your estimate of the total size of the market and the estimate of your share of the market. Your market share simply means the proportion of the total market (for the particular product), which you hope to control if you establish the business.

Your share of the market becomes your sales forecast. The sales forecast is essential because important areas of decision-making like production, planning for plant and equipment, staffing requirements, raw material purchases, advertising, and cash flow depend on your sales estimate. Nothing happens without sales. Unless there is sufa ficient market for your product, establishing the business will be a waste of money and effort.

In order to estimate the market, you have to determine the number of competitors in the industry and what part or proportion of the market will be left for you after the competitors have got their own market share.

You can estimate the market in a number of ways. Perhaps, one of the most common approaches is to estimate the number of families using your product in the geographical area where you want to market the product and multiply the number by their estimated annual expenditure for your kind of product per family.

To determine who competitors are is quite easy. Check a business or industrial directory and identify your competitors. You can also undertake a physical or electronic tour of the trade area of your interest to observe things for yourself. You can also ask people who you think can supply you with the necessary information. Visit the ministry of trade and industry. Your banker may also know who your competitors are. Talk to

existing retailers and wholesalers of the product. Visit the chamber of commerce and any manufacturers association near you. Explore all sources of information earlier discussed and any new ones you can think of.

You can calculate your market share once you have the following figures, namely:

- ✓ The estimated market for the product in the industry and
- ✓ The number of competitors (including, of course, yourself) you can then estimate your market share.

Illustration:

Let us take, for example, that there are 50,000 visitors in the geographical area where you want to sell your product. We assume each of the tourists spends N200.00 a year on your proposed tourism product. Let us assume also that there are five competitors (including you).
Then the estimated market for the product in the industry can be calculated as follows:

The market for the product = Number of visitors ×Annual expenditure
= N200×50,000
= N10,000,000

Market share per competitor
= N10,000,000/5
= N2,000,000.

While your estimated share of the market is N2,000,000 you must remember that you are new to the market. It will therefore be unrealistic for you to assume you will capture your whole share of market initially. You may therefore have to reduce your estimate of your share of the market by some percentage to make your estimate realistic. Another forecasting approach is to assume that sales will grow according to past history at a given percentage or that they will grow in proportion to the value of the Gross National Product (GNP). The GNP means the market value of all goods and services produced by a country in a given year. This approach assumes not only that you are already in business but also that there are no ups and downs in the economy. If you are just starting a new business, you have no past sales to work with. If, you can get your competitors' salesmen to make such estimates that will be fantastic. At the end of your opinion poll you average all the estimates of sales for your proposed product and arrive at the sales estimate and the market for the product. For example, assuming five salesmen give estimates of a particular product as follows:

Salesman	Estimate (₦)
A	5,000,000
B	6,500,000
C	7,000,000
D	6,000,000
E	5,500,000
Total	30,000,000
Average	= ₦30,000,000/5 = ₦6,000,000

You can therefore assume that the size of your market is about N6,000,000

It must be cautioned that this estimate is subject to the problem of human estimating optimism.

There are more sophisticated approaches to estimating the market for your product. You can consult books on business statistics or market research for more sophisticated approaches if you are interested. Any combination of the approaches discussed above will enable you make a reasonable estimate of the market for your product. You can also devise other creative approaches to assess the market. Once you have made a sales forecast, you have built the foundation for making the other estimates in your feasibility report.

3. The Management Team

Another item of utmost importance in your feasibility report is a brief but sufficient description of the background and experience of the persons who will manage the enterprise. One financial institution considers strong market for the product and sound management as crucial. The financier's decision will depend heavily on his evaluation of the management team and its members' ability to perform their assigned roles, duties and responsibilities.

4. Process and Plan

Under this section you describe how to make the product available, if the proposed business is a commercial recreation enterprise. You describe clearly the stages you will go through before the site will be ready and opened for visitors to use. You can also include information on the location of the centre, space requirements and so on. You should outline the project costs involved. You do not need a production plan and related budgets but you will have to adapt the principles provided in this course to prepare relevant estimates like sales, purchases, operating expenses, etc.

Let us assume you are going into packaging tour. If that is the case, you have to prepare a budget. This budget shows the quality of the expected activities to be offered during a given period, say a year. You should remember that the number of visitors expected should be based on your sales forecast, availability of facilities and the capacity of the tourist attractions. You should also estimate the days of tour and tour guides to be employed and their pay. You should also estimate the type and cost of any other facilities you may want to provide during the tour.

In this connection, you may have to prepare a cost budget. In this budget, you set a standard cost which shows the number of number of facilities (standard quantity) to be visited by a visitor and the price to be paid to enjoy and have a memorable tourism experience. The standard cost can be calculated as follows:

Standard Facilities Cost = Standard quantity × Standard price

Your facilities cost budget is thus derived by multiplying the standard facilities cost per visitor (i.e. single product) by the number of facilities to be visited. Your facilities purchases should be enough to cover:

It needs to be pointed out here that the preparation of a material cost budget may not be possible sometimes and may not even be necessary in some situations. The important thing, however, is that you give a careful thought to the quantity and cost of materials to be used in your factory. This will force you to plan very carefully like a good businessman.

Setting standard costs can be learned from experience. It is as you go along that you may be able to set a standard. Even then, the standard needs review periodically especially if economic conditions in the country are not stable.

Just like in the case of materials you can also set up a labour budget. It is the same principles used in setting a facilities cost budget that you use here. A standard labour cost can be developed by considering labour time and wage rates. You should estimate the number of labour hours to be spent on producing a unit of finished product and the rate of pay for the right grade of labour. A formula for calculating standard labour cost may be as follows:

Standard Labour Cost = Standard Hours × Standard Rate of Pay

The calculation of the labour cost forces you to study the operations or stages involved in making the product in the factory, the time to be taken and the type of labour required, if you are experienced. For example, you

can ask a departmental manager or supervisor in a similar enterprise to give you some help. A cost accountant in such a venture can also be of help.

Another cost you may think of estimating is the overhead or indirect costs involved making the product available. Overhead refers to those costs arising from the provision of business facilities and services required to present tourism products. The overhead budget will therefore cover all production cost not included in the facilities and labour cost budgets, including such items as management and supervisors' salaries, depreciation of plant and equipment, repairs and maintenance, light, fuel and power and so on. With these estimates you will arrive at the production cost comprising:

- ✓ Facilities
- ✓ Labour and
- ✓ Overhead

As you go through all the activities, we have described so far you can see that compiling a feasibility report from the study is quite interesting and you can learn a lot in the process. It forces you to develop a high degree of discipline in the way of managing your affairs and business, in particular.

5. **The Marketing Plan**

It is very important that you indicate in your feasibility report the marketing strategy you intend to follow to achieve your sales target as reflected by your sales forecast. It is necessary to emphasize that failure to meet your sales forecast will affect your Net Profit and will threaten the ability of the business to remain profitable. You therefore under the marketing plan state your marketing goals and how you are going to achieve them.

You should describe the distribution channel you will use to sell the product. You should also describe your advertising and sales promotion arrangements. You should also specify who, where and when to implement the marketing plan.

6. Manpower Requirements

Apart from your management team, there may be other grades of personnel the business will require in order to function properly. You should therefore under your estimate of the manpower requirements, outline the kind and number of personnel the business will need and their pay. For example, you need to determine whether you need one or two accountants, bookkeepers, departmental managers, supervisors, labourers, etc. You must also estimate their wages or salaries. If you have done your research well, you will have no difficulty in estimating the type and the cost of your manpower requirements.

7. Estimated Capital Expenditure

Capital expenditure refers to expenditure on such things like plant and machinery, tools, transportation equipment, superstructure, buses or coaches, ranchers, recreation equipment, office furniture and fittings. Capital here therefore, refers to those items that tie up capital for a long time and do not turn over into cash fast enough but take several years to return their cash outlay (i.e. money spent on them).

Under this section you should therefore estimate carefully your equipment requirements and the cost of each equipment. You can get help on this from suppliers of the machines and equipment. Determine the types and cost of office furniture and equipment you need to run the business. In the case of machines and equipment, you should include their transportation cost to the site and their installation charges as part of the capital expenditure. Your total capital expenditure should be made up of

- ✓ The cost of your fixed assets (equipment and fixtures as earlier explained) and
- ✓ Start-up costs – initial expenditure in starting the business before actual operation commences.

8. Estimated Working Capital

Under this section you estimate the amount of cash necessary to cover anticipated expenditure before revenue begins flowing in. This involves a study of anticipated payment for labour, utilities, rents, supplies and other expenses following initiation of the business. Inventory requirements (covering initial raw material cost) should be included in this estimate. If you have performed all the activities suggested so far, you will have no difficulty in determining the amount of working capital needed for, say, the first month or two.

9. Cash Budget

The estimate of your working capital is followed by your cash budget, which is in a way planning for your working capital. The cash budget is nothing more than an estimate of your cash receipts and cash payments over a given period. To use the technical jargon, the cash receipt and cash payments are referred to as cash flow. The cash flow thus has two aspects: the cash inflow (the receipts) and the cash outflow (the payments).

When you deduct your total cash payments from your total cash receipts you get the estimated cash balance. You may prepare a cash budget for 12 months in respect of each year you want to prepare a projected balance sheet. The cash budget will help you not only anticipate your cash needs but also enable you exercise proper control over the management of cash in your business. Such control and monitoring help you prevent your business from experiencing financial crises whereby you run out of cash or have excess cash.

10. Projected Income Statement

If you have done a good job up to this point in estimating your sales, inventory requirements (both raw materials and finished goods), payments for labour and other expense items, you will have no difficulty in preparing your estimated income statement. This is because the income statement summarizes your estimated operating expenses and operating revenue and show the Net Profit or Loss as the case may be.

The Net Profit is the return on your investment. If the Net Profit is not up to the desired minimum or acceptable level, you have to think twice before deciding to go ahead with the project. In preparing the income statement, you put all the income items on the right side of the statement.

11. Projected Balance Sheet

The balance sheet summarizes the assets and liabilities of your business. Again, all the information here will come from preceding estimates. The estimated figures for cash balance for a year, accounts receivable and inventories are together called current assets which refer, to all the items in the estimated capital expenditure (after deducting allowances for depreciation).

Liabilities will consist of amounts due to third parties and the owners of the business. Amounts due to third parties include accounts payable (i.e. the amounts the business owes on purchases). Amounts due to owners include the capital invested and, of course, the Net Profit.

When all the assets (except cash), liabilities, and capital are projected on to balance sheet the cash on hand can be determined by deducting the sum of the assets from the sum of liabilities, that is to say, after you have listed all the liabilities and all the assets (excluding cash), you obtain the total of liabilities and the total of assets. Then you subtract the total of assets from the total of liabilities; the difference becomes the cash balance at the end of the period. For example, if the sum of assets (except cash) is N900.00 and the sum of liabilities is N1,000.00, the cash balance is N100.00.

The overall company's objective will be fully integrated into the various aspects highlighted below:

- ✓ **Purpose of the Report:** This is to ascertain the viability and profitability of such project.

- ✓ **The Objective and Scope:** The objective of the study should reflect the purpose for which the owner/investor commissioned the consultant.

- ✓ **The Business:** For an already established company/business, a brief history of the business will be necessary. The nature of the business, the status of the company, that is, whether it is limited liability or not, and if it is indigenous or foreign. The total shareholding and its composition, the business head office, directors and their nationalities.

For others, personal details of the investor or group of investors will be given. It may be pertinent here to state that financial institutions are more favourably disposed towards an incorporated business. Even then some financial institutions have peculiar demands.

- ✓ **The Project:** Here, the project to be undertaken should be clearly described. The product or service should be well defined. The industry to which the business belongs should be well identified. In fact, this is the point at which the total project package is considered.

- ✓ **Land and Location:** The description of the area where the business is or will be located and the plant layout are necessary here. Title to the land has to be secured either from the state or local government.

- ✓ **Operational Plan:** The plan of the conversion process and its use, the goal setting, policy making, forecasting, timing and

standardization of work should be described. Details of each sub-unit of the project should be discussed.

- ✓ **Desirability of the Project:** Why is the particular project necessary? Of what importance is it to the society? What is the government policy on similar project? Is it export – oriented type that will earn the country foreign exchange? All these questions need to be answered in this section.

- ✓ **Demand and Supply Outlook:** There should be a market analysis of the product or service. This is to identify the gap in the supply/demand profile. This sector should also identify the market segment and their composition and competitors in terms of their names, location, strengths and weaknesses as well as strategies.

- ✓ **Management and Manpower Requirement:** Much of the success or failure of the operation will depend on the ability of personnel to effect the plan. In doing this, you need to consider the size of the organization, the resources, and get high caliber of personnel within the limit of available financial resources.

- ✓ **Salaries and Benefits:** The salaries provisions should take into consideration the manpower projection. Allowances should be made for annual increases in salaries in subsequent years which will be directly related to the qualification of staff, nature of work, and occupational hazard there in.

- ✓ **Administrative Expenses:** This can be considered under the following headings: Salaries, transport and vehicle maintenance, insurance, advertising, utilities, contingencies, interest expenses, tax and depreciation.

- ✓ **Other aspects include:** Production cost, marketing strategy, distribution and promotion, and sales and pricing and finally the Project's General Appraisal.

Self-Assessment Exercise: 2

Enumerate and discuss five (5) contents of a tourism project feasibility report.

3.4 Summary

The information gotten as a long way to affect your tourism business feasibility report. It is necessary to remind you that if, for any reason, you do not want to cover all aspects of feasibility report, you should at least prepare the following:

- ✓ A market forecast i.e. sales forecast
- ✓ A market plan
- ✓ A cash flow budget and
- ✓ Projected income statement.

Now that you are on a firm ground, go ahead and try. Remember the old adage: 'if you try and do not succeed, try, try, and try again.' There is no way you can learn except by practice.

This study discussed the meaning of and how to gather information for a tourism project feasibility report, as well as relevant information applicable to
such feasibility report.

3.5 References/Further Readings

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3.6 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

A tourism project feasibility report displays whether a tourism business plan will succeed or fail. The report concerns itself with determining whether the business will be profitable or not.

Self-Assessment Exercise: 2

The contents of a feasibility report cover:

- ✓ The Product
- ✓ The Management Team
- ✓ Process and Plan
- ✓ The Marketing Plan
- ✓ Manpower Requirements
- ✓ Estimated Capital Expenditure
- ✓ Estimated Working Capital
- ✓ Cash Budget
- ✓ Projected Income Statement
- ✓ Projected Balance Sheet

Unit 4 Tourism Project Funding

4.1 Introduction

The next significant decision to make after decision has been made on the tourism project(s) to invest in is the source of funds. This is otherwise referred to as finance decision. The issues to consider in the course of taking the financing decision include the sources of funds, cost of funds, expected rate of return and so on.

Accounting flows may be classified into three distinct types – profit flow, funds flow and cash flow. Therefore, funds flow and cash flow statements are needed to obtain a complete picture of accounting flows in respect of accounting period. The profit and loss account provides details of financial performance resulting in the net profit figure. The balance sheet is an explanation of the financial status of the enterprise in the form of a listing of its assets and liabilities at the close of the accounting period.

The funds flow statement provides reconciliation between the opening and closing balance sheets for a given accounting period through an explanation of the changes which might have occurred. This explanation is in the form of an analysis of the sources of additional funds available to the business during the accounting period. It also extends to an analysis of the manner in which they have been utilized. As a result, the funds flow statement covers both the funds internally generated and additional funds obtained by the enterprise during the accounting period. The funds statement deals with the changes which have occurred in the size of the business, as well as changes which took place in the structure assets, liabilities, and invested capital. In addition to the traditional profit and loss account and balance sheet, a stipulated size, SSAP10 ‘Statement of Source and Application of Funds’ imposes a disclosure of a periodic funds flow statement for all enterprises including tourism firms. In the following unit we shall examine various aspect of sources and uses of funds.

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- Know sources of funds in tourism business organizations
- Analyze uses of funds in tourism business organizations
- Compute fund flow statement
- Discuss and apply fund flow statement

4.3 Sources of Tourism Project Funding

Those activities that bring in cash are called sources of cash. Those activities that involve spending cash are called uses or application of cash. Some of the major sources are:

- ✓ Personal Savings
- ✓ Borrowing from family and friends
- ✓ Borrowing from financial institutions
- ✓ Internal funding
- ✓ Venture Capital
- ✓ Sale of Securities to the public
- ✓ Leasing
- ✓ Long term Debt Issuance
- ✓ Grants

1. Personal Savings

Finance for a tourism business depending on the size can be sourced through personal savings of the person that is starting the business. However, the period of raising funds through this source can be long depending on the size of the project.

2. Borrowing from family and friends

A tourism business investor can also approach friends and family members in order to raise funds for the project. This source can attract little or no interest depending on the relationship.

3. Borrowing from financial institutions

This is a source where a tourism business investor either a start-up or an existing can visit financial institutions in order to raise funds. Financial institutions will demand for a business proposal, feasibility report, collateral and other documents that may be required. If the financial institution is satisfied, then the fund will be provided called loan to the

investor. Both parties need to agree on loan terms such as the amount, interest rate, duration, mode of repaying principal and interest and others.

4. Internal Funding

This source is used when an existing tourism company needs further financing for projects. The company first of all looks inwards for retained earnings from the previous profits and after paying dividends.

5. Venture Capital

Financial institutions might not be interested in a starter in tourism business with good ideas but having no personal funds and track records. This is mainly because of his lack of experience in the business, business track record and related risks of doing such business. Alternative source for the starter can then be venture capital. Venture capital is financing source for start-ups usually with high risks that are not attractive to financial institutions such as banks and institutional lenders. In venture capital financing, individual venture capitalists invest their own private money, while the specialist venture capitalist tourism firms source their funds from a pool of funds from pension funds, individuals, large corporations and insurance companies and so on. The venture capitalists always seek for compensation for the high risk and huge capital invested in tourism businesses. As a result, they usually demand for a very high share proportion and number of seats on board of directors.

6. Sale of Securities to the public

Another source of funds for tourism projects especially for initial placement orders (IPOs) in the primary security market. Certain steps must be observed before any security can be offered to the public.
First, the management of the tourism project must vote that such public offer of the shares of the company be made. Second, shareholders are supposed to vote during their annual general meeting (AGM). Next, the process must be registered with the Securities and Exchange Commission (SEC). The prospectus must be prepared and necessary and appropriate fees will be paid. Fourth, sale can be through public or private placement especially if the capital expected to raise is not huge.

7. Leasing

A lease is a contract that transfers the right to use and control an asset from its bona-fide owner to user who pays periodic rental payments. The real owner to a user who pays periodic rental payments. The bonafide owner of the asset is referred to as the lessor. The user is the lessee. The lease premium is the periodic payment to be made. The lessee uses the

assets because of the relatively little payment of the premium instead of spending huge amount on purchasing the asset**.**

8. Long term Debt Issuance

Long term debts are of two types. They are bonds and direct private and long-term loans. The rules and regulations for shares listed above and public issue of bonds are the same. The basic difference is that there must be a bond indenture which is more or less like a statement that states the terms of the bond. For instance, it is of interest to observe in less developing nations, over half of all debts are issued privately. Direct private long-term loans can be further classified into term loans and private placement. Term loans are actually direct tourism business loans but they have maturities of between a year and five years. Furthermore, most of the loans are repayable during the life term of the loan. Commercial banks, insurance and other specialists in corporate finance are the lenders because of their relatively short-term mature matches with the nature of their sources of funds.

9. Grants

Grants is another source of raising funds for tourism businesses. Grant is a kind of fund offered by individuals, government, NGOs and so on to start-up or existing tourism business owners without paying back and no interest. However, it may attract submission of business plan, pitching and business trainings. Although, it is more of free money, however, the donors expect the grantees to make judicious use of the fund.

Self-Assessment Exercise: 1

1. Identify five sources of fund for tourism businesses.

4.3.1 Uses of Tourism Project Funding

The sources can be traced based on the changes in the firm's balance sheet to see how the firm obtained its cash and how the firm spent its cash during the period. To get started, let us consider the balance sheet for the Travel and Tours Enterprise in Table 4.1. Notice that we have calculated the change in each of the items on the balance sheets. Looking over the balance sheet for the Tours and Travel Enterprise, we see that quite a few things changed during the year. For example, Travel and Tours Enterprise increased its net assets by N149 million and its inventory by N29 million. Where did the money come from? To answer this and related questions, we need to first identify those changes that used up cash (uses) and those that brought cash in (sources).

A little common sense is useful here. A firm uses cash by either buying assets or making payments. So, an increase in an assets account means the firm, on a net basis, bought some assets, a use of cash. If an asset account decreases, then on a net basis, the firm sold some assets. This would be net source. Similarly, if a liability account goes down, the firm has made net payment, that is a use of cash.

Looking again at Balance sheet of Tours and Travel Enterprise, we see that inventory rose by N29 million. This is a net use because the enterprise effectively paid out N29 million to increase inventories. Accounts payable rose by N32 million. This is a source of cash because Tours and Travel Enterprise effectively has borrowed an additional N32 million payable at the end of the year. Note payable, on the other hand went down by N35 million, so the enterprise effectively paid off N35million worth of short-term debt – a use of cash.

Table 4.1: Tours and Travel Enterprise
Balance Sheets as of December 31, 2019 and 2020 (₦ in million)

	2019	**2020**	**Changes**
	Assets		
	₦	**₦**	**₦**
Current Assets:		98	+14
Cash	84	188	+23
Account receivables	165	422	+29
Inventory **Total**	393		
Fixed Assets:	**642**	**708**	**66**
Net plant and Equipment			
Total Assets	2,731	2,880	+149
	3,373	**3,588**	**+215**
Liabilities and Owners' Equities			
Current liabilities:			
Account payable	312	344	+32
Notes payable	231	196	-35
Total	**543**	**540**	**-3**
Long term debt Owners' equity:	531	457	-74
Common stock and paid in surplus			
	500	550	+50
Retained earnings	**1,799**	**2,041**	**+242**
Total	**2,299**	**2,591**	**+292**
Total liabilities and owners' equity	**3,373**	**3,588**	**+215**

Therefore, based on our discussion we can summarize the sources and uses from the balance sheet as follows:

Table 4.2: Sources and Uses of Cash

Sources of Cash:	₦'Million
Increase in account payable	32
Increase in common stock	50
Increase in retained earnings	242
Total sources	**324**
Uses of cash:	
Increase in account receivables	23
Increase in inventory	29
Decrease in notes payable	35
Decrease in long-term debt	74
Net fixed asset acquisition	149
Total uses	**310**
Net additional cash	**14**

The net addition to cash is just the difference between sources and uses, and our N14 million result here agrees with N1 million change shown on the balance sheet. To further trace the flow of cash through the firm during the year, we need an income statement. For Tours and Travel Enterprise, the results for the year are shown in Table 4.3 below. Notice here that the N242 additional to retained earnings we calculated from the balance sheet is just the difference between the net income of N363 and the dividends of N121.

Table 4.3: Travel and Tours Enterprise

2020 Income Statement

		₦Million
Sales		2,311
Cost of goods sold	1,344	
Depreciation	276	1,620
Earnings before interest and taxes		691
Less Interest paid		
Add Taxable income		141
Less Taxes (30%)		550
Net Income		165
Dividends		385
Addition to retained earnings		121
		264

3.3 The Statement of Cash Flows

Flexibility occurs in summarizing the sources and uses of cash in the form of a financial statement. However, if it is presented, the result is called

statement of cash flows. Historically, this statement was called the statement of changes in financial position and it was presented in terms of the changes in net working capital rather than cash flows. We will work with the newer cash format. We present a particular format for this statement in Table 4.4. The idea is to group all the changes into three categories: operating activities, financing activities, and investment activities. The exact form differs from one preparer to another.

Table 4.4: Tours and Travel Enterprise
2020 Statement of Cash Flows (₦ in million)

	(₦ in million)	(₦ in million)
Cash, beginning of year		84
Operating activity:		
Net income		385
Plus: Depreciation	276	
Increase in account payable	32	308
Less: Increase in account receivables	(23)	
Increase in inventory	(29)	(52)
		641
Investment activity:		
Fixed asset acquisitions		425
Net cash from operating activity		216
Financing activity:		
Decrease in notes payable	(35)	
Decrease in long term debt	(74)	
Dividend paid	(121)	
Increase in common stock	50	
Net cash from financing activity	(180)	(180)
Net increase in cash		14
Cash end of the year		120

Do not be surprise if you come across different arrangement. The types of information presented will be very similar; the exact order can differ. The key thing to remember in this case is that we started out with N84 million in cash and ended up with N98 million, for a net increase of N14 million. We are just trying to see what event led to this change. Interest paid should really go under financing activities, but unfortunately that is not the way the accounting is handled. The reason, you may recall, is that interest is deducted as an expense when net income is computed. Also, notice that the net purchase of fixed assets was 149. Because Travel and Tours Enterprise wrote off N276 million worth of assets (the depreciation), it must have actually spent a total of N149 + N276 = N425 million on fixed

assets. Once we have this statement, it might seem appropriate to express the in cash on a per-share basis, much as we did for net income.

Ironically, despite the interest we might have in some measure of cash flow per share, standard accounting practice expressly prohibits reporting this information. The reason is that accountants feel that cash flow (or some component of cash flow) is not an alternative to accounting income, so only earnings per share are to be reported. As shown in the Table above, it is sometimes useful to present the same information a bit differently. We will call this "the sources and uses of cash statement."

Table 4.5: Tours and Travel Enterprise

2020 Sources and Uses of Cash

	(₦ in million)	(₦in million)
Cash, beginning of year		84
Sources of cash		
Operations:		
Net income	385	
Depreciation	276	661
Working capital:		
Increase in account payable		32
Long term financing:		
Increase in common stock		50
Total sources of cash		**743**
Uses of cash		
Working capital		
Increase in account receivables	23	
Increase in inventory	29	
Decrease in notes payable	35	
Long term financing:		
Decrease in long term debt	74	
Fixed asset acquisitions	425	
Dividend paid	121	
Total uses of cash	**707**	
Net addition to cash	14	
Cash end of the year	**120**	

Self-Assessment Exercise: 2

Answer True or False

i. When seeking for funds. financial institutions will demand for a business proposal, feasibility report, collateral and other documents that may be required.
ii. If the financial institution is satisfied, then the loan will be provided to the investor.
iii. All the parties need not to agree on loan terms.

4.5 Summary

In the course of our study in this unit we were able to discuss sources and uses of funds. Those activities that involve spending cash are called uses or application of cash while those activities that involve accumulation of cash are called sourcing for funds. Therefore, ability to balance the two activities or making the sourcing for funds greater than use and application of funds constitutes a good leverage for any company. In a nutshell, this unit showcased source and use of cash, statement of cash flows and its computation.

4.6 References/Further Readings

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Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1
Some of the major sources are:

- ✓ Personal Savings
- ✓ Borrowing from family and friends
- ✓ Borrowing from financial institutions
- ✓ Internal funding
- ✓ Venture Capital
- ✓ Sale of Securities to the public
- ✓ Leasing
- ✓ Long term Debt Issuance
- ✓ Grants

Self-Assessment Exercise: 2
i. True
ii. True
iii. False

Unit 5 Tourism Business Plan and Planning

Unit structure

5.1 Introduction

Why start a tourism business? As an aspiring entrepreneur who is interested in starting a business in the tourism sector of the economy, you can be rest assured that there are loads of business opportunities available in the industry and sectors. Tourism business is known to be a profitable business and over the years, it has evolved from small scale to a global industry across most countries. It is imperative to note that starting a tourism business comes with its own challenges, but it is actually a profitable business venture. An aspiring entrepreneur can either choose to start a tourism business, depending on their financial status, on a small scale or on a large scale. So, if you have decided to go into tourism business, then you should make sure that you carry out thorough feasibility studies and also market survey as discussed in the previous unit. Business plan is yet another very significant business document that should not be taken for granted in the bid to launch your own tourism business. Business plans are required whenever money is to be raised, whether from a bank, a finance house, or a provider of equity capital. To you, your business is of supreme interest and importance while business plan is but one of many to be received by the bank or fund manager.

Therefore, you must win their approval by keeping his or her interest. Running a tourism business without a business plan is likened to how a driver wanting to drive a vehicle from one place to the other without a route plan that will state the route that he will take the kilometer and speed including amount of fuel that will be needed for the journey. This topic is therefore, designed to help in learning a simple but highly effective ways

to develop business plan for the business. It will also assist in learning the rudimentary of writing a business plan.

5.2 Learning Outcomes

By the end of this unit you should be able to:

- Identify different types of business plan
- Enumerate contents of a business plan
- Comprehend basic steps in tourism business plan writing
- Write and present tourism business plan
- Make effective business plan elevator pitch

5.3 Overview of a business plan

Some business plan is not a new term but make sure that you understand the term in order to know what to do as far as writing a business plan is concerned. What is a business plan? Business plan is simply defined as a written representation of where a company is going, how it will get there, and what it will look like once it arrives (Siegel, Ford & Bornstein, 1993)**.** The business plan guide in other words, it is a road map for any business including tourism business.

5.3.1 Types of business plan

Generally, there are two main types of business plan, namely periodical and non-periodical business plan.

1. Annual or periodical plan: This is that which the tourism establishment company needs to achieve its objectives for the year. It includes sales volume, profit, market share and growth which must be coordinated with one another.

Then the tasks and budgets for all the sections and departments are set for every month or quarter depending on how the firm decides to evaluate its own success or otherwise.

2. Non-periodical business plan: This can be looked at in two ways.
a. Plan for start-up a new business
b. Plan for new investment

The non-periodical business plan will contain objectives of the establishment ranging from three to five years. It is generally done as a necessity for tourism company either at start up or when they need to raise

capital or to get a new business license. It can also be used as guidance for management in terms of operational directions.

5.3.2 Content of a business plan

In summary the business plan content can be categorized into three as showcased in the figure below.

a. Company description
b. Analysis
c. Estimation and evaluation

The important thing is to make sure that in writing the business plan there is consistency, between the three parts of the business plan.

Description

A description of the company's product and services of the company, an analysis of the company its products, its market so that the reader can clearly understand the company, the characteristics and the needs of the company's customers, its product and who is competitors are

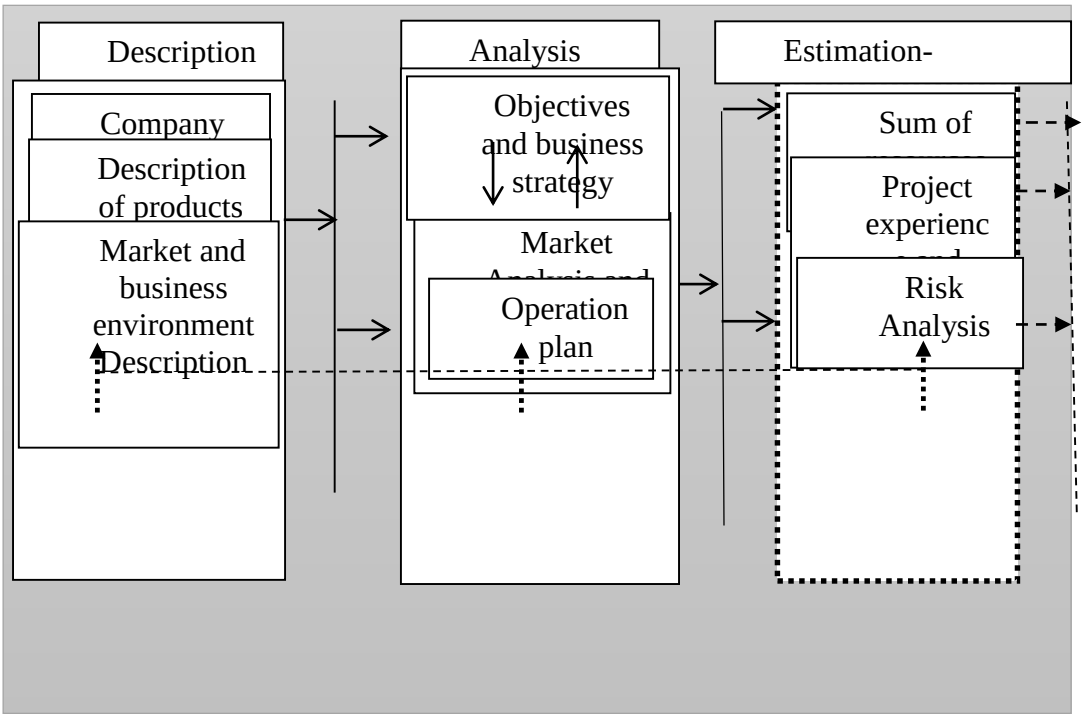

Figure 5.1: Business Plan Content

Company's objectives

General strategies and devices together with concrete functional operations which the company intends to implement to achieve its objectives. The ability of forming this strategy and the thinking of the plan maker is shown in this second part of the business plan.

Estimation-Evaluation

The last part of the business plan is concerned with analyzing the resources needed to implement the business plan. It also contains forecast of the financial result which the company plans to achieve. The risk analysis part is used to consider and compare the real fact relation to the assumptions in the business plan.
It is important to note that all of the parts of the business plan are all interconnected as one leads to the other. If you take any part out of the business plan, most likely the company will not be able to achieve its set objective.

Although the business plan is divided into parts, for the business to be able to operate effectively, all interrelated parts must show some level of consistency. It is important to note at this point that the details shown in the business plan is dependent on what the business plan is designed to do and who the reader is.

Self-Assessment Exercise: 1

How can you establish a desire business of your own with the help of business plan?

5.4 The Steps in the Business Plan Process

A business plan is a process that involves certain steps as displayed in the figure below. The layout of your business plan can help greatly in keeping the reader interested. Above all, the information you give must follow a logical pattern. The information required for presentation in your material are sequentially depicted in the figure below, using headings, so that the reader can survey your plan and navigate without much difficulty.

The process commences with the market, if there is no market you will not be in business. There is a need to study the market, understand the market, customer and
then look at who else is competing with you in this market. As a result, you will then go ahead to build the marketing plan. Then, proceed to build operational and

production plan to produce for the market, build the financial plan and then conclude by writing your business plan.

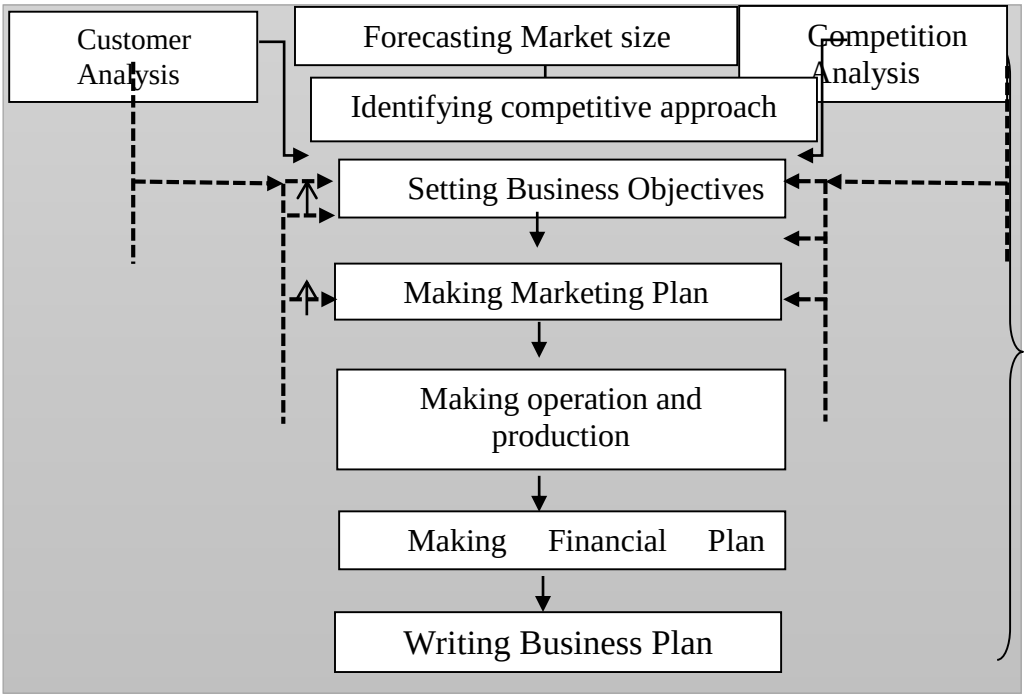

Figure 5.2: The Steps in the Business Plan Process

5.4.1 Analyzing Market and Making the Marketing Plan

A. Forecasting Market Size

In the business plan, it is very important to analyze the market and competition to necessitate competitive approach identification prior to setting the business objectives. In the same vein, market size forecast will be geared towards identifying competitive devices and setting business objectives. In other words, factors in making marketing plan are interwoven. Marketing plan process is showcased in the figure below.

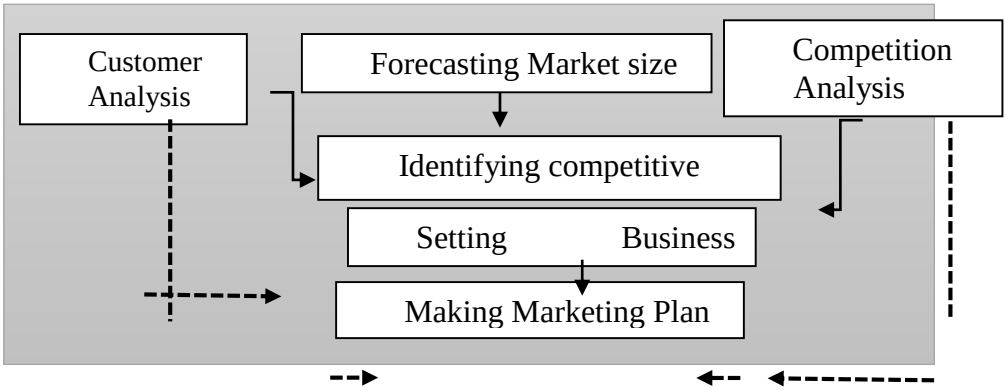

Figure 5.3: The Marketing Plan Process

Forecasting market size in the current and in the future will help to identify the potentiality of the market. This will help to decide whether to get into the market or not and to project what sales volume we will be able to achieve in this market. So phise to say that it is so possible that the goods or the product that we are thinking of bringing to the market is a mature product in that there are many people who are providing such products already. Market size forecast poses questions of:

- ✓ What is the size of the target market?
- ✓ What is the size of total market?
- ✓ What makes us different?
- ✓ Does the market still have the ability to contain this product we are bringing to the market?
- ✓ Will there be people within that market that would still be able to accommodate whatever it is that we bring in and also be able to provide the necessary patronage for our own products?
- ✓ Yes, we have a target market, what is the size of the total market?
- ✓ Can this total market be grown? Or
- ✓ Are we leaving it something that is finite and cannot be expanded?

a. Estimating market growth

For us to be able to target our sales volume. Target sales volume = Market size X Target Market share. For instance, if the total market size is one million persons, we have targeted to serve just 25% of that total market. What that means is that our sales revenue can only be based on 250,000 persons which represents a target market share of 25%. Market are built/meant to grow or shrink. The query is how do we estimate market growth?

b. Considerations for market growth

i. Growth in the past: The market growth is estimated based on historical growth. It is expressed in terms of percentages. How much percentage represents the growth in the market over the years?

ii. Influences of Environmental factors such as economy, law, technology, substitutes products, with these factors we can anticipate how the market growth will be in the future. Considering economy, if it is a consumer product, the more the disposable income within the economy the higher the probability of growth for most consumer products. Technologically, in the last few years, a number of developments in the technological terrain has changed the taste and how people want to assess market. We need to take all of that into consideration when we are estimating market growth.

B. Market Analysis

This is often referred to as customer analysis. That is, to outline characteristics of the target customers. Among such questions to provide answers to include the following:
Who are the customers?
What are their characteristics?
What are their behaviours when buying, using the products and after buying the products?
How do they approach information?

a. **Who are the customers** that we are targeting to buy our products? There are many people involved in buying process. They can be buyers or users or both. For example, when we buy soft beverages to drink, we are the buyers and the users. Sometimes the buyers could be different from users. This can be seen in a situation when we buy toys for our children, we are the buyers but children are the users. So, you need to understand who the customers are, and be able to make provisions for them and how to reach them.

b. **What are their characteristics**? We may have many types of customers. For example, a restaurant having family customers, office staff customers, VIP customers etc. Different kinds of customers need different approaches and we need to be aware of this. The characteristics include age, sex, education, occupation, psychology, and culture. We need to be mindful of all these when we are setting strategies for customers.

c. **What are their behaviors** when buying, using the products and after buying the products? It is important to know that each type of customers have their varying behaviors. Where, when and how do they buy the products? How often? How much/many do they buy at/for each time? Are they price sensitive?

Do they easily switch to other products? How do they use the products? This is extremely important because we might make the product for something else, and then the customer uses the product for something else. Examples: Use of analgesic for pain killing and recreational purposes as it has been very rampart with youth in different parts of the world today. How they discard the products?

d. How do they approach the information? What kind of information are they interested in? When and from what source do they get or rely on for their information? This would assist us in knowing how to send our information to our would-be customers. For example, anyone interested in targeting the use of or what is called the millennial customers today knows that it is fruitless putting them hard copy or traditional media rather you should approach them through social media.

C. Competition Analysis

It is important to note at this point that strategies built around competition is at its best reactive. That is why it is important for you, yes do not ignore competition but do not built your strategies around the competition. The question will be:

- ✓ Who are my competitions/competitors?
- ✓ What is the interrelation between you and your competitors?

a. Who are my competitions/competitors?

When you analyze competition, you can look at different kinds of competitors.

i. Direct competition: Somebody who does the same kind of the product and place in the same market with you. For example, UAC Restaurants and Chicken Republic.

ii. Indirect competition: It is when the customer uses their budget to do something else. This could be when customers decide to use budget for the replacement of the product. Using the funds that they have to buy your product to do something entirely different. Some indirect competitors have very deep influences. You need to

be mindful of this and take it into consideration. In order to show distinct levels we need to compare the company with its competitors to identify distinct strengths of each company.

b. Question to ask when comparing competition is what is the interrelation between you and your competitors?
The interrelation between you and your competitors can be perceived in the following ways:

i. Marketing: How do they distribute their products, pricing, and communicate?
ii. Production: Do they have better equipment than we have?
iii. Human resources: Are their people better motivated than we are?
iv. Finance: Do they have better access to finance and capital than we have?

Weaknesses or strengths can be justified by the following:

a. Whether the customer need what you consider crucial to them. That is are we able to provide value to the customers.
b. Whether we are stronger than the competitors on the aspect that we are considering known as comparative analysis. That is, do we have any comparative advantage over the competitor in any of those areas that we consider ourselves being strong.
Remember the customers should be your focus at all times but we should be aware of what the competition is doing and where we best provide value to the customer.

D. Identify Competitive Approaches

There are different places where we can provide competitive edge against the customer. They include questions in terms of

- ✓ Product: The most stable product quality and are we stable than the competitors?
- ✓ The best service
- ✓ The highest value compared to the money paid
- ✓ The safest
- ✓ The quickest
- ✓ The most advanced technology
- ✓ The most convenient
- ✓ The best design
- ✓ Impressive image: How impressive is our image.

All of these competitive approaches can be best described by the customer as they are the ones who know what represent values. Two customers

could experience services in the same environment and two different experiences as far as that same environment is concerned. For example, two ladies in the same office work in the same environment and stay in the same hotel in the same of one week from each other. One of them believed that the hotel provides the best services she had experienced in that region in a long time. The other thought that is the worst service she had ever received. You need to be mindful of all these and the kind of services you provide to your customers. For example:

- ✓ Competitive approach of the Air Peace Airline
- ✓ Offer diversified products.
- ✓ Build the company's image: Air Peace developed its corporate image as a companion of domestic and regional travelers on their way to explore domestic and regional tours and adventures.
- ✓ Competitive approach of Qatar Airline
- ✓ Offer diversified products.
- ✓ Build the company's image: Qatar Airline developed its corporate image as a companion of international travelers on their way to explore international tours and adventures.

E. Setting Business Objectives

Business objectives are to be derived from competitive approach identified. They encompass

- ✓ Sales volume (or market share)/Net earnings/Profits
- ✓ Target Sales Volume

a. Sales Volume/Customer Analysis

What does it help us to do? It helps us to set business objectives. The most important objectives of a firm are sales' volume (or market share) and net earnings which is called profit. These two objectives are not mutually exclusive. A company can work on the two objectives at the same time. However, they might prioritize them.

In order to reconcile the two objectives, we need to identify the target sales volume and the profit index which should be calculated in the financial business plan.

If the minimum profit index calculated in the financial forecast seems not achievable, we need to come back and review the whole plan. If there is no other way to increase profit, the plan should be considered unfeasible. Thus, calculating target sales' volume = target market share x target market size. All of these are estimates that help to determine the revenue and accrues to the organization.

b. Target Sales Volume

Target sales' volume is said to be target market share x target market size (estimate).

In setting target sales volume, you need to be mindful of the fact that the target market share is subjective and does not have a general formula. Although, it is based on marketing analysis, but it still remains subjective. It is important to:

- ✓ Consider the results of all analysis
- ✓ Get the agreement and commitment of the board of management
- ✓ Review the sales of each product or of distribution channel or region
- ✓ Observe practices of similar companies
- ✓ Establish targets on previous orders of customers

The way people collect and analyze information may vary from one person to the other. Be mindful of this and have the organization and individual discuss within themselves to improve on this subjective while committing everyone to those objectives. For a new investment subjective factors can play and even bigger role. The management of organizations need to try and use historical and market share to
develop the annual market plan.

F. Making Marketing Plan

Making marketing plan comprises the marketing activities to be implemented in order to achieve the set business objectives. However, this is not a marketing management module but only touches on the marketing plan on how to reach the customers that you have analyzed earlier.

a. Activities of Marketing Plan

Basically, there are 4 main activities of marketing plan. They are referred to as 4ps or panel of marketing, viz; product, price, place and promotion. At this point we are able to show that the product we can talk about the size, the packaging, the different offerings that the product has. The price, how it will be distributed, where it can be bought, sold, and how will intend to do promotions around it. They are very essential when we are building a marketing plan.

i. Product

Product can be tangible, intangible, distinctive or simple. Therefore, how will be the product? How does the product look? The marketing plan helps to achieve the business objective and communicate the competitive approach into specific activities. Imagine that you have analyzed the customer and the customer characteristics effectively. You have also embarked on a viable and effective marketing campaign, you still need to make provision for things that could go wrong. Sometimes or most times as Moses law says whatever would go wrong, would go wrong. At this point also you should take a deep look at some risks that could surface.

ii. Products and price

How will the price be set? Applying average price compared to competitors demands strategies. Price strategies that can be adopted comprises skimming and penetration. Skimming strategy can be embraced for new products. It is not easy to define the value of the product. Price elasticity is low. Penetration strategy on the other hand denotes that price elasticity is high. Mass production will reduce the price dramatically. It is easy to produce, easy to copycat and can easily be accepted.

iii. Product and Place

How will the product be distributed? Distribution network strategy expresses that consumer goods product will require wide distribution network. Specific product will demand exclusive distribution. Home appliances products will attract selective distribution network

iv. Product and Promotion

How will the communication be? Is it by using image of intelligent person in high technology? Is it stepping up advertisement and PR according to sales volume increasing? For tangible product, communication can focus on the products. For intangible product, communication be geared towards the company. For distinctive product, ccommunication can focuse on the rational side, while simple product ccommunication tend to focus on emotional side.

Example: Marketing plan for confectionery
Products: Increase from 10 to 15 types of products. Created product with soft flour ink (before only doughnut and sausage roll). There are two or three new products launched every year.

Distribution: Widely distributed in shops, restaurants, supermarkets, schools, and retail sales shops increased 3% per year.
Price: Applying average price compared to competitors.
Communication: Using image of product consumers in high technology. Increase advertisement and public relations according to sales' volume increasing.

Sometimes market condition does not go as planned, sometimes marketing activities encounter some level of obstacles. Therefore, you should consider in advance the possible events and prepare contingency plans such as shown in the figure below.

Table 5.1: Risk Analysis and Contingency Plan

Risk	Possibility	Contingency plan
Competitors reduce the price	Medium	Push up advertising activities
Customers are not interested in the products	High	Conduct market research to find out reasons and identify solutions

What events could possibly occur? What is the possibility? How the contingency plan should be? This will help to be more proactive and lead to limiting risk when events begin to unfold. Risk analysis include the forecast of what mishap could possibly occur. Something that could happen. It is like a stronger competitor that enters the market, or government suddenly change its policies. The story is being said of a company that shared its plan with government and government made a promise to impose high tariffs on importation of certain commodities. Only for when the company had made all the investment, and was about to launch into the market the government lower the tariff on the same commodity. What happened after can be a guess between you and me. We must prepare a contingency plan to state what we will do in case the risk that we forecast happens.

b. Evaluate Criteria of a Marketing Plan

i. Consistency and co-ordination to build competitive approaches: Marketing should be consistent so that it can build a competitive approach. Example, a certain shoe manufacturing company communicated in its marketing approach that he cares for the Nigerians feet. However, the company did not change its services and the customers suddenly discover that they are not cared for. That simply means that it was an empty slogan. So, there have to be consistency between what the marketing promises and company actually does.

ii. Suitability between customers' characteristics and competitive situation: There is the need to check and consistency of market coordination with the customer characteristics and competitive situations. Often times, manufacturers or producers are disconnected from their customers and this leads to distrust between the customers and the manufacturers.

iii. Possibility to achieve sales' volume: Consider the possibility of achieving the marketing plan objectives. If the objectives cannot be achieved, the marketing plan needs to be reconsidered, if it still fails in then the company has to reconsider its all objectives.

c. Estimated Cost of Marketing

The cost includes:

- ✓ Advertising: What cost of advertising using a specific medium.
- ✓ Promotion: In case we do buy one get one for free, 20% off, 50% off. All of these come as a cost and we need to consider it.
- ✓ Selling and distribution: How do we get the goods to the market? How and what are the incentives we give to the distributors in the case of us who use distributors.
- ✓ Research and development (R and D) cost needed in the cost of the business.
- ✓ Contingency plan expenses: This will not be used if there are no contingencies. Marketing are calculated as top down according to the budget identified based on average industry levels or competitor. For example, marketing expenses takes 10% of sales turnover. This depends on the level of the promotion needed to be done, and where the company is at its own life cycle.
- ✓ Specific expenses needed to be added up and we can use market price and experience to do it.

Generally speaking, the marketing plan is based on market analysis and it is subjected to determination of various persons within the management of the company. Hence,iinterrelationships exist between marketing plan and production plan. Marketing plan gives the objective, production plans produces for the marketing objectives.

5.4.2 Making the Production and Operation Plan

In a business plan after you might have set your objectives there must be a link between marketing plan and production plan. Remember that when we discuss earlier we said that marketing plan set the objectives for the business plan while the production plans fulfils the objectives that have been set. There is no point setting revenue objectives when you do not have production capacities to meet those objectives. As a result, this section covers the role of the production or operation plan in a business plan, the component of the operation plan and the process of production and operation plan making.

a. The Significance of a Production Plan

A production or operation plan describes how an organization will meet the demand for product established in the sales projections or sales objectives. A production and operation plan help to do the following:

- ✓ Examine feasibility of marketing plan.
- ✓ Propose production alternatives: To have plan B.
- ✓ Provide inputs for making financial plan.
- ✓ It helps to formalize the marketing plan from production point of view. It answers the following questions; how the product will be made? Which resources will be used? What will be cost of production?
- ✓ Predict the quantity, cost and labour.

To formalize marketing plan from production point of view helps us to examine the feasibility of the plan so that timely adjustment can be made. The production plan will examine if current capacity is able to meet sales demand? For example, in an existing organization, if the company can provide products on time for the market? To meet the sales objectives, what will be the action plan and what resources are needed?

b. Contents of a Production Plan

A production plan contains certain elements. They include:

- ✓ Description of the product and proposed production volume
- ✓ Description of production procedures.
- ✓ Plans for equipment and machinery
- ✓ Plan for raw materials and other resources
- ✓ Estimation of operation costs (cost of investment and cost of production).
- ✓ Operating competitive advantage

i. Description of the product and proposed production volume

The product is described from a production perspective, it will include the raw materials to be used, the equipment to be used that requires, the cost of production, what product to be produced, how many products of each type should be produced by the company to meet its marketing and stocking plan.

ii. Description of production procedures

How will the product be produced? That is what is the production process, the technology to be used, the set of components that will be used that is are we going to outsource or are we going to produce in house and why are we taking such decisions.

iii. Plans for equipment and machinery

It needs to be provided separately because it influences the decisions on other resources. Equipment and machineries usually require substantial investment. Therefore, this plan is very important to be able to meet our financial projections.

iv. Plan for raw materials and other resources

Looking at the demand for stocking and using raw materials, qualities and quantities required, substitutes materials in case the original that we need are not available, suppliers of raw materials, what are the terms of those supplies, what is an economic order quantity that makes it reasonable for us to keep stock, what are the risks involved in the production process and requirements of human resource such as number of employees and skills required are concerned.

v. Estimation of operation costs (cost of investment and cost of production)

How much financial investment is needed for the production process, what are the cost of production, what expenses will be run as far as production is concerned.

vi. Operating competitive advantage:

It describes product quality, price, scale of production, technology, experiences and the level of flexibility.

c. Production Planning Process

It covers the production capacity, production quantity and product structure and competitive advantage. Other stages of the process comprise production procedures, plans for raw materials and other resources, plans for equipment and machine, cost of investment and cost of production. The figure below further portrays the process.

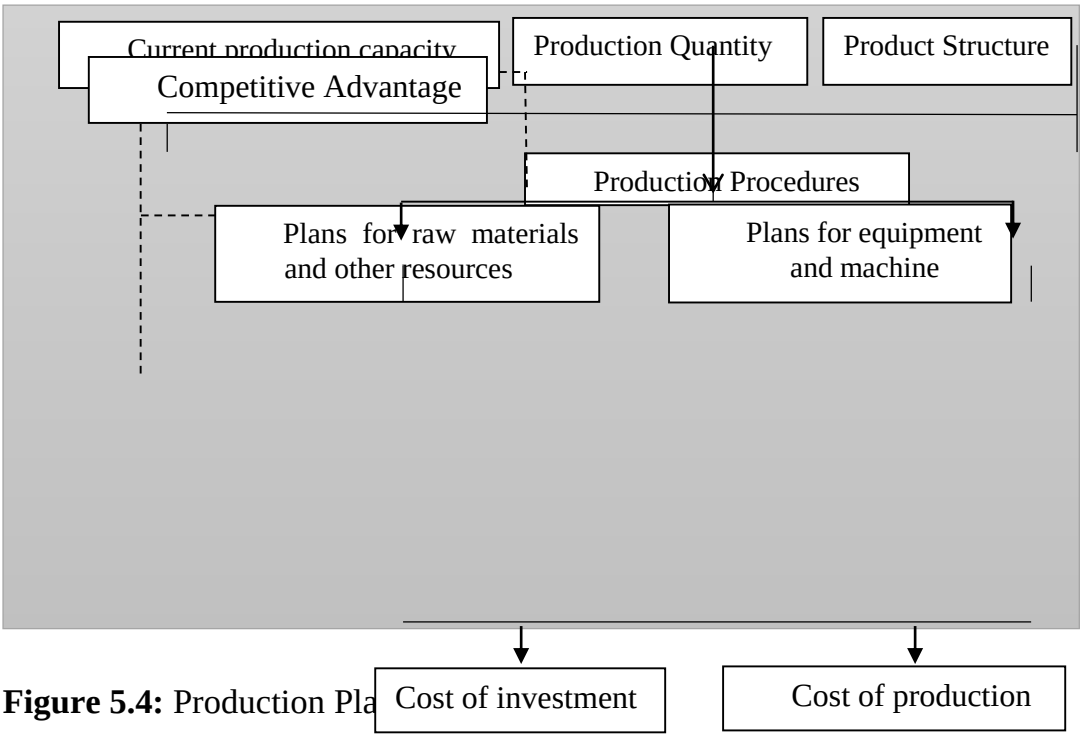

Figure 5.4: Production Pla

i. Product structure

It includes the product components, the shape, raw materials specifications, technical specifications and everything that you need to be able to bring out the product. The production process also describes everything in case you are producing several products.

ii. Production quantity

How much of each type of product you need to produce when we look at the production quantities to be sure that we have what it takes to produce what the marketing plan stipulates. How do we determine production quantity? With different target of production quantity, the decision for technology and capacity will be different and this will result in different production procedures and the demand on the equipment and machinery. Production quantity depends on: In terms of production quantity, we look at the revenue proposed in marketing plan. Hence, production quantity = Revenue + Desired stock level. Therefore, stock-holding policy refers to

how much of finished goods we want to keep in order for us to avoid stock out when we produce. For example, we have a target of producing five hundred pieces of a specific product. We agree on having a policy of holding a 20% of our production capacity in order for us to avoid been out of stock just in case for anything we cannot produce at certain times. So that we do not get our product out of the market. This policy comes with its own costs and it must be taken into account whenever we are calculating production cost.

iii. Production capacity

We must consider what the current production capacity is. What is the capacity of the equipment, how large is the factory, how many people are there to man the equipment in the factory? All of these will help to determine if the production process still have space to accommodate or more what has been spelt in terms of objectives in the marketing plan.

iv. Production Procedure

How can a production procedure be determined? Product structure, quality, current production capacity and competitive advantage will influence production procedures: For example, if we are adopting outsourcing model, it affects the amount of space that we need, within the organization. It also has a bearing on how quickly we can bring things to the market. If we are stocking raw materials or not. Typical decisions to be made when deciding on a production procedure include which process plan to be used? Produce in-house or have subcontractors produced complete product or some components? The decision should be made on **w**hich process are we using, manual or automate**?** Are we producing in-house or have subcontractors/outsourcing, producing complete products or some components?

v. Competitive Advantage

The planning process also make provision for competitive advantage that the company adapted. To show consistency with the marketing strategy, the competitive advantage needs to be very clear in the production planning process.

Basis for Decision Making for Competitive Advantage

What assists in being able to make these decisions in order for us to be able to have competitive advantages are:

- ✓ State-of-the-art technology
- ✓ Cost of production
- ✓ Quality
- ✓ Know-how

a. State of the art technology: what technology are we using, does somebody else have better technology than we do, can the person handle more volume than we can, can that person produce cheaper than we can? These helps to decide whether to produce in house or outsource.
b. Cost of production: Are we able to produce competitively, are there people who
are producing cheaper for the same quality or better
c. Quality: What is the quality of the production? Are we better at some part of the production process or is somebody else better than us in some other parts? So can we give out some parts of it and keep the ones we are better at?
d. Know-how: What kind of people do we have? What expertise do we have in house to produce?

These are the reasons for us to make decisions in order for us to be able to work best with our competitive advantage.

Plans for Raw Materials and other Resources

Demand for raw materials and other resources depend on production procedures,
competitive advantages and equipment. However, the basis for decision making on raw materials and resources include:

- ✓ Competitive advantages on product quality, production cost and technology.
- ✓ Time of delivery, terms of payment: Are they flexible with payment, rigid, or just provide value for the amount of money that we have invested?
- ✓ Cost of stock characteristics of material, cost of purchasing. Do you need to spend a lot to stock them?
- ✓ Production procedures and process plan: Does the production plan support the stock of raw material and resources that you have?

Typical decisions to be made will include what should be the quality of the raw materials needed? Who will be the suppliers? What should be level of stock? When talking raw material or inventory, the question is what mode of inventory management do you want to adapt? Is it just-in-time, economic order or hold minimum level of stock? All these depend on the policy of the organization and what you have decide to do as far as

holding on to stock is concerned. Do not forget that holding on to stock whether be it finished goods stock or raw material stock all of these come with a cost and that cost must be taken into account when these decisions are made. How many workers are needed? What are the skills and qualification requirements? They are needed in order to get the best of the equipment that you have spent a lot of money on. Do you want to buy an equipment which costs you so much and you have an untrained man to man the equipment which could be a risk to that equipment?

Plans for equipment and machine

Our production procedure is the basis to determine the demand on equipment,
machinery and the factory. Basis for decision making for machinery and equipment comprise the following:

- ✓ Capacity requirement plan: How are you going to expand, what is the plan that you have for expanding your capacity?
- ✓ Current capacity: What capacity do you have? Have you mapped out the number of the shifts that you can do on the machine that you already have?

Typical decisions on machinery and equipment cover do we buy new equipment or use existing ones or open more production shifts? This decision comes up from time to time when the demand for our product increases. Also, when the capacity that we have seems to have been maximized or we feel that we did not have enough capacity of the machine to be able to produce for the market. Which equipment should we buy if we are buying a new one? With what capacity? The question is if you have a demand, twice what you currently produce and you have a situation where there is an opportunity to buy an equipment that would make exactly twice that amount should we invest in that equipment or should we buy one that will be having bigger capacity. Thereby, making provision for expansion later. What is area, location and layout of company? Where will you site your business, location? The layout of the company in terms of the equipment one will put in there**.**

Cost of investment

Its calculation is based on the experience of the people who prepare the production plan.

The production plan provides information for us to be able to calculate investment expenses in the following areas:

Total cost of investment includes the following:

a. Land and infrastructure: Are we buying or renting. Infrastructure that is needed, electricity, water, sewage, treatment, internal roads fencing, all of them are important to be taken into account and their cost so that we will be able to estimate the investment that will require in the financial plan.

All of them will go to expected investment cost when we get to financial plan stage

b. Building and Plant: Offices and factory. What is the design? What is the cost?
c. Machinery and equipment
d. Working capital: Required level of materials, work in progress and finished goods.

All the costs of these will go into what we will make provision for in the financial plan.

Cost of production

The production planning process is to help us determine the investment and the production cost will need.

Estimation of Costs of Production

Structure of the production costs include:

Fixed Costs entails general production costs, indirect labor costs, depreciation costs on the equipment and so on.

Variable Costs: It include the raw material costs; it depends on the quantity and volume to produce directly related labor costs to the production and other production costs.

Important Note

When writing a production plan in a business plan, writers need to pay attention to the following issues. Be clear about whom the target readers of the business plan will be and their motivation. If their motivation is simply for investment evaluation, you want to be careful of the kind of information you want to put in the production plan. If the motivation is to work with you either to expand or production better, then you may need to give a little more detail than if just for an investment evaluation.

Information in a production plan should be convincing but be careful (should) not provide information or corporate secrets.

You must take care of these two issues. It is important to give only information that is required and not too much/corporate secret information.

i. If business plan is prepared to plan for company's future activities and strategies and the target readers could be the board of management. So, the production plan should present details of alternatives, analysis of each alternatives, explanations, rationale for choosing the one that we have chosen. If the target readers are outsiders, should be presented of the possibility and feasibility of the decision and how profitable the production within the company ability.

ii. If it is for the business plan that is for starting up a new business. Information on cost of equipment, raw materials and labour must be presented clearly in the production plan. These information will be the basis for financial calculations. Those companies who make plan to expand the production scale should carefully assess current production capacity and capacity of existing equipment.

5.4.3 Preparing the Financial Plan

Marketing plan and production plan make input into financial plan. Marketing plan gives both revenue and cost input. Revenue in terms of sales objective, cost input in terms of marketing cost and contingency cost. The production plan gives us the cost implication of all the production activities. Be it equipment, infrastructure, and the production cost. All of these become input into the financial plan. This section covers the following:

- ✓ Role of a financial plan
- ✓ Contents of a financial plan
- ✓ Process of preparing a financial plan

a. Roles of a financial plan

When we put investment ideas in practical figures, certain expected receipts and expenditure of the project is one of the things that show that those projects are viable. A financial feasibility performs the following functions:

- ✓ Demonstrates the financial viability of a business or a new investment or a project in terms of profitability investment return and ability to repay debt in order to get financing.

- ✓ Determines the long-term cashflow projection of a business or a new investment.
- ✓ Prove project's feasibility with a financial index in the financial projection.
- ✓ Provides a basis for evaluating and controlling the implementation.

The simplest way to control project implementation is to make a comparison of real
revenue and expense and forecasted revenue and expenses in the financial projections.

b. Contents of a Financial Plan

A financial plan ought to present the following:

- ✓ Summary of historical financials
- ✓ Summary of forecasted financial figures
- ✓ Appendices

i. Summary of historical financials

This will include the growth of turnover, profitability, profit balance for at least two years, and other attaché illustrated data. This section should not be over two pages long. It gives historically the company revenue are grown over the number of years that is in view. This section demonstrates the company past performance and its ability to support the new project to potential investor. This section is not applicable for financial projections of new ventures because new ventures means that there is no historical record. When we have written and shown the summary of historical financial record then prepare.

ii. Summary of forecasted financial figures

The forecasted financial should not be over three pages long. It explains investment item and financial requirement. It tells us what funds are required and what they are to be used for. It will present key assumptions written in the financial projections. It also shows the forecasted/estimated financial data results based on index, profitability, quick payable, long term solvency, the flexibility of the project, to the changes in the market and the financial outlook of the project.

iii. Appendices

Appendices can consist documents of detailed calculations. This is not presented as the part of the business plan. It is attached as the appendices at the back of the business plan so that we don bore our readers**.**

c. Process of Developing a Financial Plan

Financial projection is a cycle. Financial projection results are key contents of a financial plan. People usually make financial projection before writing the financial plan. Why is financial projection a cycle? The first data needed for financial projection are forecasted expenses, such as the cost of sales, what we need to start the investment cost, the sources of finances. They are put into use and generate sales revenue. Sales revenue has associated cost with it. When you mix investment and add the sales revenue to it, take away the cost it brings one to the point of results of financial projections.

If you have the result of the financial projection, it will show either the investment is profitable and some level of solvency with it. If it is, you can make a decision whether to invest or not. When you do that, go back to the beginning and that is how it becomes a cycle.

NOTE: For emphasis sake, please note that the project size will determine, the turnover, the selling cost and other expenses. Turnover and other expenses will determine the profitability and if the project is to be solvent or not, the investor will decide to or not to invest. If the profitability or solvency are at risks level you should adjust the project size high, increase turnover or reduce the expenses. If the project cannot be adjusted, then the project is not feasible.

A critical part of financial plans is assumptions. Because we are dealing with projections, assumptions are extremely critical for this process. The key assumptions when developing a financial plan include cost structure, selling and general administration expenses, credit conditions and terms, and components of working capital. Why are the assumptions needed? The financial assumptions are made for a period of three to five years. At the time of making the projections, the necessary information and data are generally not sufficient. Therefore, assumptions are needed. The assumptions are based on a historical data, experience, and the estimate.

Four Groups of Assumptions

i. Financial Structure: Percentage of raw material relating to production cost.

ii. Working capital needs and allowed number of debt dates talking in terms of how much you can be owed and how much you are allowed to owe by your suppliers.
iii. Management expenses: Everything that has to do with everything that has to do with managing the enterprise.
iv. Credit conditions including bank interest rates.

The accuracy of the assumptions will determine the accuracy of the forecast. Therefore, one need to be very careful when making assumptions because whatever you put in is what you get out of it. If you prepare your forecast with unrealistic assumptions, forecast themselves will be very unrealistic. Business characteristics influence assumptions, so there is no standard for making assumptions. It all depends on what you want to achieve, and what the conditions in the environment are at the time of that forecast?

a. Project expenses from the person managing the project or the owner of the project about the size based on opinion of sales and operations department.
b. Financial sources for the estimation of the financial department. They will be able to tell where the financing will come from and what kind of means the financing would be.
c. Turnover will be the forecast of the sales department
d. Production cost data collected by the financial department for current product or data from trial results of the operation department for new ventures.
e. Sales and management (marketing) expenses data collected by the financial department for new ventures and the expenses estimated by the sales department.

are making the assumptions. What you forecast that the condition will be in three to four years of what you are making the plan for.

Sources of Data for Financial Projections

The advocacy is that we should look at the things that we have control over. In improving financial projections, there are two possible solutions to improve feasibility of the project:

a. Solutions from Internal resources: Should consider solutions from Internal resources first: Example: We can adjust the investment scope which will reduce the amount of investment that we project. We can change the size of inventory and decide not to keep as much as we would have kept. If we are looking at an optimistic position.

Look at cost in terms of production cost, cost of managing the enterprise and see if there are things that we can bring down. So that financial projections will look better.

b. Solutions from Market conditions: Solutions from the market can provide information to make an optimistic financial forecast. But they are not easy to implement. For example, we can increase sales volume, or reduce cost of sales. If we are increasing sales we must do that in a realistic way that would then be in turn be what the market can take. Should not play with numbers. The warning is that we must not play with numbers. In order words, ensure that whatever we do in terms of increasing projections must be within realistic levels. If after adjustment, the forecasted figures results are looking back, then, it is generally not advisable to invest.

Financial Considerations

Basis for financial considerations are financing structure and investment decision.

I. Financing structure

In terms of financing structure, 2 things are very important. They are financing sources and percentage of each of the sources.

a. Financing sources

Where are we going to get the finances both to start the venture and to run the venture from. Usually sources of capital are either from the owner or shareholders and can be divided into two, namely, debt and equity. That is, either capital that is owned by the company or you get as debt from other sources. Another source is retained earnings for the businesses. Retained earnings mean that the profit that has come from the venture. We can retain cash from it and put it back in to the business. Other sources could be finance lease, loan from bank and other financial organizations, and risk investment funds.

b. What percentage of each of the sources are we talking about.

One can categorize them into debt or equity. In terms of the percentage of each source, the higher the percentage of owner's capital, the higher the risk for the lenders. Therefore, bank generally fixed a maximum lending rate of about 70% of the investment cost. Bankers usually allow the owners to have a skin in the game by pegging whatever the contribution by the owners to about 30%. If the company raises capital from the shareholders, the project owner will want to be the majority shareholder in order to take the management position. There are a lot of things that you need to look at as bases for consideration. In determining if the project will get capital from debt or equity, consider the following:

i. What we are using the capital for. We use long term sources of capital for fixed assets and especially long-term fixed assets and use short term sources for working capital. One can take a quick loan from the bank to finance working capital and to meet short-term needs. If you use capital from short term sources for long term project, the pressure form debt repayment will increase, this will not augur well for the management of the enterprise. The cost of capital in terms of interest rates and dividend payout is also the basis for consideration in determining capital for any of the sources mentioned earlier. The longer lending term, the higher the risk

ii. The cost of capital is the interest. Interest cost are usually lower than cost of share because as shareholders take greater risk, they require greater return on investment. In case the company goes bankrupt, shareholders are refunded only after all other lenders are refunded. There has been an age long debate on which is more expensive? Is it debt or equity? To further the debate, some people think that equity is cheaper than debt. However, in terms of management equity is a lot easier to manage than debt. But debt at the end of the day might actually be cheaper depending on the consideration that is been given.

iii. Payback period: It is defined as the time required to repay all of the invested funds from the money generated by the project. This is one of the most appraisal techniques when using technique. The best project is the one with the shortest pay back.

II. Investment decision

Investment decision could be should invest or should not invest. Size of investment or phases of investment. Standard Basis for decision making comprises profitability: NPV, IRR, net margin, solvency: cashflow projection. Debt coverage ratio and sensitivity to changes of the market. Considering all these, we can then put marketing plan, operations plan and financial plan into business plan. All of the different components come together to give us result because they are interrelated with one another

In summary, business planning is a cycle. Business plan is an embodiment of financial plan, operation and production plan, marketing plan, analysis of competitors and customers. Is marketing plan in line with the business objectives? Does the production department have sufficient resources to produce and achieve target sales? Has the financial department reviewed the production costs and marketing expenses?

5.4.4 Writing the Business Plan

In terms of contents, this section will expose you to knowing the key factors to consider as well as the steps involved in writing a business plan.

Considerations when Writing a Business Plan

Four possibilities or considerations when writing a business plan are derived from what we are writing and whom we are writing for. This gives rise t four (4) types of business plan.

Company's situation **Objectives of BP writing**	**Starting business**	**Expanding investment**
Raising capital, applying for license **Reader: outsider**	1	3
Management **Reader: insider**	2	4

Table 5.2: Who to Write for? What to Write?

1. Starting business and raising capital
2. Starting business and management
3. Expanding investment and raising capital
4. Expanding investment and management

1. **Starting business and raising capital:**

The consideration for this we must identify and evaluate the difficulties which may occur when establishing new venture. We must conduct a detailed analysis of the business activities. Highlight the distinctive strengths, weaknesses and challenges that may occur in order to develop solutions.

What to write

- ✓ Highlight feasibility of a new venture: We will need to highlight the feasibility of the venture showing.
- ✓ Total additional capital and capital needs for every stage of the venture: Highlight assumptions and key variables that may affect the big scenario.
- ✓ Investment return.

Who to write:

- ✓ Bank.
- ✓ Potential investors.
- ✓ Summary nature of the business ideas under a logical structure allowing bank and potential investors to evaluate the feasibility of the venture.
- ✓ When writing a new business plan for potential investors or banks you must be ready to show the investment returns and show the full capital requirement for the project.

2. **Starting business and management**

The content is the same as type 1 but however, there is no need to convincing the reader about its success because it is something that is already known to all of them. Writers need to concentrate on information, specific solutions on the activities of the company.

Who to write:

- ✓ Founders
- ✓ for in house people, management, colleagues and the owners of the business

What to write:

- ✓ Objectives, business strategy and tactics
- ✓ Detail technology and production process description
- ✓ Necessary resources and timeline
- ✓ Sensibility analysis, scenario analysis and risk evaluation of the best case, worst case and the realistic case when considering the financial aspect of the venture

3. Expand and investment and raise capital

Who to write:

- ✓ Banks, shareholders, potential investors
- ✓ This should present clear turnover, current earnings, receivables and while the company needs extra supports

What to write

- ✓ The feasibility of the new venture
- ✓ Total additional capital requirements for every stage of the venture. To identify all the factors that the company needs to succeed.
- ✓ Risk analysis, risk prevention solutions: Identify the level of risks and the level of the tolerance of the company

4. Expand investment and management

The content is the same as 3 but be specific and concentrate on the main issues like current difficult situation of the company and the solutions to them. The plan should help the manager to know the difficulties they will meet and make right and on time decisions in implementing the process.

Who to write for

- ✓ Board of management
- ✓ Managers
- ✓

What to write

- ✓ Very detailed technology, selective production process and marketing strategy.
- ✓ Brief introduction of the company, owners and management
- ✓ The content of the plan is determined by the audience

5.4.5 Steps in Business Plan Writing

The figure below showcases the steps involved in writing a good business plan.

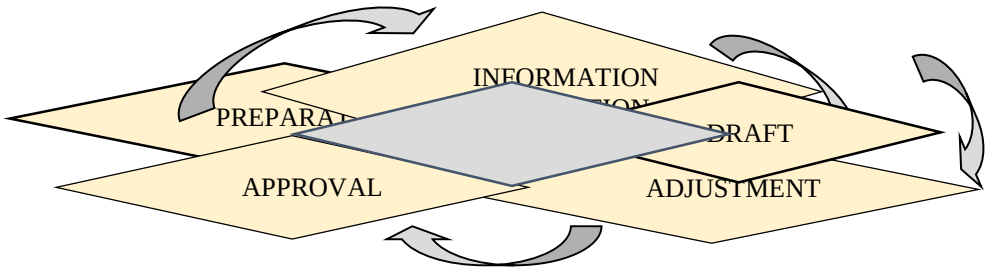

Figure 5.5: Steps in Writing the Business Plan

1. Preparation: It includes stating of needs, shaping the ideas, determining your objectives, action plans for necessary resources. This is the point you prepare all of that and start to shape the ideas around the venture that you are going into.
2. Information collection: At this point make a note of the information requirement and the way to collect every type of information. Determining the level of accuracy, you required as this will have a strong influence on the amount of time that is necessary and the cost and the way to collect the information.
3. Draft: It includes information collection analysis, building strategies and action plan, forecast and collection of the resource requirement as well as risk analysis. At this point you put your draft together on the way the business plan will eventually look. Suggested outlines are highlighted below.

a. (Executive summary}: It should give full view in not more than two pages of what the business plan is about, the venture, the market and the expected results of the what the business you intend to do.
b. Overview
c. Introduction of the company, the owner, and the board of management (the governance structure)
d. Products/services description
e. Market Analysis
f. Marketing plan
g. Financial plan
h. Appendix

Should business plan be written in house or hiring consultant (outsource)?

The generally accepted mode is to have a combination of both because the business plan owner understands the business or the venture, he wants to go into much better than the consultant would. However, the business plan owner might not have the prerequisite knowledge and the ability to write a professional business plan. So, he needs a consultant to do that.

	In-House	**Hiring Consultants**
Advantages	Internal knowledge of the initiative Flexible with time Ease of collecting information collection	Professionalism Objectivity Effective
Disadvantages	Lack professional business plan knowledge Lack of experience in writing business plans Subjectivity	Expensive Time costly Low guarantee of results

Table 5.3: Merits and Demerits of Business Plan Writing

We will look at this even though is much more expensive to hire a consultant but with the business plan owner doing some level of work it is easier for the process to be managed and might at the end of the day be cheaper to hire a consultant just to help in finalizing the plan and making it more professional.

4. Adjustment: Your draft is presented to either the board or consultant to get their contributions. This contribution should be considered carefully in order to make any necessary adjustment. This process will be repeated as needed so that the business plan will have the required accuracy.

5. Approval: The writer will conclude the plan and submit it to the company management for approval. The business writing process is completed when management accepts its quality and agrees with.

5.4.6 Important Notes on Business Plan Writing

1. Clearly identify the purpose of the plan and who the readers are. It will help to tailor the way or the content of the plan in order for it to be acceptable to the reader is meant for.
2. Writing what comes easily first then what is more difficult: Tasks are more difficult at the earlier stage from shaping of ideas, to data collection, to write the business plan but writing should begin at the easy steps like company description, products and services. If you meet difficult issues and cannot solve them immediately you can make assumptions or postpone writing them and come back to them when things are a lot clear.
3. Having a clear flow of ideas: Arranging the content logically allows clear understanding of the plan. Write clearly and shortly. Make references, having detailed and accurate index, list of tables, pictures, where necessary but do not make the business plan a junk yard
4. Being logical and objective: It must be objective and accurate regarding the company weaknesses and should show how the company will deal with these weaknesses.
5. Using simple language and style of presentation: The writing style and structure must be clear and logical. Avoid writing long sentences using difficult terms. The plan must be printed on a good quality paper. It should be twenty to thirty pages long. This is not including the appendices. Every other detail could be put in the appendices but the size of business plan must not be more than 30 pages.

“No one plans to fail they fail because of having no plan.” It is important for every tourism business to develop a business plan in order to have a road map to run the businesses.

5.4.7 Pitching Your Business Plan

Every day of our lives we make presentations. Sometimes we are not even aware we are making a presentation. As tourism entrepreneurs, we are compelled to make presentations to our stakeholders. Therefore, it makes sense to understand how to make better presentations in order to meet our desired tourism objectives and goals. To win an investor, you need to tell your story. There are four identified ways of telling your story:

- ✓ Financials
- ✓ Presentation
- ✓ Executive Summary
- ✓ Elevator Pitch

An elevator pitch is a brief, persuasive speech that you use to spark interest in what your organization does. You can also use them to create interest in a project, idea, or product – or in yourself. A good elevator pitch should last no longer than a short elevator ride of 20 to 30 seconds, hence the name.

The Pitch should be interesting, memorable, and succinct. They also need to explain what makes you – or your organization, product, or idea – unique. Use it when you run into a potential customer or investor at an event – tradeshow, conference or social events. The elevator pitch consists of three parts, namely:

- ✓ **The Benefit:** That's the reason the customer might want what you're selling.
- ✓ **The Differentiator:** That's the reason the customer might want to buy from you.
- ✓ **The Ask**: That's where you ask for meeting the customer, if the customer shows interest.

For effective presentation, think through these three stages

- ✓ Before
- ✓ During
- ✓ After

i. Before

Know your Audience. Why should they listen to you How credible is your message and Why are you the one delivering it What is the benefit to them? How can you organize your presentation to ensure that you catch and sustain their attention. Your message must be clear and concise. It should not be more than two or three core messages. Try to reinforce, refocus where possible. Do your research and know the reference. Present facts in simple (possibly visual) formats.

Getting Started by preparing yourself, not just your idea. Investors first invest in the entrepreneur before the business. Capture the essentials by explaining the project, return on investment and growth strategy. Have a compelling story. Take care of your due diligence upfront. Do your investor research. Have a plan for the investor from day one. What is the exit strategy? Prepare your negotiation for a term sheet offer. Inexperience can be costly. Understand the language of business – you should be able to converse intelligently with your investors. As you

prepare for the Presentation, prepare your slides and ensure logical flow. Make sure you can present without reading your slides. Time yourself and do not dwell on one slide. Test the gadgets and be comfortable with them Have a Plan B in case anything happens.

Prepare your product or service by having a demo/prototype or sample of your product or service. Prepare your business plan and financials, go with hard and soft copies. Condense business plan to PowerPoint of about 20 slides. Have an executive summary of two page. Prepare a two-page executive summary. Be prepared for tough questions because **y**ou definitely do or might not need all this money you are requesting for. Specify how much you have put into the business. Justify your pay in the business plan. Test the market before pitching to investors. Specify how much revenue the business has earn. Present realistic revenue figures. Start with a product before diversifying Presentations take time to perfect so make sure you practice before hand. Arrive on time and familiarize yourself with the gadgets, room and possibly the audience. If you are using cue cards or paper for a speech make sure you have put them in the right order. Avoid mix-up! Dress appropriately for the occasion.

ii. During

First Impression Matter. The first 30 seconds are the most important seconds of your presentation. You must grab the attention of the audience. Here are some tips! Keep a professional appearance. Get attention, within the first 30 seconds you either win them or lose them! Your audience first question will be what's in the presentation for me. Therefore, have a strong opening. The introduction or opening should indicate the area that you would like to address. During opening matters, ask a thought-provoking question. Make an interesting statement. Give an inspiring quotation or a joke that is relevant to the subject being addressed. In the body of the presentation, know the message(s) you are trying to deliver. Then, refocus using knowledge and context, constantly refocus your audience on key message(s). And finally, signposting- when the presentation is over, what should the audience do or take away?

Be Interactive as much as possible by engaging the audience as much as possible beyond Knowledge of subject matter. Body Language is just as important - how you carry yourself, the tone of your voice, brief silence can draw attention just before making an important point. Body language matter. Use numbers to speak more. As you conclude, reinforce message and call to action. You can take advantage of opportunities in online mails, logistics, online financial institutions, create payment platforms, audio-visual content production, growth of digital marketing and cyber security.

iii. **After**

Immediately after the presentation, try as much as possible, to get feedback use it to appraise yourself, use it to improve your next presentation and show a video for presentation skills.

5.5 Summary

We have seen in our discussion of basic concept of business plan that your plan is but one of many that is received. So, you must win financial provider/ bank an approval and keep his or her interest. To do this, you need to be clear; brief, logical, truthful and back up words with figures wherever possible and also know the simple cash flow forecast. Thus, this chapter taught us how to write a business plan and run a business; as well as maintain a business plan.

In the course of this unit, we were able to discuss how to plan, write and design a business. Also, the chapter discussed the market and use of funds and other sections and aspects of a business plan.

Self-Assessment Exercise: 2

Design a tourism business or company of your choice, choose a product or service and make a pitch to your prospective investors/board of directors.

5.6 References/Further Readings

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5.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

The steps to observe include:

1. Preparation
2. Information collection
3. Draft
   a. Executive summary
   b. Overview
   c. Introduction of the company, the owner, and the board of management
   d. Products/services description
   e. Market Analysis
   f. Marketing plan
   g. Financial plan
   h. Appendix
4. Adjustment
5. Approval

Self-Assessment Exercise: 2

For effective business plan and pitching presentation**, POEMS** assist to discover the following:

P - Product features, benefits and price.
O - Organization, structure, people, competitive edge.
E - Economics, pricing, viability and returns.
M - Milestones, where you are now, going and future.
S - Sales, prospects, distribution and naira value.

MODULE 2

Unit 1 Tourism Business Simple Cash Flow Forecast

1.1 Introduction

This is because they believe it will give them at least some ideas on return on investment. That is, as to whether and when they are likely to get their money back.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- ✓ Know significance of cash flow forecast
- ✓ Identify and Understand Simple Cash Flow Principles
- ✓ Apply the principles of cash flow when developing a cash flow statement in a business plan

1.3 Cash Flow Forecast

What is a cash flow forecast? A cash flow forecast expresses the sums tourism business expects to receive by way of sales, business start-up allowance, etc. It compares this inflow of money with the payments that will be made for stock, materials, overheads, equipment, and the money you to take out of the business for living expenses usually in monthly columns.

It is not a forecast of probability of business, but merely a guess as to whether, in the short term, more cash will come in than go out. That is not

necessarily the same as profitability. On the one hand, although your profit margins might not be adequate to cover overheads and write off the cost of equipment, your cash flow could be good enough to pay the bank back its money while you were losing yours. On the other hand, there are profitable businesses. That is, their net assets are growing nicely) that are called 'cash hungry'. They may be making fine profits, but all the cash they take in, and more, is needed to increase stock or give credit to an ever-larger number of customers. So, the bank will call a halt, and they may have to close their business, despite its underlying profitability.

1.3.1 Significance of Cash Flow Forecast

A cash flow forecast that is badly drawn up is clearly of little use. It serves merely as a snare and delusion. Unfortunately, the tourism project figures in your forecast will depend on the reliability of your crystal ball in foretelling your sales figures. You may improve the accuracy of those figures by conscientious market research or by peering into an uncertain future.

However, if the sales figures appear reasonable and conservative, and if the cash flow forecast has been well and logically drawn up, the bank or investors will be able to 'take a view' as to whether it can lend the money (and get it back again without having to sell up your house and furniture- a step even the toughest bank manager is reluctant to take). To persuade the bank or building society to lend you the money you need is, of course, the primary purpose of a cash flow forecast. It has, however, some other very important uses.

Actually, producing a well-thought-out forecast fulfils the same function as writing a well-prepared business plan. It will sharpen up your ideas. It will make you aware of the effect on your bank balance of the decisions you take in your planning, e.g. of the amounts to be spent on advertising, your terms of sale (very important for cash flow), whether or not to buy your own transport, etc. Giving thought to your cash flow is a very worthwhile exercise. Try drawing up several forecasts, each based on rather different assumptions of sales and expenditure.

The few hours you spend could prove the most profitable of your life! Even the smallest business is more likely to do well if its owner keeps a close eye on its financial progress, comparing what is hoped and planned for with what is actually happening. In business jargon this is called 'budgetary control'. In your cash flow forecast you will have an invaluable little tool when you come to set up your own small-scale budgetary control. Therefore, do not tear it up once the bank has seen it. Most of the banks appreciate the value of their cash flow sheets as budgetary control documents and provide adjoining columns for

'forecast' and actual'. If, every month and immediately after the month-end, you fill in all the figures in the 'actual' column, you will get a quick indication of anything that is going wrong, together with strong hints as to target any remedial action.

Self-Assessment Exercise: 1

What do you understand by tourism business cash flow?

1.3.2 Simple Cash Flow Form Filling Principles

- ✓ Enter the more certain figures first.
- ✓ Make every entry in the month in which cash and cheques are handed over.
- ✓ All entries must be inclusive of VAT where applicable.
- ✓ Start by entering those payments of which you are certain (or almost certain): The rent- in the actual months when it must be paid - The rates- for each month when they must be paid
- ✓ HP payments on any vehicles or machinery
- ✓ Loan repayments on any fixed-term loan you have agreed or hope to agree
- ✓ Wages of any regular employees
- ✓ The sums you will have to draw from the business to live on
- ✓ Any other payments you expect to have to make if you know the amounts
- ✓ Now also enter the sure regular receipts, such as:

Business Start-up Allowance payments - Rents from any sub-let.

The next items are more difficult. They are overhead payments, the amounts of
which are not yet certain because the invoices have not been received. These will include:

- ✓ Gas and electricity bills
- ✓ Telephone bills
- ✓ Advertising and publicity costs
- ✓ Petrol and other motor expenses
- ✓ Stationery and printing
- ✓ Postage and packaging
- ✓ Insurances
- ✓ Repairs and renewals
- ✓ Contingencies depending on the nature of the business

These items cannot be predicted with any great accuracy but, if you have done your homework, you should be able to make reasonable estimates. Enter them, of course, for the months when you will have to pay them. 'Repairs and renewals' are a special case. They are by their very nature

uncertain, both as to amount and timing. Make a good guess as to the yearly cost and divide this into four quarterly payments.

The next thing to do is to enter the initial receipts and payments- those once-and-for-all transactions that get you started. The receipts could include:

- ✓ Fixed loans from the bank
- ✓ Loans from family or friends
- ✓ Money of your own which you pay into the business account after the date of start-up
- ✓ Grants

The payment could include:

- ✓ Capital payment for the lease
- ✓ Machinery and equipment
- ✓ Initial license fees
- ✓ Legal fees
- ✓ Installation costs
- ✓ Office equipment
- ✓ Starting cost
- ✓ Advertising to launch the product

Remember that the cash flow forecast is deemed to start on a specific day- usually the first of the month. Any payments made or moneys received before that date must be ignored. You are writing a cash flow, not a profit and loss account.

Many of these initial costs will be paid in the first month and should be entered in the appropriate spaces for that month. However, you may get extended credit for, say, 30 days or six weeks for some items. Enter them for the months in which they will actually be paid.

Most of your figures will have been entered now. But you will have the difficult part to do. You must tackle the sales side. This is a matter of putting hard figures to the faith you have in your product. You know in your plan that the product or service will sell. But how well? And how soon will the money start to come in? You will have some market research even if, as a potential window cleaner, you have done nothing more than call on the neighbors to find out how many will pay to have their windows cleaned. Use all the information you have gleaned about your market. Link this with the amount of time you will be able to devote to selling, and you should be able to make some sort of educated guess at the turnover you can expect once you have got going properly.

Self-Assessment Exercise: 2

Itemize five of the principles guiding the application of cash flow forecast.

1.4 Summary

In the course of this study we have been able to discuss the meaning of cash flow forecast and its various uses as well the principle to adopt while applying cash flow forecast. A tourism business cash flow forecast is probably as complicated a production as can be expected from someone lacking professional training. It will just about do when a loan of up to a certain amount is required. But if tens of thousands of the amount are required, then a more sophisticated document will have to be prepared, preferably a full tourism business model together with forecast profit and loss accounts and balance sheets. This is a task that should be put into the hand of professionally qualified accountants.

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1.6 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

A tourism business cash flow expresses the sums tourism business experts receive by way of sales, business start-up allowance, etc. It compares this inflow of money with the payments made for stock, materials, overheads, equipment, and the money taken out of the business for living expenses usually in monthly columns.

Self-Assessment Exercise: 2

The principles include:

- ✓ Entering the more certain figures first.
- ✓ Making every entry in the month in which cash and cheques are handed over.
- ✓ All entries must be inclusive of VAT where applicable.
- ✓ Starting by entering those payments of which you are certain (or almost certain): The rent- in the actual months when it must be paid - The rates- for each month when they must be paid
- ✓ Hire purchase payments on any vehicles or machinery
- ✓ Loan repayments on any fixed-term loan you have agreed or hope to agree
- ✓ Wages of any regular employees
- ✓ The sums you will have to draw from the business to live on
- ✓ Any other payments you expect to have to make if you know the amounts
- ✓ Entering the sure regular receipts, such as:
  business start-up allowance payments - rents from any sub-let.
- ✓ Grants

The payment could cover:

- ✓ Capital payment for the lease
- ✓ Machinery and equipment
- ✓ Initial license fees
- ✓ Legal fees
- ✓ Installation costs
- ✓ Office equipment
- ✓ Starting cost
- ✓ Advertising to launch the product

Unit 2 Tourism Project Cycle Management and Application

2.1 Introduction

The World Bank defines project as "a proposal for capital investment to develop facilities to provide goods and services". It is a technically coherent production undertaking which can be carried out independently of other projects by a private or public agency. It is the smallest unit of investment activity for producing goods and services. The United Nations (1958) on its part defines a project as 'the compilation of data which will enable an appraisal to be made of the economic advantages and disadvantages attendant upon the allocation of a country's resources to the production of specific goods and services".

Projects may be conceived and prepared for all types of activities contained in the International Standard Industrial Classification, and may vary from a simple car-wash undertaking or an arable-crop farm to produce maize or beans, through a more complex manufacturing outfit such as aluminum cooking pots, to a more generalized investment involving many facilities and activities such as the automobile, the Kainji dam, the iron and steel complex, the petroleum refinery, and the construction of the railways. A project may be an investment to build something entirely new for example the BRT road constructing by Lagos State Government or for the expansion, improvement, rehabilitation, replacement or modernization of an existing facility.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- ✓ Describe process of project cycle management, and application of project management by World Bank.

2.3 Project Cycle

A project may be distinguished from a program. A program is defined by Odufalu (2000), as a coordinated set of projects within the same country, state, local government areas or city. For example, a rice project may require for its success, access road and transportation facilities for the evacuation of the products, and water supply for parboiling rice to prevent the germination of the harvested rice. Both the road and transportation facilities, the water supply and the rice project may be regarded as a program if they have to be simultaneously implemented to ensure the success of the rice project.

The World Bank, according to Odufalu (2000), regards project study as a continuous and self-sustaining cycle of activity which runs through four principal stages viz.: the identification of the project, its preparation, its appraisal, and supervision of the project in its construction and operating stages to make sure that it achieves its objectives.

2.3.1 Project Cycle Management

The process of planning and managing projects can be drawn as a cycle. Each phase of the project leads to the next.

Identification

To identify what a project will focus on, we need to find out who should benefit and what their needs are. A 'needs assessment' will give an overview of community problems. A 'capacity assessment' will help identify which problem the project should address.

The manner in which the process of project identification proceeds depends on the findings of the preliminary review of the situation and identification of relevant stakeholders. For example, if the constraints exist principally at the macro level, the problem may best be tackled through stakeholders operating at the national level. Stakeholders network vertically as well as horizontally. Thus, intermediate level stakeholders can assist with addressing constraints at the community level as well as provide linkages from the field to the policy environment.

Design

Once it is decided to go ahead with the project, we can start to think about the detail. This involves carrying out further research into the people affected by a problem and how they are affected by it. We also need to consider the risks to the project and how we will measure the project's performance.

Implementation

During the implementation of the project it is important to monitor and review the progress of the project and any outside changes th;/at affect it. The project plans should be adjusted where necessary.

Evaluation

Evaluation should be carried out at or after project completion. Evaluation could be carried out a few months or years after the project has finished in order to assess its long-term impact and sustainability.

Lesson Learning

While the project cycle is a useful way of outlining the stages of a project, it has one drawback: it makes it look as though one tool follows another. In fact, many of the planning tools can be used at any stage of the project. They should be repeated throughout the project's life to ensure that any changes that might affect project success are accounted for. Findings should also be used for organizational learning and to improve other projects.

Self-Assessment Exercise 1:

Enumerate the process of planning and managing projects.

2.3.2 Application of Project Cycle by World Bank

Each year the World Bank lends between US$15-$20 billion for projects in the more than 100 countries it works with. Projects range across the economic and social spectrum in these countries from infrastructure, to education, to health, to government financial management. The projects the bank finances are conceived and supervised according to a well-documented project cycle. Documents produced as part of the project cycle can be valuable sources of information for interested stakeholders wanting to keep abreast of the work the bank is financing and for businesses wishing to participate in bank-financed projects. Below is a step-by-step guide to the project cycle, the documents that are produced as part of the process, and how to access them.

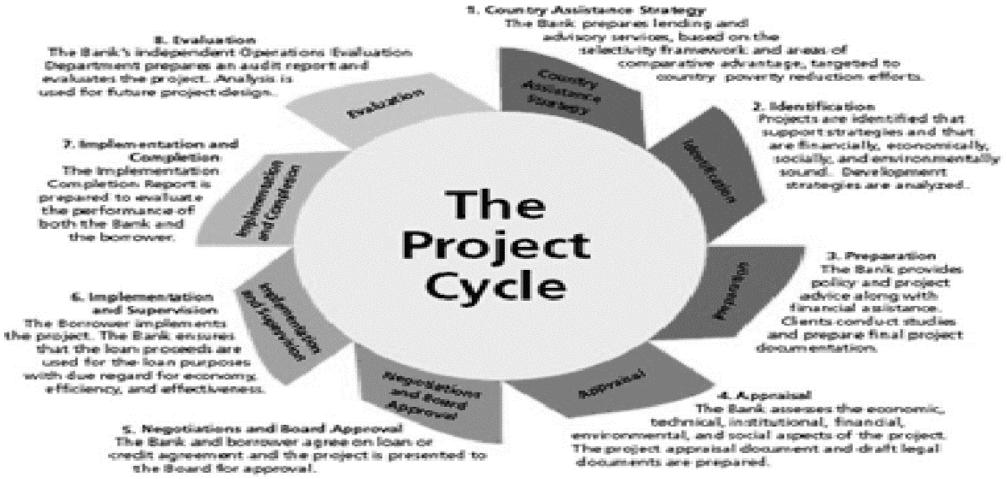

Figure 3.1: ***The Process Begins: Poverty Reduction and Country Assistance Strategies***

The bank recognizes that many past assistance efforts, including some of its own, failed because the agenda was driven by donors rather than by the governments it was trying to assist. Under its current development policy, the bank helps governments take the lead in preparing and implementing development strategies in the belief that programs that are owned by the country, with widespread stakeholder support, have a greater chance of success.

In low-income countries, the bank uses the Poverty Reduction Strategy (PRS) approach which involves widespread consultation and consensus building on how to boost development. Under this process, a national poverty reduction strategy is prepared by the country, creating a framework for donors to better co-ordinate and align their programs behind national priorities. The government consults a wide cross-section of local groups and combines this with an extensive analysis of poverty in the country's society and its economic situation. The government determines its own priorities from this process and produces targets for reducing poverty over a three to five-year period. These are outlined in a Poverty Reduction Strategy Paper (PRSP). The bank and other aid agencies then align their assistance efforts with the country's own strategy - a proven way of improving development effectiveness.

The bank's blueprint for its work with a country is based on a Country Assistance Strategy (CAS) which, in the case of low-income countries, is derived from the priorities contained in the country's Poverty Reduction Strategy Paper. The CAS is produced in co-operation with the government and interested stakeholders. The preparation of the CAS may draw on analytical work conducted by the bank or other parties on a wide range of economic and social sectors, such as health, education, agriculture, public expenditure and budgeting, fiscal management, or procurement, among others.

The Identification Phase

The bank's Country Assistance Strategy (CAS) forms the blueprint for its assistance to a country. In low-income countries, the CAS is based on the priorities identified in the country's Poverty Reduction Strategy Paper (as outlined above). The goals outlined in the CAS guide the priorities of the bank's lending program and are a useful source of information for interested stakeholders and businesses wishing to identify potential future areas of bank lending. During the identification phase, bank teams work with the government to identify projects which can be funded as part of the agreed development objectives. Once a project has been identified, the bank team creates a Project Concept Note (PCN) which is an internal document of four to five pages that outlines the basic elements of the project, its proposed objective, likely risks, alternative scenarios to conducting the project, and a likely timetable for the project approval process.

Useful Public Documents

The *Project Information Document* (PID) is prepared after an internal review of the PCN and is released publicly through the bank's Info Shop. It is usually four to five pages long and contains the information mentioned above - the objective, a brief description, etc. It also contains the name of the World Bank Task Manager or Team Leader who is supervising the project, a useful contact for companies interested in bidding for work on the project. The PID is an essential resource for tailoring bidding documents to the project concerned.

The *Integrated Safeguards Data Sheet* (ISDS) is also prepared for the first time after the project's first formal review and made available publicly. It identifies key issues under the World Bank's safeguard policies for environmental and social issues, and provides information about how they will be addressed during project preparation.

The Preparation Phase

This part of the process is driven by the country that the bank is working with and can take anything from a few months to three years, depending on the complexity of the project being proposed. The bank plays a supporting role, offering analysis and advice where requested. During this period, the technical, institutional, economic, environmental and financial issues facing the project will be studied and addressed - including whether there are alternative methods for achieving the same objectives. An assessment is required of projects proposed for bank financing to help ensure that they are environmentally sound and sustainable (Environmental Assessment). The scope of the Environmental

Assessment depends on the scope, scale and potential impact of the project.

Useful public documents

An *Environmental Assessment Report* (EAR) analyzes the likely environmental impact of a planned project and steps to mitigate possible harm.

An *Indigenous Peoples Development Plan* identifies potentially adverse effects on the health, productive resources, economies, and cultures of indigenous peoples.

The *Environmental Action Plan* - describes the major environmental concerns of a country, identifies the main causes of problems, and formulates policies and concrete actions to deal with the problems.

The Appraisal Phase

The bank is responsible for this part of the process. Bank staff review the work done during identification and preparation, often spending three to four weeks in the client country. They prepare for bank management either Project Appraisal Documents (investment projects) or Program Documents (for adjustment operations) and the Financial Management team assesses the financial aspects of the project. The PID is updated during this phase. These documents are released to the public after the project is approved (see below).

The Negotiation and Approval Phase

After bank staff members have appraised the proposed project, the bank and the country that is seeking to borrow the funds, negotiate on its final shape. Both sides come to an agreement on the terms and conditions of the loan. Then the Project Appraisal Document (PAD) or the Program Document (PGD), along with the Memorandum of the President and legal documents are submitted to the Bank's Board of Executive Directors for approval. The appropriate documents are also submitted for final clearance by the borrowing government which may involve ratification by a council of ministers or a country's legislature. Following approval by both parties, the loan agreement is formally signed by their representatives. Once this has occurred, the loan or credit is declared effective, or ready for disbursement, after the relevant conditions are met, and the agreement is made available to the public.

Useful Public Documents

The *Project Appraisal Document* (PAD) presents all the information the Board needs to approve bank financing of the proposal. Before 1999, this document was called the Staff Appraisal Report. The *Program Document*

(PGD) describes adjustment lending operations, and sets out the bank's appraisal and assessment of the feasibility and justification for the program.

The *Technical Annex* supplements a Memorandum and Recommendation of the President for freestanding technical assistance loans, which do not require Project Appraisal Documents.

The Implementation and Supervision Phase

The implementation of the project is the responsibility of the borrowing country, while the bank is responsible for supervision. Once the loan is approved, the borrowing government, with technical assistance from the bank, prepares the specifications and evaluates bids for the procurement of goods and services for the project. The bank reviews this activity to ensure that its procurement guidelines have been followed. If they have, the funds will be disbursed. The Bank's Financial Management Team maintains an oversight of the financial management of the project including periodically requiring audited financial statements.

Useful Public Document

Report on the Status of Projects in Execution provides a very brief summary of all projects that were active during the previous fiscal year. Previously an internal communication to the Board of Executive Directors, the SOPE Report now is available to the public. Projects that closed during the fiscal year are no longer included in the SOPE, since their Implementation Completion Reports are also publicly disclosed.

The Implementation Completion Report

At the end of the loan disbursement period (anywhere from 1-10 years), a completion report identifying accomplishments, problems, and lessons learned is submitted to the Bank Board of Executive Directors for information purposes.

Useful Public Document

Implementation Completion Reports review the results and assess an operation on completion of each loan financed by the bank. Operational staff prepare these self-evaluations for every completed project.

The Evaluation Phase

Following the completion of a project, the Bank's Operations Evaluation Department conducts an audit to measure its outcome against the original objectives. The audit entails a review of the project completion report and preparation of a separate report. Both reports are then submitted to the executive directors and the borrower. They are not released to the public.

Useful Public Documents

Project Performance Assessment Reports rate project outcomes (taking into account relevance, efficacy, and efficiency), sustainability of results, and the institutional development impact. One in four completed projects (or about 70 a year) is chosen for a Project Performance Assessment Report, which takes Operations and Evaluation Department staff about six weeks to produce and normally includes a visit to the project in the borrowing country.

Impact Evaluation Reports assess the economic worth of projects and the long-term effects on people and the environment. These "second looks" at projects are performed five to eight years after the close of loan disbursements.

Inspection Panel Reports review claims by affected parties that the bank failed to follow its operational policies and procedures with respect to the design, appraisal and/or implementation of a bank-financed operation.
Projects may be dropped at any point in the project cycle from preparation to approval. For these projects, which never achieve active status, Project Information Documents, described above, are effectively the final documents.

Self-Assessment Exercise: 2

How would you apply the process of project cycle with a particular tourism project?

2.4 Summary

In the course of our study in this unit we were able to examine the process of project management cycle. The project cycle process discussed the project identification, design, implementation, and evaluation. While the application of the project cycle by World Bank followed the same processes. Therefore, it is very important to use the foregoing mentioned sequence of events in designing project cycle for both private and public projects.

In summary, project cycle entailed those sequence of events needed to follow in order to complete a project. It usually involves the project identification where people needs and capacity assessments are conducted, project design, which involves carrying out further research into the people affected by a problem and how they are affected by it. During the implementation of the project it is important to monitor and review the progress of the project and any outside changes that affect it.

2.5 References/Further Readings/Web Sources

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World Bank (1999). World bank project cycle. https://www.worldbank.org/en/projects- operations/products-and-services/brief/projectcycle

2.6 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

Identification
Design
Implementation
Evaluation
Lesson Learning

Self-Assessment Exercise: 2

The Identification Phase
The Preparation Phase
The Appraisal Phase
The Negotiation and Approval Phase
The Implementation and Supervision Phase
The Implementation Completion Report
The Evaluation Phase
Note: It is critical to observe useful public documents after each phase.

Unit 3 Project Planning and Control

Unit structure

3.1 Introduction

Engineers and engineering teams vary greatly in how they carry out their projects, in the university and in business. Their performance varies from smooth easy productivity, to complete chaos, ending in failure. Variations are expected, because of the inherent differences in the difficulties in the projects. This alone is not sufficient to explain all the differences in performance. On close examination, the variation can usually be attributed to the lack of proper planning and control. High performing engineers and engineering teams always have their project under control. When faced with an impossible task they find out quickly, face it, and reorient themselves. They overcome the difficulty and then get on with the next problem. The basic elements of any project are the same. Unfortunately, most projects do not permit the use of infinite time or money. Usually the time and/or money are established at the start. They represent a constraint of the project. The question is no longer, how the technical requirements are optimized. Rather, how to accomplish the technical requirements with the time and money available. Therefore, the technical goals schedules are based upon the time and money available. With the cost and delivery fixed as cornerstones, the technical effort must be made to fit.

3.2 Learning Outcomes

By the end of this unit you will be able to:

- ✓ Use a project management discipline that is applicable to most projects
- ✓ Use a step-by-step process for successful projects
- ✓ Improve scheduling of project tasks
- ✓ Improve estimation of project costs, resources and time
- ✓ Control projects through special methods, tools and techniques

- ✓ Assess and improve your current project management process • immediately apply project management principles back at work.

3.3 Project Planning

The differences can be attributed to the difficulties and details of basic elements.

A typical project would consist of the following elements:

- ✓ Defining the objectives of the project
- ✓ Defining the constraints; physical, financial, manpower, and time
- ✓ Gathering information
- ✓ Generating alternate methods of solution
- ✓ Evaluating alternative solutions
- ✓ Selecting the best solution
- ✓ Carrying out solution
- ✓ Evaluating against objectives
- ✓ Generalizing and extending the results
- ✓ Iterate
- ✓ Report results

Recognizing that these things have to be done is not planning. All projects are composed of these. Planning means identifying for each element the specific tasks that must be accomplished by determining what must be done, by whom, and when.

Good project planning means identifying, early and continuously, the specific tasks that must be achieved; considering the resources in money, personnel, facilities, and time available. This means that where more than one person is needed, specific tasks are assigned to the individuals by name. They must commit themselves to accomplishing the task by a fixed time. And, there should be no duplication of effort. The interfaces between tasks must be recognized and the responsibility for resolving the differences assigned.

Beyond the responsibility for the performance of their own specific tasks, every engineer on the team must accept the responsibility for the success of the whole project. An excellent engineering task that is part of an unsuccessful project is wasted.

From experience and many examples, it is apparent that:

- ✓ Good technical work is often obscured and even negated by poor administrative control.

- ✓ Good technical work cannot by itself control a project, and a project cannot control itself. Engineers must consciously work at controlling their projects.
- ✓ As the work on a project progresses the plans and schedules must change.
- ✓ Many engineers erroneously believe that technical work cannot be controlled. This in itself becomes a self-fulfilling prophesy.
- ✓ Management expects and demands that technical work be administered and controlled effectively.

The planning process should result in major parties to the project having a clear sense of the cost, schedule, and technical objectives. The figure below portrays the project management triangle comprising cost, schedule, and technical objectives. The establishment of these three should attempt to define the possible. Project management control can only be achieved when cost, schedule, and technical objectives are clearly documented, realistically derived, and managed deliberately.

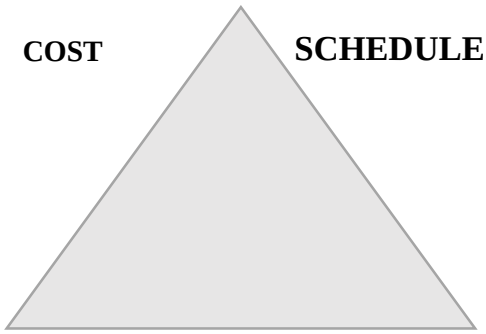

Figure 3.1: The Project Management Triangle

The project's technical objectives should be derived from a clear understanding of the business requirements. Project costs should be realistic and affordable. The schedule should be achievable and appropriate for the business needs.

Trade-off studies balancing technical performance, schedule, and costs may be used to adjust project parameters to fit with organizational priorities. The realism inherent in determining these three project parameters can largely affect the perceived success or failure of the project.

Efforts to accelerate project schedules will usually increase project risks. Innovative techniques must be used to achieve orderly schedule compression without creating unacceptable risks and quality impacts. Without reducing project scope or attempting radical development

methodologies, a project schedule can often be compressed by up to 20% by increasing concurrency of tasks and adding additional staffing. A typical project environment will usually involve pressures to add scope, accelerate schedule, and decrease costs. Nevertheless, changes to project scope and schedule accelerations will tend to make cost the dependent variable, causing cost to expand as if one were squeezing a balloon.

3.3.1 Planning and Establishing the Project Baseline

An Iterative Process begins here:

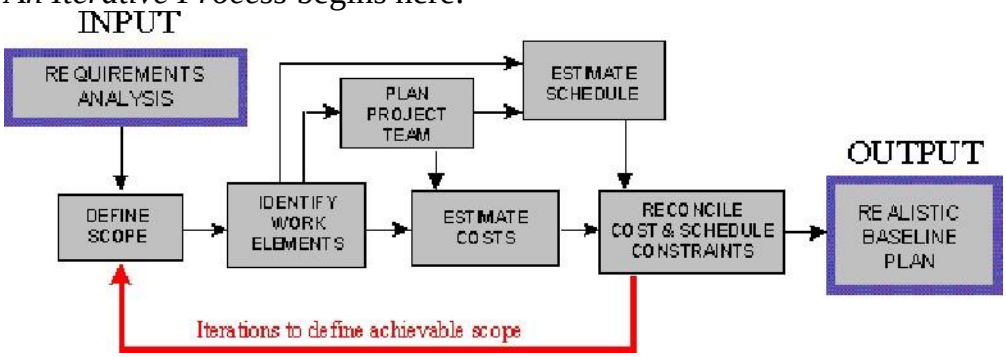

Figure 3.2: Planning and Establishing the Project Baseline

Project baseline definition begins with understanding the user or customer requirements. Understanding requirements involves making judgments about what the organization, technologies, and markets will be like in the time-frame after project completion. Sometimes a requirements analysis will have to penetrate beyond a mere synthesis of what user's think they need. The project requirement may be part of a larger need to improve vital business processes.

After the requirements analysis has resulted in definition of the project's technical scope, the cost and schedule estimates can be refined. Project costs and schedules can be estimated with no greater certainty than that inherent in the definition of technical scope. Cost and schedule estimates will require assumptions about labor categories, availabilities, and rates - knowing who will do the work - so assumptions and commitments about organizational involvements are needed. When cost, schedule, and requirements definition are acceptable to the organization, a project planning baseline must be established.

Very often, establishing the project baseline will be an iterative process involving a number of successive approximations before a baseline is established. The first pass may result in a project that is too costly and will take too long. This can happen if the requirements analysis is done well. If the requirements analysis is done incompletely, the project plan may look affordable and achievable, but further emerging requirements may drive the project over budget and prolong the schedule.

A rigorous requirements analysis and a realistic cost and schedule estimate are necessary to establish a project baseline plan that provides a practical map for project success.

3.3.2 Manage Your Project as a Closed-System

The only way to really control a project is to treat it as a closed system. That means you put the project "in a box" and then control what goes into the box and what comes out. The closed system must address each element of the project management triangle. Each element must be established as a BASELINE, and then changes tracked and managed methodically. You will never be able to stop changes on a project, but if you don't manage them methodically, your project will go out of control. Don't be surprised if establishing and maintaining control of the schedule, cost, and scope baselines is a continual struggle.

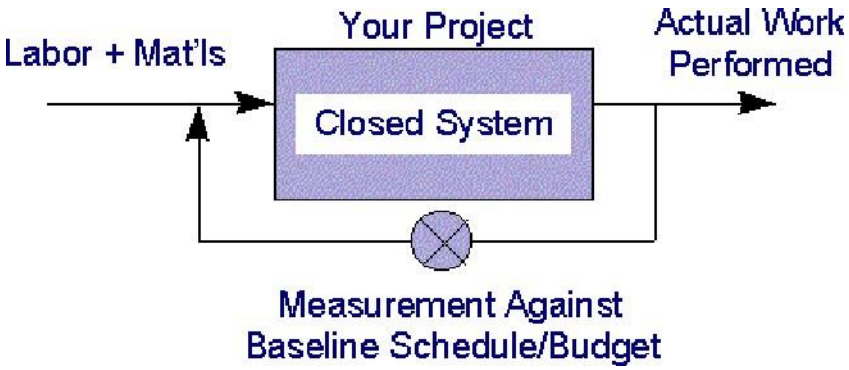

Figure 3.3: A Closed System

Most project environments are so turbulent that you will have to work hard to control the project as a closed system. This means you need to manage the scope, cost, and schedule in such a way that you understand and can generally quantify anything that changes as the project progresses. The primary way to do this is by various forms of "baseline controls."

The project scope needs to be defined clearly in a scope document or specification, and then any changes to that document need to be incorporated into the project plan very carefully. The cost estimates, project budgets, and project schedule (with associated commitments of work hours and resources) need to be baselined in order to have a useful standard against which to measure.

You need to be able to measure the work that goes into a project in dollars and work hours and the productivity that comes out of the project, in per cent completions and tasks accomplished. Without a stable baseline and measurement of input and output, the project cannot be measurable and in control.

On modest sized projects and in informal project management environments you will need to develop innovative ways to set up a performance measurement baseline and keep that baseline stable enough to be able to track project progress. In some cases, scope changes will be small enough so your baseline can still be useful for project tracking. For larger changes in project scope, the baseline will have to be updated. This is a judgment call for the project manager and for those involved with the project control function. You just need to have a sense that your baseline is useful for tracking schedule progress and for measuring project team productivity.

Self-Assessment Exercise: 1

Identify basic elements essential for consideration in the course of tourism project management.

3.4 Project Control

Project control is making sure that the technical objectives of a project are achieved within the time and money constraints. Time and money scheduling are not separated from the technical activity. Technical decisions by their very nature affect time and money considerations. Project engineers must take responsibility for the control of their projects. If they do not, management will assign others to the control. Then the engineer will not have all of the factors under his jurisdiction. If others have control of time and money, rational trade-offs cannot be made. Control comprises of those administrative measures that need to be taken to get and keep a project on schedule with respect to time and money.

Scheduling

Scheduling is the planning and recording part of control. To schedule, the engineer must identify and list the tasks that must be accomplished, and the activities required.

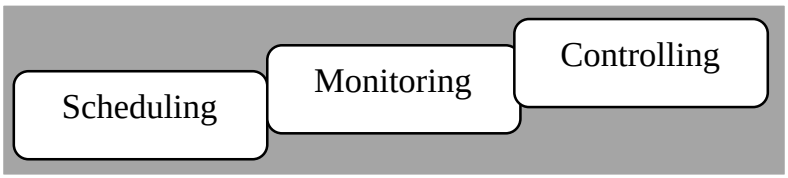

Figure 3.4: Parts of Control

The level of detail will depend on the purpose of the schedule and who will use it. In a situation where there is a little detail, not enough planning takes place to anticipate major problems. Including too much detail, obscures the important tasks and milestones in trivia and reduces flexibility. The level of detail should reflect the size and importance of

the project. The preparation of a schedule generates a check list to be sure that nothing is forgotten at the planning stage. On large projects, it is sometimes convenient to produce a relatively undetailed schedule covering the entire project. This is supplementing periodically with more detailed schedules showing decisions and assignments over short intervals between events in the overall schedule. These supplementary schedules can be produced as the project moves into different phases of the work.

It is essential to make and maintain schedules. Where more than one individual is concerned the schedule must be produced and distributed in a form that is easy to understand. The people using it and responsible for the work should easily see where they stand and appreciate what is expected of them. Each individual should perceive exactly what he is responsible for, and how their effort fits into the overall schedule. Although actual names do not normally appear on the schedule, the items on the schedule should appear in a form that the responsibility can be identified with a single individual. Schedule the whole project at the beginning. Identify the critical items early. Seek the best time and cost estimates. Modify and update the schedule. Bring all the contributors into the scheduling process.

Often, tasks overlap in time on a schedule. This may show the interdependency between tasks or resources. It is, therefore, valuable to find, list, and show the milestones that signal start or completion of a tasks. Milestones should indicate when resources or information from one task must be available for use in another task. Thus, the schedule
will indicate when a task is completed and what must be available to perform or start additional tasks.

Sometimes, there may be a cost schedule associated with the time schedule that shows the relative intensity of activity on the project. The cost schedule acts as warning if the costs are out of control. It ensures there is a reasonable balance between costs and time, and that time/cost trade-offs are made deliberately.

Schedules provide a common meeting place between engineers, coworkers, and management during its construction and its subsequent updating. If everyone contributes to its construction and agreeing to its validity, everyone will make every effort to keep to it, where necessary. When circumstances dictate changes, they can be made without recriminations.

Monitoring

Monitoring means; the progress of the project must be continuously measured against the established schedule. No matter how good the schedules are, if they are not used for monitoring, they serve very little purpose other than recording expectations. Monitoring does not require holding to the schedule rigidly. Circumstances change and as the project develops new information becomes available that may require a change in plans. The schedules serve as a yardstick against which to measure progress, to show where and how plans must change. The schedule is a tool to keep attention on the final objective and goal.

The project's progress must be continually monitored with respect to the be higher for the first units and decrease thereafter until the point at which a market schedule. The engineer uses the schedule to see where he stands and to ensure that commitments are met as planned. If they cannot be met, then those whose work depends on them can be forewarned. Resources can be diverted, reallocated, and the schedule revised so the overall project commitment is achieved.

The checking of progress against schedules is never interesting and the temptation is to avoid it. Therefore, it should be a mandatory routine. The most useful way to do monitoring is to combine it with the regular project technical reviews. Thus, once technical progress is reviewed and established, the project's status is checked against the schedule. Most projects do not always run smoothly, unexpected difficulties do occur. Monitoring is the only way that resources can be reallocated effectively and judiciously.

Controlling

Scheduling and monitoring by themselves are not control. Controlling is the adjustment of the work when needed, so the overall time and money commitments are maintained or at least optimized. Thus, controlling means taking the appropriate action in the light of the information gained from monitoring. The whole purpose of scheduling and monitoring is to permit intelligent control. Control must be deliberately exercised. The engineer must, with help, if necessary, decide what action must be taken to keep the project on schedule. Once the controlling action has been decided on, it must be implemented.

The most common error in project control is not acting soon enough. Action is delayed either because of poor monitoring or more often because of unwillingness to face the facts. The solution to a problem is assumed to be just around the corner or will yield on completion of the next test. The true facts cannot work against a project, but erroneous assumptions can. When it becomes reasonably clear that a certain line of investigation or approach is not going to work, stop it. Redirect the effort in a more fruitful direction. Delay wastes time and money.

Control is exercised by a definite, specific action. It is often a mistaken assumption that delays or difficulties can be overcome by working harder. Engineers should always be working hard. This will rarely solve the problem. Delays can only be overcome by adding extra time or extra resources. Expert help can be sought, tests can be run concurrently, overtime can be put in, or the approach can be changed to one that is more likely to yield result.

One of the major blocks to effective control is a common error in the engineer's view of the project. When project engineers are given a task, they tend to identify with it, and feel that its success is their success. The more effort they put into it the stronger they feel that way. This is good because it means commitment. Unfortunately, they often begin to see their solution or approach as the only correct one. Controlling actions threaten this image and engineers often resent and resist them. Engineers must learn to identify with success of the whole project. The controlling actions are for the good of the whole project. Individual success comes from being identified with successful projects.

Self-Assessment Exercise: 2

Compare and contrast between project planning and control?

3.5 Summary

In the course of our discussion in this unit, were able to conclude that project planning and control could be achieved through proper establishment of project baseline and project management triangle which comprises of costs, schedule and technical objectives. Also, we established that planning control comprises of three major parts which are scheduling, monitoring and controlling. Thus, any successful project officer must be articulate enough to effect the foregoing in their current and future projects. Proper project management means excellence in the technical, cost, and delivery aspects of the project. This requires proper attention being paid to the administrative aspects of the project scheduling, monitoring, and control. For good project planning and

control, the following has to be observed. Schedule the whole project at the beginning. Recognize interdependence of the parts. Identify the critical items early. Seek the best time and cost estimates. Modify and update the schedule. Bring all contributors into the scheduling process. Follow and monitor on a regular basis. Include all contributors in the monitoring process. Plan general alternatives for each contingency. Keep the goals and alternatives in mind. Take early corrective action when needed. Balance project effort. Look for where effort can be reduced. Make changes early rather than late. Take early corrective action when needed. Balance project effort. Look for where effort can be reduced. Make changes early rather than late.

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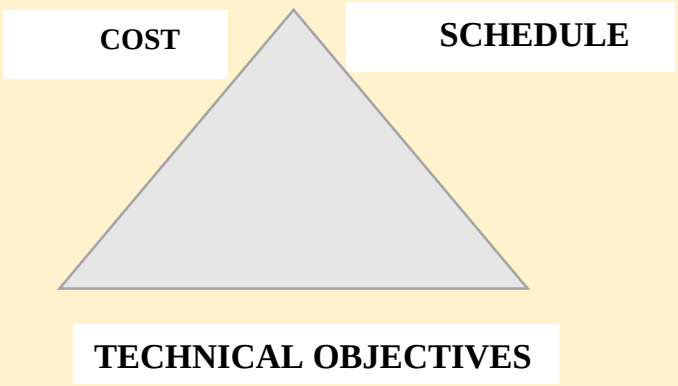
3.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

Tourism project management control can be achieved when elements as indicated in the figure below are clearly documented, realistically derived, and managed deliberately.



Self-Assessment Exercise: 2

Project planning means identifying, early and continuously, the specific tasks that must be achieved; considering the resources in money, personnel, facilities, and time available. Project control entails achievement of the technical objectives of a project within the time and money available.

Unit 4 Tourism Business Financing and Objectives

4.1 Introduction

Financial statement analysis is the analysis of the borrower's financial statement as it relates to the project and as it relates to the amount asked for. The first establishes the end and need for the loan as well as the repayment ability while the second will establish how much is required, for how long, when required, and whether the loan demand conforms to the existing directives/guidelines both of head of head office and of the Central Bank.

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- ✓ Explain the principle of financial analysis
- ✓ Describe the roles of credit officers
- ✓ Investigate loan requirement of a project
- ✓ Use ratio analysis as financial tools

4.3 Principles and Components of Financial Analysis

The principles cover the analysis of borrower's financial statement as it relates to the project and as relates to the amount asked for. The first establishes the end and need for the loan as well as the repayment ability. The second will establish how much is required, for how long, when required and whether the loan demand conforms to the existing directives and guideline both of head office and of the Central Bank.

In analyzing the end use, the banker should endeavor to establish whether all reasonable estimated costs are allowed for, and whether the estimates are realistic. He should also attempt to establish whether the sources of

finance contemplated by the sponsors will be adequate and be forthcoming. Otherwise the banker will be stuck with his own lending.

Finally, he would attempt to ascertain the likely impact of the project on the level of production, sales, net earnings, borrowings etc. of the borrower, and when the project is expected to break even and start yielding profit (Akujobi, 2006; Gautam, 2008).

Having established the above, the banker then turns to analyze the amount of the loan asked. An up-to-date audited balance sheet or the appropriate financial statement normally gives some clues. Generally, the capital employed including any undistributed profits is one guide to how much the customer can borrow; while the figures for creditors of all kinds, of stock and work-in-progress and of trade debtor show the liquid position of the business and may indicate the difficulty or with which credit can be paid regularly. All in all, the objective must be to determine that the amount demanded is neither too much nor too small but is just adequate, and that magnitude of the available surplus or profits, including any other cash accruals, will be adequate to service the loan effectively through repayment of principal and interest plus a margin for incidentals. The point to emphasize is that there should be a proper perspective of the financial position of the concern. For this purpose, a single year's performance as revealed in the profit and loss account and the balance sheet will not be adequate. A dynamic view has to be taken of the organization both in prospect and retrospect.

Self-Assessment Exercise: 1

As a prospective tourism project manager in charge of a particular tourism project in search of loan, how can your loan requirement for that project be investigated by loan lender(s)?

4.4 Tools and Techniques of Financial Analysis

The tools for financial analysis are intended to show relationships and changes. Among the more widely used of these techniques are horizontal analysis, trend analysis, vertical analysis, and ratio analysis (Akujobi, 2006; Gunn & Var, 2002; Siier, 2020)

4.4.1 Horizontal Analysis

Generally accepted accounting principle calls for presenting comparative financial statements that give the current year and past year's financial information. A common starting point for studying such statement is *horizontal analysis*, which involves the computation of dollar amount changes and percentage changes from year to year. The percentage

change must be figured to show how the size of the change relates to the size of the amounts involved. A change of N1 million in sales is not so drastic as a change of N1 million in net income, sales is a larger amount than net income.

The percentage change is figured as follows:
Percentage change = 100 (amount of change) **(**base-year amount)
the base year in any set of data is always the first year being studied. For example, from 1981 to 1982, the base year will be 1981.

4.4.2 Trend Analysis

A variation of horizontal analysis is trend analysis, in which percentage changes are calculated for several successive years instead of between two years. Trend analysis is important because, with its long-run view, it may point to basic changes in the nature of the business. Besides comparative financial statements, most companies give out a summary of operations and data on other key indicators for five or more years.

4.4.3 Vertical Analysis

Vertical analysis uses percentages to show the relationship of the different parts to the total in a single statement. Vertical analysis sets a total figure in the statement equal to 100 per cent and computes the percentage of each component of that figure. This figure would be total assets or total liabilities and stockholders' equity in the case of the balance sheet, and revenues or sales in the case of the income statement. The resulting statement of percentages is called a 'common-size statement'.
Vertical analysis is useful for comparing the importance of certain components in the operation of the business. It is also useful for pointing out important changes in the components from one year to the next when comparative common size statements are presented

4.4.4 Ratio Analysis

Ratio analysis is a useful tool in financial statement and project analysis. It is used in the initial stages to reduce the large number of individual items in the financial statements to a fewer number of meaningful ratios that assist the lending officer to analyze the borrowers' current position. It helps also to identify critical areas for further detailed examination. The basic commonly used ratios relate to liquidity, management efficiency, leverage or debt, and profitability. The ratios are not universally applicable to all situations (Akujobi, 2006; Gautam, 2008; Gunn & Var, 2002; Siier, 2020). Inventory turnover, for instance, is not relevant and meaningful in the analysis of service firms but very relevant and

important in the analysis of retail or manufacturing firms. The table below shows the key ratios commonly used by analysts.

Table 4.1: Commonly used Ratios in Financial Analysis of Project

Type of Ratio	**Name**	**Function**	**Mode of Measurement**
1) Liquidity	a. Current Ratio	Indicate the extent to which claims of short-term creditors are covered by assets that can be readily converted into cash without loss. High values suggest high safety margins for short-term creditors but does not consider quality of receivables and inventories.	Current asset (CA) Current Liabilities (CL)
	b. Quick (Acid Test) Ratio	A more reliable measure of liquidity than the current ratio. Purges the current ratio of lack of concern for the quality of receivables and inventories. NB: a and b, each measures the ability of the firm to generate cash to meet short-term obligation	Current Asset – Inventories Current Liabilities
2) Profitability	a. Net Profit Margin or Return on Sale (ROS)	Measures profitability of the firm relative to sales.	Net Income Sale
	b. Return on Equity (ROE)	Measures profitability of the firm relative to net worth or owner's equity in the firm.	Net Income Total Equity or Net Worth
	c. Return on Asset (ROA)	Measures profitability of the firm in relation to assets employed.	Net Income Total Assets
3) Leverage	a. Debt to Asset	Measures the amount of debt employed by the firm in relation to the total assets of the firm. The bigger the debt the more volatile the earnings	Total Debt Total Assets
	b. Debt to Equity	because of the fixed charge Measures the amount of debt employed by the firm	Long Term Debt Total Equity (Net Worth)
	c. Times Interest or Financial Charges Coverage	in relation to total equity or net worth. Measures the coverage of interest payment in the debt	Earnings before Interest + Taxes Annual Interest Expense
	d. Account Payable Turnover	Measures account payable in relation to purchases	Average accounts Payable Average. Purchase Per Day
4) Activity or Management Efficiency	a. Collection Period	Measures the degree of efficiency with which	Average Account Receivables Sales Per Day

	b. Total Assets Turnover	management collects receivables Measures the degree of efficiency with which management utilizes assets in relation to sales	Sales Total Assets
	c. Inventory Turnover	Measures management efficiency in turning over inventories to generate profit i.e. inventory control	Sales Average Inventory
	d. Fixed Asset Turnover	Measures net sales over net fixed assets	Sales Net Fixed Assets
	e. Receivables Turnover	Measures sales over receivables	Credit Sales Account Receivables

For better results, common size ratios should be obtained by expressing each balance sheet item as a percentage of total revenue and each expense item as percentage of total expenses. The ratios should also not be analyzed in isolation as there are no absolute standard for them. They can be analyzed cross-sectionally by comparing the firms' ratios with the ratios of peer firms in the industry or at a point in time. Another way is time series. This deals with historical trends in the ratios, in effect measuring the firm against itself at different time periods. This helps to detect looming problems before they occur.

A firm experiencing rapid sales but steadily declining profit margin because of rising costs may find, through time series analysis, that the rapid growth may have masked the dangerous slide in profit margins and would then try to do something about it – get away from the euphoria of rapid growth and correct deficiencies in costing matrix and therefore in profit margins.
It is also usually advisable not to rely on a single ratio but on combination of ratios. Return on equity, for instance can be broken down to its constituents such as leverage, profit margin, activity and common size ratios. This enables analysts to simultaneously view the key relationships governing the business enterprises.

Self-Assessment Exercise: 2

Highlight possible tools and techniques of financial analysis in tourism industry.

4.5 Summary

In the course of our study in this unit we were able to discuss the principles and components of financial analysis as well as use financial ratios as financial tools in analyzing and assessing the financial capability of the borrowers of funds. Thus, the foregoing is very important in order to safeguard any future defaults in loan repayment. In analyzing the end use,

the banker should endeavor to establish whether all reasonable estimated costs are allowed for, and whether the estimates are realistic, He should also attempt to establish whether the sources of finance contemplated by the sponsors will be adequate and whether they would, in fact be forthcoming. Otherwise, the banker will be stuck with his own lending. Finally, he would attempt to ascertain the likely impact of the project on the level of production, sales, net earnings, borrowings etc. of the borrower, and when the project is expected to break even and start yielding profit.

4.6 References/Further Readings/Web Sources

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4.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

By analyzing borrower's financial statement as it relates to the project and as relates to the amount asked for. The second will establish how much is required, for how long, when required and whether the loan demand conforms to the existing directives and guideline both of head office and of the Central Bank.

Self-Assessment Exercise: 2

Horizontal Analysis
Trend Analysis
Vertical Analysis
Ratio Analysis

Unit 5 Tourism Business Financing and Related Risks

5.1 Introduction

Project financing is an innovative and timely financing technique that has been used on many high-profile corporate projects. Employing a carefully engineered financing mix, it has long been used to fund largescale natural resource projects, from pipelines and refineries to electric generating facilities and hydro-electric projects. Increasingly, project financing is emerging as the preferred alternative to conventional methods of financing infrastructure and other large-scale projects worldwide.

Project financing discipline includes understanding the rationale for project financing, how to prepare the financial plan, assess the risks, design the financing mix, and raise the funds. In addition, one must understand the cogent analyses of why some project financing plans have succeeded while others have failed. A knowledge-base is required regarding the design of contractual arrangements to support project financing; issues for the host government legislative provisions, public/private infrastructure partnerships, public/private financing structures; credit requirements of lenders, and how to determine the project's borrowing capacity; how to prepare cash flow projections and use them to measure expected rates of return; tax and accounting considerations; and analytical techniques to validate the project's feasibility.

Project finance is finance for a particular project, such as a mine, toll road, railway, pipeline, power station, ship, hospital or prison, which is repaid from the cash-flow of that project. Project finance is different from traditional forms of finance because the financier principally looks to the assets and revenue of the project in order to secure and service the loan. In contrast to an ordinary borrowing situation, in a project financing the financier usually has little or no recourse to the no- project assets of the borrower or the sponsors of the project. In this situation, the credit risk associated with the borrower is not as important as in an ordinary loan transaction; what is most important is the identification, analysis, allocation and management of every risk associated with the project.

This unit explains, in a brief and general way, the manner in which risks are approached by financiers in a project finance transaction. Such risk minimization lies at the heart of project finance.

In a no recourse or limited recourse project financing, the risks for a financier are great. Since the loan can only be repaid when the project is operational, if a major part of the project fails, the financiers are likely to lose a substantial amount of money. The assets that remain are usually highly specialized and possibly in a remote location. If saleable, they may have little value outside the project. Therefore, it is not surprising that financiers, and their advisers, make substantial efforts to ensure that the risks associated with the project are reduced or eliminated as far as possible. It is also not surprising that because of the risks involved, the cost of such finance is generally higher and it is more time consuming for such finance to be provided.

5.2 Learning Outcomes

By the end of this unit, you will be able to:

- ✓ Discuss the risk minimization process
- ✓ Types of risks
- ✓ Risks common to both construction and operational phases Participant/credit risk.

5.3 Types of Risks

Of course, every project is different and it is not possible to compile an exhaustive list of risks or to rank them in order of priority. What is a major risk for one project may be quite minor for another? In a vacuum, one can just discuss the risks that are common to most projects and possible avenues for minimizing them. However, it is helpful to categorize the risks according to the phases of the project within which they may arise: (1) the design and construction phase; (2) the operation phase; or (3) either phase. It is useful to divide the project in this way when looking at risks because the nature and the allocation of risks usually change between the construction phase and the operation phase.

1. Construction Phase Risk-Completion Risk

Completion risk allocation is a vital part of the risk allocation of any project. This phase carries the greatest risk for the financier. Construction carries the danger that the project will not be completed on time, on budget or at all because of technical, labour, and other construction difficulties. Such delays or cost increases may delay loan repayments and

cause interest and debt to accumulate. They may also jeopardise contracts for the sale of the project's output and supply contacts for raw materials. Commonly employed mechanisms for minimising completion risk before lending takes place include: (a) obtaining completion guarantees requiring the sponsors to pay all debts and liquidated damages if completion does not occur by the required date; (b) ensuring that sponsors have a significant financial interest in the success of the project so that they remain committed to it by insisting that sponsors inject equity into the project; (c) requiring the project to be developed under fixed-price, fixed-time turnkey contracts by reputable and financially sound contractors whose performance is secured by performance bonds or guaranteed by third parties; and (d) obtaining independent experts' reports on the design and construction of the project. Completion risk is managed during the loan period by methods such as making pre-completion phase drawdowns of further funds conditional on certificates being issued by independent experts to confirm that the construction is progressing as planned.

2. Operation Phase Risk-Resource/Reserve Risk

This is the risk that for a mining project, rail project, power station or toll road there are inadequate inputs that can be processed or serviced to produce an adequate return. For example, this is the risk that there are insufficient reserves for a mine, passengers for a railway, fuel for a power station or vehicles for a toll road.

Such resource risks are usually minimised by: (a) experts' reports as to the existence of the inputs (e.g. detailed reservoir and engineering reports which classify and quantify the reserves for a mining project) or estimates of public users of the project based on surveys and other empirical evidence (e.g. the number of passengers who will use a railway); (b) requiring long term supply contracts for inputs to be entered into as protection against shortages or price fluctuations (e.g. fuel supply agreements for a power station); (c) obtaining guarantees that there will be a minimum level of inputs (e.g. from a government that a certain number of vehicles will use a toll road); and (d) "take or pay" off-take contacts which require the purchaser to make minimum payments even if the product cannot be delivered.

Operating Risk

These are general risks that may affect the cash-flow of the project by increasing the operating costs or affecting the project's capacity to continue to generate the quantity and quality of the planned output over the life of the project. Operating risks include, for example, the level of experience and resources of the operator, inefficiencies in operations or

shortages in the supply of skilled labour. The usual way for minimising operating risks before lending takes place is to require the project to be operated by a reputable and financially sound operator whose performance is secured by performance bonds. Operating risks are managed during the loan period by requiring the provision of detailed reports on the operations of the project and by controlling cash-flows by requiring the proceeds of the sale of product to be paid into tightly regulated proceeds account to ensure that funds are used for approved operating costs only.

Market/Off-Take Risk

Obviously, the loan can only be repaid if the product that is generated can be turned into cash. Market risk is the risk that a buyer cannot be found for the product at a price sufficient to provide adequate cash-flow to service the debt. The best mechanism for minimizing market risk before lending takes place is an acceptable forward sales contact entered into with a financially sound purchaser.

Self-Assessment Exercise: 1

State and discuss the various risks associated with project financing in Nigeria

5.3.1 Common Risks to both Construction and Operational Phases Participant/Credit Risk

These are the risks associated with the sponsors or the borrowers themselves. The question is whether they have sufficient resources to manage the construction and operation of the project and to efficiently resolve any problems which may arise. Of course, credit risk is also important for the sponsors' completion guarantees. To minimize these risks, the financiers need to satisfy themselves that the participants in the project have the necessary human resources, experience in past projects of this nature and are financially strong (e.g. so that they can inject funds into an ailing project to save it).

Technical Risk

This is the risk of technical difficulties in the construction and operation of the project's plant and equipment, including latent defects. Financiers usually minimise this risk by preferring tried and tested technologies to new unproven technologies. Technical risk is also minimised before lending takes place by obtaining experts reports as to the proposed technology. Technical risks are managed during the loan period by

requiring a maintenance retention account to be maintained to receive a proportion of cash-flows to cover future maintenance expenditure.

Currency Risk

Currency risks include the risks that: (a) a depreciation in loan currencies may increase the costs of construction where significant construction items are sourced offshore; or (b) a depreciation in the revenue currencies may cause a cash-flow problem in the operating phase. Mechanisms for minimizing resource include: (a) matching the currencies of the sales contracts with the currencies of supply contracts as far as possible; (b) denominating the loan in the most relevant foreign currency; and (c) requiring suitable foreign currency hedging contracts to be entered into.

Regulatory/Approvals Risk

These are risks that government licenses and approvals required to construct or operate the project will not be issued (or will only be issued subject to onerous conditions), or that the project will be subject to excessive taxation, royalty payments, or rigid requirements as to local supply or distribution. Such risks may be reduced by obtaining legal opinions confirming compliance with applicable laws and ensuring that any necessary approvals are a condition precedent to the drawdown of funds.

Political Risk

This is the danger of political or financial instability in the host country caused by events such as insurrections, strikes, suspension of foreign exchange, creeping expropriation and outright nationalization. It also includes the risk that a government may be able to avoid its contractual obligations through sovereign immunity doctrines. Common mechanisms for minimizing political risk include: (a) requiring host country agreements and assurances that project will not be interfered with; (b) obtaining legal opinions as to the applicable laws and the enforceability of contracts with government entities; (c) requiring political risk insurance to be obtained from bodies which provide such insurance (traditionally government agencies); (d) involving financiers from a number of different countries, national export credit agencies and multilateral lending institutions such as a development bank; and (e) establishing accounts in stable countries for the receipt of sale proceeds from purchasers.

Force Majeure Risk

This is the risk of event which renders the construction or operation of the project impossible, either temporarily (e.g. minor floods) or permanently

(e.g. complete destruction by fire). Mechanisms for minimizing such risks include: (a) conducting due diligence as to the possibility of the relevant risks; (b) allocating such risks to other parties as far as possible (e.g. to the builder under the construction contract); and (c) requiring adequate insurances which note the financiers' interests to be put in place.

5.3.2 Risk Minimization Process

Financiers are concerned with minimizing the dangers of any events which could have a negative impact on the financial performance of the project, in particular, events which could result in: (1) the project not being completed on time, on budget, or at all; (2) the project not operating at its full capacity; (3) the project failing to generate sufficient revenue to service the debt; or (4) the project prematurely coming to an end.

The minimization of such risks involves a three-step process. The first step requires the identification and analysis of all the risks that may bear upon the project. The second step is the allocation of those risks among the parties. The last step involves the creation of mechanisms to manage the risks.

If a risk to the financiers cannot be minimized, the financiers will need to build it into the interest rate margin for the loan.

STEP 1 - Risk Identification and Analysis

The project sponsors will usually prepare a feasibility study, e.g. as to the construction and operation of a mine or pipeline. The financiers will carefully review the study and may engage independent expert consultants to supplement it. The matters of particular focus will be whether the costs of the project have been properly assessed and whether the cash-flow streams from the project are properly calculated. Some risks are analysed using financial models to determine the project's cash-flow and hence the ability of the project to meet repayment schedules. Different scenarios will be examined by adjusting economic variables such as inflation, interest rates, exchange rates and prices for the inputs and output of the project. Various classes of risk that may be identified in a project financing will be discussed below.

STEP 2 - Risk Allocation

Once the risks are identified and analysed, they are allocated by the parties through negotiation of the contractual framework. Ideally, a risk should be allocated to the party who is the most appropriate to bear it (i.e. who is in the best position to manage, control and insure against it) and who has the financial capacity to bear it. It has been observed that financiers attempt to allocate uncontrollable risks widely and to ensure that each

party has an interest in fixing such risks. Generally, commercial risks are sought to be allocated to the private sector and political risks to the state sector.

STEP 3 - Risk Management

Risks must be also managed in order to minimise the possibility of the risk event occurring and to minimise its consequences if it does occur. Financiers need to ensure that the greater the risks that they bear, the more informed they are and the greater their control over the project. Since they take security over the entire project and must be prepared to step in and take it over if the borrower defaults. This requires the financiers to be involved in and monitor the project closely. Such risk management is facilitated by imposing reporting obligations on the borrower and controls over project accounts. Such measures may lead to tension between the flexibility desired by borrower and risk management mechanisms required by the financier.

Self-Assessment Exercise: 1

What are the steps you can take to minimize risk while venturing into a tourism project?

5.4 Summary

In the course of this study we were able to discuss project finance and the various risks associated with it. This unit only gives a brief overview of the common risks and methods of risk minimisation employed by financiers in project finance transactions. As stated previously, each project financing is different. Each project gives rise to its own unique risks and hence poses its own unique challenges. In every case, the parties - and those advising them - need to act creatively to meet those challenges and to effectively and efficiently minimize the risks embodied in the project in order to ensure that the project financing will be a success.

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Module 3

Unit 1 Tourism Business Financial Cost and Benefits Analysis

1.1 Introduction

Cost-benefit analysis (CBA or COBA) is a major tool employed to evaluate projects. It provides the researcher with a set of values that are useful to determine the feasibility of a project from an economic standpoint. Conceptually simple, its results are easy for decision makers to comprehend, and therefore enjoys a great deal of favor in project assessments. The end product of the procedure is a benefit/cost ratio that compares the total expected benefits to the total predicted costs. In practice, CBA is quite complex, because it raises a number of assumptions about the scope of the assessment, the time-frame, as well as technical issues involved in measuring the benefits and costs.

Before any meaningful analysis can be pursued, it is essential that an appropriate framework be specified. An extremely important issue is to define the spatial scope of the assessment. Transport projects tend to have negative impacts over short distances from the site, and broader benefits over wider areas. Thus, extending a runway may impact severely on local residents through noise generation, and if the evaluation is based on such a narrowly defined area, the costs could easily outweigh any benefits. On the other hand, defining an area that is too broad could lead to spurious benefits. “The aim of the study area definition should be to include all parts of the transport network which are likely to include significant changes in flow, cost or time as a result of the project” (UN 2003, 17).

Because transport projects have long-term effects, and because the analysis is carried out on a real term basis, the benefits and costs must be assessed using specific and pre-determined parameters. For example, when is the project start date, when will it be completed, over what period of time will the appraisal run, and what discount rate will be used to depreciate the value of the costs and benefits over the appraisal period? These and other parameters must be agreed upon. Costs and benefits are presented in nominal values, i.e. monetary values of the start year and discounted for inflation over the project period. Because most transport projects are assessed for a 30-year period employing different discount rates may influence greatly the outcomes.

Costs associated with the project are usually easier to define and measure than benefits. They include both investment and operating costs. Investment costs include the planning costs incurred in the design and planning, the land and property costs in acquiring the site(s) for the project, and construction costs, including materials, labor, etc. Operating costs typically involve the annual maintenance costs of the project, but may include additional operating costs incurred, as for example the costs of operating a new light rail system.

Benefits are much more difficult to measure, particularly for transport projects, since they are likely to be diffuse and extensive. Safety is a benefit that needs to be assessed, and while there are complex issues involved, many CBA studies use standard measures of property savings per accident avoided, financial implications for reductions in bodily injury or deaths for accidents involving people. For example, Transport Canada uses $1.5 million in 1991 dollars for each fatality saved. One of the most important sets of benefits are efficiency gains as a result of the project. These gains might be assessed by estimating the time savings or increased.

Many other elements relating to social impacts, aesthetics, health and the environment are more difficult to assess. The latter, in particular, is a major factor in contemporary project assessment, and usually separate environmental impact analyses are required. Where possible these factors must be considered in CBA, and a variety of measures are used as surrogates for environmental benefits and costs. For example, the commercial losses of habitat destruction and property damage can be estimated. For example, the difference in the values of properties adjacent to airports and those further away are used to assess the costs of noise.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- ✓ Differentiate between costs and benefits of a project
- ✓ Explain the theory of costs and benefits
- ✓ State the importance of costs and benefits
- ✓ State the application of costs and benefits
- ✓ Discuss the various methods of estimating costs

1.3. Theory of Cost-Benefit Analysis

Cost-Benefit Analysis is an economic tool to aid social decision-making, and is typically used by governments to evaluate the desirability of a given intervention in markets. The aim is to gauge the efficiency of the intervention relative to the status quo. The costs and benefits of the impacts of an intervention are evaluated in terms of the public's *willingness to pay* for them (benefits) or willingness to pay to avoid them (costs). Inputs are typically measured in terms of opportunity costs - the value in their best alternative use. The guiding principle is to list all of the parties affected by an intervention, and place a monetary value of the effect it has on their welfare *as* it would be valued by them.

The process involves monetary value of initial and ongoing expenses vs. expected return. Constructing plausible measures of the costs and benefits of specific actions is often very difficult. In practice, analysts try to estimate costs and benefits either by using survey methods or by drawing inferences from market behavior. For example, a product manager may compare manufacturing and marketing expenses to projected sales for a proposed product, and only decide to produce it if he expects the revenues to eventually recoup the costs. Cost-benefit analysis attempts to put all relevant costs and benefits on a common temporal footing. A discount rate is chosen, which is then used to compute all relevant future costs and benefits in present-value terms. Most commonly, the discount rate used for present-value calculations is an interest rate taken from financial markets. This can be very controversial - for example, a high discount rate implies a very low value on the welfare of future generations, which may have a huge impact on the desirability of interventions to help the environment, and so on. Empirical studies have suggested that in reality, peoples' discount rates *do* decline over time. Because CBA aims to measure the public's true willingness to pay, this feature is typically built into studies.

During cost-benefit analysis, monetary values may also be assigned to less tangible effects such as the various risks which could contribute to partial or total project failure; loss of reputation, market penetration, long-

term enterprise strategy alignments, etc. This is especially true when governments use the technique, for instance to decide whether to introduce business regulation, build a new road or offer a new drug on the state healthcare. In this case, a value must be put on human life or the environment, often causing great controversy. The cost-benefit principle says, for example, that we should install a guardrail on a dangerous stretch of mountain road if the dollar cost of doing so is less than the implicit dollar value of the injuries, deaths, and property damage thus prevented (R.H. Frank 2000).

Cost-benefit calculations typically involve using time value of money formula. This is usually done by converting the future expected streams of costs and benefits to a present value amount.

1.3.1 Importance of Cost-Benefit Analysis

Cost-benefit analysis is used for determining which alternative is likely to provide the greatest return for a proposed investment. Sometimes referred to as cost-effectiveness analysis, it is relevant to businesses as well as to not-for-profit entities and governmental units.

A business might find it helpful to use cost-benefit analysis to determine if additional funds should be invested in a facility in the home country or in another country. A community not-for profit organization that provides a variety of programs for children might use cost-benefit analysis to assist management in determining which activities will provide the most services for the costs specified. A federal governmental agency might use cost-benefit analysis to determine which of several projects planned for the national parks is likely to be most used, given the costs, by interested citizens.

Because resources such as money and time are limited, an organization usually cannot undertake every project proposed. To decide whether to undertake a project, decision makers weigh the benefits from the project against the cost of the resources it requires, normally approving a project when its benefits exceed its costs. Cost-benefit analysis provides the structure and support for making such decisions.

Benefits increase the welfare of the organization. Some benefits are monetary benefits, such as the dollar amount of cash inflows from additional sales of a product or the saving in cash outflows that a project enables. Other benefits are important but harder to quantify. For example, a project may increase customer satisfaction; increased customer satisfaction may increase future sales, but the exact relationship between sales and satisfaction is often hard to specify.

Costs are the outlays or expenditures made in order to obtain a benefit. Many costs are measured monetarily, such as the cost of buying a new machine or of hiring an additional employee.

Self-Assessment Exercise: 1

What do you understand by cost benefit analysis of a project?

1.3 Applications of Cost-Benefit Analysis

Cost-Benefit Analysis comprises Cost-Benefit Analysis in Business and Cost-Benefit Analysis in Non-Business Entities

1. Cost-Benefit Analysis in Business

A cost-benefit analysis is straightforward when all costs and benefits are measurable in monetary terms. Assume that Company X must decide whether to rent an oven for N9000. The oven will produce additional cash inflows of N10,000 during the period. The benefit of additional cash inflows (N10,000) exceeds the additional cost (N9,000), so the project should be undertaken. Not all cost-benefit analyses are this simple, however. If the benefits and costs occur in different time periods, it may be necessary to discount the future cash flows to their equivalent worth as at the time of the decision.

In another example, cost savings is a benefit. Assume that Company B makes about 100,000 photocopies a year. Company B does not have its own copy machine and currently pays ₦40,000 a year, to Copycat Copiers. Company B can lease a copy machine for ₦25,000 a year. It must also pay 2 naira per page for paper for the leased machine, or ₦20,000. In this example, the cost of leasing the machine and buying paper (₦25,000 ₦20,000 ₦45,000) exceeds the benefit of saving the ₦40,000 normally paid to Copycat Copiers. Company B should continue to use Copycat Copiers for its photocopies. However, Company B must have a pretty good estimate of the number of copies it needs to be comfortable with its decision. If Company B needs 1,500,000 copies this year instead of 1,000,000, the cost of the leasing the machine and buying paper (₦25,000 ₦30,000 ₦55,000) is cheaper than the ₦60,000 (1,500,000 @ ₦0.4) savings in fees to Copycat Copiers.

A third example involves a project with benefits that are difficult to quantify. Assume that Company C is deciding whether to give a picnic costing ₦500,000 for its employees. Company C would receive the benefit of increased employee morale from the picnic. Better employee morale might cause employees to work harder, increasing profits. However, the link between increased morale and increased monetary

profits is tenuous. The decision maker must use his or her judgment to compare the nonmonetary benefit to the monetary cost, possibly deciding that increased employee morale is worth the ₦500,000 cost but would not be worth a ₦1,000,000 cost.

In the preceding examples, cost-benefit analysis provided a framework for decision making. The range of objectivity related to measurement of the factors is typical. Techniques used in business as a basis for determining costs and benefits, such as return on investment, are generally quantifiable and thus appear to be objective. However, it is not uncommon for qualitative factors to enter into the decision-making process. For example, providing a product that individuals with limited incomes will be able to purchase may not provide the highest monetary return on investment in the short run, but might prove to be a successful long-term investment. Careful decision makers attempt to deal with a difficult-to-quantify factor in as objective a manner as possible. However, cost-benefit analysis in most situations continues to introduce measurement problems.

2. Cost-Benefit Analysis in Non-Business Entities

Cost-benefit analyses are also common in non-business entities. Boards of not-for-profit organizations establish priorities for their programs, and such priorities often specify desired program outputs. For example, assume a not-for-profit organization is interested in reducing the level of illiteracy among the citizens of a rural community in a state that has one of the lowest per- capita incomes in the United States. As alternative programs for those who need to learn to read are considered, there will be cost-benefit analyses that focus on a number of factors, including the extent to which a particular program can attract those who are illiterate. A program in the downtown area of a small town might be considered because a facility is available there at low cost and that low cost is appealing. Focus on cost is not sufficient, however. When benefits are considered, it might become clear that those who are eager for such a program do not have cars and that there is no public transportation from where they reside to the center of the small town. Further consideration of relevant factors and of alternatives, undertaken in good faith, should result in cost-benefit analyses that provide valuable information as the agency makes decisions.

At all levels of government in the United States, cost-benefit analyses are used as a basis for allocating resources for the public good to those programs, projects, and services that will meet the expectations of citizens. For example, decision makers at the federal level who have policy responsibility for environmental standards, air-quality rules, or services to the elderly often find information from cost-benefit analyses to be critical to the decision-making task.

1.4.1 Methods of Estimating Cost

There are four principal methods of estimating cost:

1. Reference to Similar Projects

Reference to any similar project previously carried out by the project sponsors or by enterprises in the same industry is the simplest method of costing; the only basic condition being that the project be comparable in every respect to the previous one. This method has the advantage that it provides a realistic basis for costing as it allows an exhaustive checklist of all the ancillary equipment and facilities which previous experience has shown to be important.

When using this method, it is important to ensure that the costs indicated are still valid. Changes which may be due to currency depreciation or and inflation must be noted.

It happens quite often that the capacity of the new project differs from that of the comparable earlier project. The problem of extrapolation then arises. A very rough and ready estimate indicating the orders or magnitude may be made by applying the "six-tenth factor" (OECD, 1968).

If S_A and S_B are the capacities of two plants A and B and K_A and K_B their respective investment costs, then
$K_A / K_B = (S_A / S_B)^X$ where $x < 1$

The coefficient 'x' represents economies of scale. For chemical engineering, it was suggested that the value of x should be 0.6. it is emphasized that the rule should be applied with caution. There are many kinds of industrial machinery that will not exhibit this relationship between area (cost) and volume (capacity).

2. Enquiry from Possible Suppliers

Enquiries from possible suppliers are the safest way of obtaining the latest price of equipment. The only draw-back is that the prices indicated do not include cost of related facilities, transport and assembly with the result that the initial price has to be doubled in order to arrive at a figure for equipment erected or installed on site and in working order. For this reason, prices indicated should always be qualified by specific delivery terms, and conditions relating to erection or installation, and also the conditions of guarantee during the initial operating period should be specified. A similar approach should be used with regard to suppliers of raw materials required for operating the project.

3. Use of Published Tariffs, Surveys and Official Regulations

Some costs may be laid down in official regulations or public tariffs e.g. water and electricity rates, guaranteed minimum wages and salaries, etc. Surveys, whether connected with the project or not may provide information about the real level of wages and salaries and other expenditure items such as average building costs, prices of certain raw materials etc.

4. Use of Technical Experts

Technical experts may have to be called in to provide the possible solution. The nature of their work puts them in a better position than anybody else for assessing prices which depend on characteristics of materials and equipment.

1.4.2 Measuring Benefits and Costs

A properly constructed cost-benefit analysis will attempt to measure the change in economic welfare associated with all costs and all benefits uniquely generated by a project. In general, these will fit into one of three categories:

(1) marketed (direct) benefits and costs
(2) nonmarketed direct benefits and costs, and
(3) non-marketed indirect benefits and costs.

For benefits, we attempt to measure the willingness to pay by all affected consumers for the relevant project benefits. The rationale for doing so derives from applied economic welfare analysis. This approach argues that economic welfare derives from preference satisfaction and that preference satisfaction is reflected by the consumer's willingness to pay.

More specifically, economists infer willingness to pay for direct benefits and costs by observing choices made in markets or by observing other choices to spend dollars to facilitate direct consumption of the resource. This is said to measure preferences revealed by choices, or simply to measure revealed preferences. For non-marketed, indirect benefits and costs, stated preference estimates derived from survey research are employed. For costs, we attempt to measure the opportunities foregone (opportunity costs) due using the economic resources (land, labor, materials, etc.) in the project rather than in some other use. For direct private costs, market prices of resources are used. Non-marketed costs, tend to be treated as benefits foregone, and are estimated exactly as are benefits. For a more detailed discussion of benefits and costs, in nontechnical terms, the reader is referred to the Resources for the Future publication "Cost-Benefit Primer."

1. Marketed Benefits and Costs

Marketed benefits, also referred to as private benefits, are measured as the sum of willingness to pay by consumers for the new quantity of product produced by the project being evaluated. For example, assume that the construction of a marina produces 10,000 days of new available dockage. The question then becomes, how to value this dockage. In the private sector, the firm would simply measure a price times quantity dollar value, but because public sector decision making seeks to take into account changes in welfare, rather than changes in revenues, a somewhat different approach is taken.

The accepted approach for measuring the willingness to pay for the new dockage (and for other privately marketed goods) is to measure the market demand curve for dockage and to calculate the incremental price that consumers would be willing to pay for the dockage. In general, this would not be a constant price, but rather it would -clearing (or marginal) price is reached, a price that would on average rent out all available dock space. Thus, while all renters may pay the same market clearing price, some might have been willing to pay a higher price than others, but we are not required to do so. In fact, each renter may have been willing to rent at a different price, but the marina may not have been able to charge each a different price. Observing the price paid tells the analyst a lower bound for benefits; that is, if the consumer did not receive benefits at least equal to the price paid, he or she would not have purchased the good. Adding back an amount the consumer would have been willing to pay adjusts the total revenue measure obtained from multiplying the total quantity rented by the price to affect more accurately the increase in economic welfare as a result of the marina. This concept is referred to as consumers surplus within the economics literature. It is used to value all benefits when a

demand curve can be estimated. This same approach is used for estimating welfare for non-marketed direct and indirect benefits.

The private costs associated with the project, unlike the benefits, are typically measured at market prices. This reflects the fact that factor inputs, like land, labor and materials tend to be much more substitutable and therefore supplied at roughly constant prices. Few projects are by themselves large enough to cause changes in prices through project activities, and, hence, the assumption of constant prices is reasonable.

The issue of underutilized resources is a bit more problematic, however. Local administrators are typically enthusiastic about new jobs created economic developed, private or public. National administrators, on the other hand, recognize that the benefits are not unique to the project, because they would occur anywhere a project was undertaken, and would likely be similar for quite different projects or roughly equal magnitude. The only question to a national decision maker would be whether special weight would be given to economic development in particular areas as a matter of policy.

2. Non-Marketed Direct Benefits and Costs

A large number of natural and environmental resources are consumed directly, but are not purchased in markets. Examples, include fishing in a mountain stream, enjoying a panoramic view, living in a community or neighborhood with clean (or dirty) air, or working in an occupation that provides opportunities to enjoy increased (decreased health). We note that environmental "dis-amenities" as well as amenities can come into play.

As it turns out, individuals who consume these amenities often leave behavioral "footprints" from which revealed preferences can be recovered using statistical methods. For example, some individuals work in highly desirable occupations, like forest rangers, and as a consequence receive lower wages than they would otherwise receive. Symmetrically, workers in very undesirable occupations often received wage premia. A statistical tool called hedonic analysis can be used to estimate these wage differentials. In simple terms, a forecasting model is developed for various occupations, such that the impacts of job attributes such as skills, education, as well as desirable and undesirable job features on wages can be estimated. Hedonic models are also often used to measure the impacts of favorable or unfavorable environmental conditions on property values. For example, the impacts of a view could be isolated statistically, by controlling for size of house, size of lot, construction, and other features. In other cases, a travel cost approach is used to infer willingness to pay for an environmental amenity. For example, costs incurred by fishers can be observed and related to stream attributes, such as beauty, isolation,

average catch, average sized catch, and the like. By isolating other affects statistically, it is possible to infer the willingness to pay for attributes of many natural attractions, like national parks, seashores, lakes and mountains.

These approaches are referred to as revealed preference measures because they infer willingness to pay as revealed by consumer choices. From them, demand schedules can be estimated and consumer surplus measured.

3. Non-Marketed Indirect Benefits and Costs

Non-marketed indirect benefits and costs arise not because of direct use of a resource, but rather because individuals place value on the "existence" of the resources. For example, many people have never seen the redwood forests, but have willingness to pay to see them preserved. Likewise, people who will never encounter a baby seal outside of a zoo may have strong feelings, backed by willingness to pay, concerning their harvest for use as furs. These values are appropriate costs and benefits. The challenge lies in measuring these values in meaningful scientific ways, that is, ways that can be validated and replicated.

In general, because there are no behavioral footprints from which to infer value survey-based approaches are used to derive indirect values. The most commonly applied approach is called contingent valuation analysis wherein a hypothetical, or "contingent," choice is made that is designed to reveal an individual's willingness to pay. Typically, these analyses present detailed scenarios to respondents that include information about the program under consideration, what it hopes to accomplish, how it will be paid for, and over what time period actions will take place. Various formats are then employed to obtain a contingent value that is an estimator of actual willingness to pay. Some analysts use a family of approaches termed conjoint analysis to seek similar information. These are termed stated preference measures because respondents are asked to state their willingness to pay.

Stated preference measures have been criticized for a large number of reasons, some quite esoteric and others quite practical. Some question, for example, if individuals actually have preferences for a diverse and nearly limitless set of resources that can be estimated in this way. Others question the sensitivity to the quality of the program being purchased. Still others concern themselves, that respondents, sensing that their answers may affect policy, respond strategically with very large or with zero responses. Analysts are making some headway on overcoming these problems. A good review of these issues can be found in a book by NCEDR researchers Bjornstad and Kahn.

These approaches have also been criticized by those who question whether or not preference satisfaction is a useful approach to making environmental decisions. These critics suggest that environmental decision making is essentially an ethical process that should be removed from economic considerations. At the extreme, these observers might argue that a clean environment is a "right" and that no expense should be spared in this pursuit. The difficulty with such criticism is that it flies in the face of scare resources and the need to make hard decisions. Ultimately, some mechanism must provide guidance as to priorities, proportions and overall costs of programs that must compete with other activities for funding. In addition to cost-benefit analysis approaches such as citizen juries, focus groups, decision analysis, risk analysis, and many other approaches have been proposed to help decide these difficult issues. A more pragmatic concern, however, is just whose preferences should count when the sub-national decision maker confronts an issue. Certainly, it is informative that other citizens in faraway regions value the actions of others in other regions, but they are unlikely to support these activities financially. A good rule of thumb is that the citizens in the jurisdiction that will make economic sacrifices for the project should be included.

Self-Assessment Exercise: 2

What four methods can you adopt while estimating costs in tourism projects?

1.5 Summary

This unit discussed theory of cost-benefit analysis, importance of cost-benefit analysis, application of cost benefit analysis in business, non-business entities, and finally methods of estimating/ measuring cost and benefits. In the course of our study in this unit we were able to differentiate between the costs and benefits of a project, identified the theory of costs and benefits, examined the importance of costs and benefits, stated the application of costs and benefits and finally enumerated various methods of estimating costs. Thus, cost-benefit analysis is a major tool employed to evaluate projects. It provides the researcher with a set of values that are useful to determine the feasibility of a project from and economic standpoint. Conceptually simple, its results are easy for decision makers to comprehend, and therefore enjoys a great deal of favor in project assessments.

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1.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1
Cost-Benefit Analysis is referred to as economic tool to aid social decision-making, and is typically used by governments to evaluate the desirability of a given intervention in markets. The aim is to gauge the efficiency of the intervention relative to the status quo.

Self-Assessment Exercise: 2
Reference to Similar Projects
Enquiry from Possible Suppliers
Use of Published Tariffs, Surveys and Official Regulations
Use of Technical Experts

Unit 2 Tourism Business Breakeven Analysis

2.1 Introduction

Break-even analysis is a technique widely used by production management and management accountants. It is based on categorizing production costs between those which are "variable" (costs that change when the production output changes) and those that are "fixed" (costs not directly related to the volume of production). Total variable and fixed costs are compared with sales revenue in order to determine the level of sales volume, sales value or production at which the business makes neither a profit nor a loss (the "breakeven point").

2.2 Learning Outcomes

At the end of this unit you will be able to:

- ✓ Discuss what break-even point defines when an investment will generate a positive return.
- ✓ Discuss the fact that fixed costs are not directly related to the level of production.
- ✓ Illustrate the fact that variable costs change in direct relation to volume of output.
- ✓ Explain the fact that total fixed costs do not change as the level of production increases.

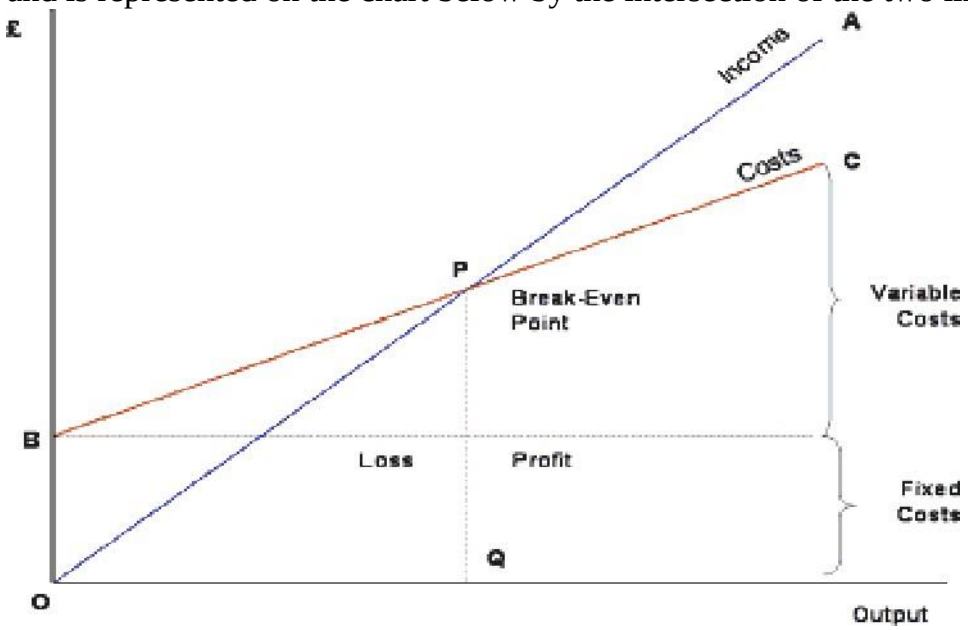
2.3 The Break-Even Analysis

Cash flow forecast is designed to assure a bank manager or other lender that he is likely to get his money back. It is also a fine tool for helping you to understand your business better. Even more useful, however, is what is called a ‘break even analysis’- a means of determining how much you must sell in order to meet your commitments. To produce a simple break-even analysis, add up all your overheads and the payments you will have to make whether you produce anything or not. Included will be rent, rates, insurance, lighting and heating, etc.; also, office staff wages, the basic

wages, production workers, interest on bank overdrafts or loans, sales, costs and, of course, depreciation. Work out the cost of making one article, excluding all the above overheads, etc. included in this ‘marginal cost’, as it is called, will be raw materials, and those wages that are directly related to production, i.e. piece work or bonus payments and overtime. Settle on your selling price (which should be the highest your market will stand). Work out the difference between the cost (2) and the selling price to determine your gross profit per unit. Now work out how many units you will have to sell to meet your commitments before you make a penny for yourself.

2.3.1 The Break-Even Chart

In its simplest form, the break-even chart is a graphical representation of costs at various levels of activity shown on the same chart as the variation of income (or sales, revenue) with the same variation in activity. The point at which neither profit nor loss is made is known as the "break-even point" and is represented on the chart below by the intersection of the two lines:



In the diagram above, the line OA represents the variation of income at varying levels of production activity ("output"). OB represents the total fixed costs in the business. As output increases, variable costs are incurred, meaning that total costs (fixed + variable) also increase. At low levels of output, Costs are greater than Income. At the point of intersection, P, costs are exactly equal to income, and hence neither profit nor loss is made.

Fixed Costs

Fixed costs are those business costs that are not directly related to the level of production or output. In other words, even if the business has a zero output or high output, the level of fixed costs will remain broadly the same. In the long term, fixed costs can alter - perhaps as a result of investment in production capacity (e.g. adding a new factory unit) or through the growth in overheads required to support a larger, more complex business.

Examples of Fixed Costs

- Rent and rate
- Depreciation
- Research and development
- Marketing costs (non- revenue related)
- Administration costs

Variable Costs

Variable costs are those costs which vary directly with the level of output. They represent payment output-related inputs such as raw materials, direct labor, fuel and revenue-related costs such as commission.
A distinction is often made between "**Direct**" variable costs and "**Indirect**" variable costs.

Direct variable costs are those which can be directly attributable to the production of a particular product or service and allocated to a particular cost center. Raw materials and the wages those working on the production line are good examples.

Indirect variable costs cannot be directly attributable to production but they do vary with output. These include depreciation (where it is calculated related to output - e.g. machine hours), maintenance and certain labor costs.

Semi-Variable Costs

Whilst the distinction between fixed and variable costs is a convenient way of categorizing business costs, in reality there are some costs which are fixed in nature but which increase when output reaches certain levels. These are largely related to the overall "scale" and/or complexity of the business. For example, when a business has relatively low levels of output or sales, it may not require costs associated with functions such as human resource management or a fully-resourced finance department. However, as the scale of the business grows (e.g. output, number people employed, number and complexity of transactions) then more resources are required. If production rises suddenly then some short-term increase in

warehousing and/or transport may be required. In these circumstances, we say that part of the cost is variable and part fixed.

Self-Assessment Exercise: 1

What do you understand by break-even analysis?

2.4 Break-Even Method of Investment Analysis

Break-even analysis is a useful tool to study the relationship between fixed costs, variable costs and returns. A break-even point defines when an investment will generate a positive return and can be determined graphically or with simple mathematics. Break-even analysis computes the volume of production at a given price necessary to cover all costs. Break-even price analysis computes the price necessary at a given level of production to cover all costs. To explain how break-even analysis works, it is necessary to define the cost items.

Fixed Costs (FC) incurred after the decision to enter into a business activity is made, are not directly related to the level of production. Fixed costs include, but are not limited to, depreciation on equipment, interest costs, taxes and general overhead expenses. Total fixed costs are the sum of the fixed costs.

Variable Costs (VC) change in direct relation to volume of output. They may include cost of goods sold or production expenses such as labor and power costs, feed, fuel, veterinary, irrigation and other expenses directly related to the production of a commodity or investment in a capital asset. Total variable costs (TVC) are the sum of the variable costs for the specified level of production or output. Average variable costs are the variable costs per unit of output or of TVC divided by units of output.

Total Fixed Costs (TFC) are shown in Figure 3.1 by the broken horizontal line. Total fixed costs do not change as the level of production increases. Total variable costs of production are indicated by the broken line sloping upward, which illustrates that total variable costs increase directly as production increases.

The total cost line is the sum of the total fixed costs and total variable costs. The total cost line parallels the total variable cost line, but it begins at the level of the total fixed cost line.

The total income line is the gross value of the output. This is shown as a dotted line, starting at the lower left of the graph and slanting upward. At any point, the total income line is equivalent to the number of units produced multiplied by the price per unit.

The key point (break-even point) is the intersection of the total cost line and the total income line (Point P). A vertical line down from this point shows the level of production necessary to cover all costs. Production greater than this level generates positive revenue; losses are incurred at lower levels of production.

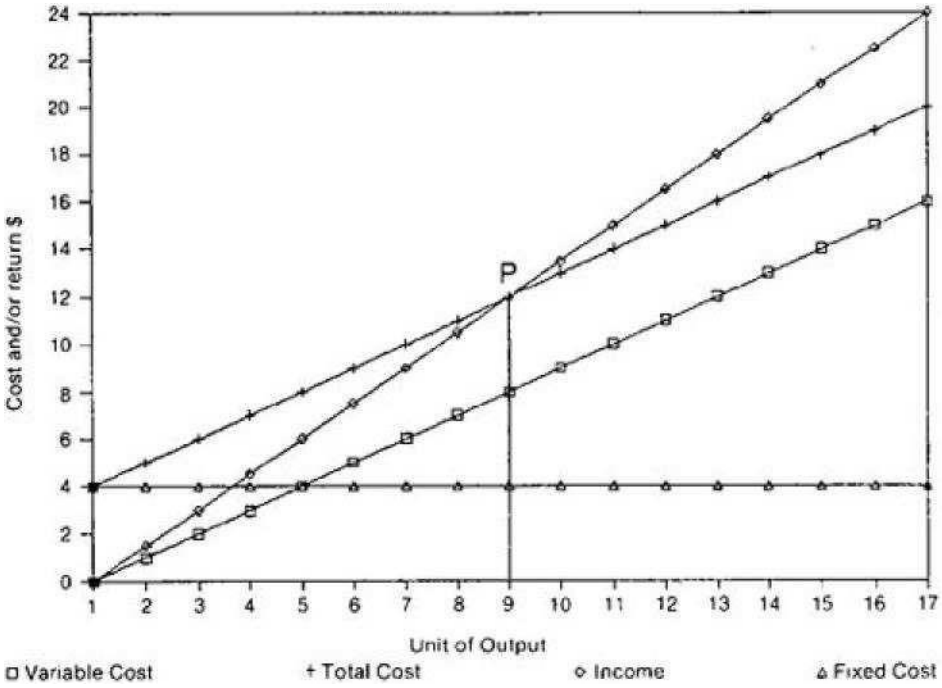


Figure 3.1: Graph form of break-even analysis.
Mathematical Explanation

The graphic method of analysis helps the reader understand the concept of the **break-even point**. However, graphing the cost and income lines is laborious. The break-even point is found faster and more accurately with the following formula:

B-E = F / (S - V) where:
B-E = break-even point (units of production),
F = total fixed costs,
V = variable costs per unit of production,
S = savings or additional returns per unit of production, and the mathematical approach is best presented using examples.

Example 1

A baker wants to buy a new mixer rather than hire a mixer. The total fixed costs for the desired mixer are ₦21,270 per year. The variable costs (not counting the operator's labor) are ₦8.75 per hour. The baker can produce

5 loaves per hour. The hired mixer charges ₦16.00 per hour. How many loaves must be produced per year to break-even?
Fixed costs (F) = ₦21,270
Savings (S) = ₦16/A
Variable costs (V) = ₦8.75/hr. / 5 A/hr. = ₦1.75/A
B-E = ₦21,270 / (₦16/A - ₦1.75/A) = ₦21,270 / ₦14.25/A = 1,493 loaves

Example 2
Break-even analysis can be easily extended to consider other changes. If the baker can save two additional loaves per hour more than the current mixer, what would be the break-even point if a loaf is worth ₦4/loaf?
Additional income =₦4/bu * 2 bu/A = ₦8/A
B-E = ₦21,270 / (₦16/A + ₦8/A - ₦1.75/A) = ₦21,270 / ₦22.25/A = 956 Acres

Example 3

A farmer raising 1,200 acres of wheat per year considers purchasing a combine. How much additional return (to land, capital labor, management and risk) would result?
Additional return = (savings or additional income) - (fixed costs + variable costs)
Additional profit = [₦16/ac + (₦4/bu * 2 bu/ac)] x 1200 A = ₦21,270 + [(₦8.75/hr. / 5 A/hr.) x 1200 A] = ₦28,800-₦23,370 = ₦5,430
Thus, the farmer would generate another $5,430 in additional return by purchasing the combine. A farmer harvesting only 900 acres would probably choose not to buy the combine because the acreage is below the break-even point of 956 acres. The farmer may want to evaluate the purchase of a smaller or used combine.

Additional Situations

Two additional situations are presented as follows:

Problem 1. If the fixed costs for the combine are ₦12,000 per year, no additional yield is expected, variable costs are ₦7 per hour and the farmer can combine 4 acres per hour, what is the new break-even point?

Problem 2. If 900 acres are harvested, what is the effect on the farmer's profits?

Solutions: Problem 1
Fixed costs = ₦12,000
Savings = $16/A
Variable costs = ₦7/hr. / 4 A/hr. = ₦1.75/A Problem 1:

B-E = ₦12,000 / (₦16/A - ₦1.75/A) = ₦12,000 / ₦14.25/A = 842 Acres

Solutions: Problem 2
Additional profit = (₦16/A x 900 A) - [₦12,000 + ($7/hr. / 4 A/hr. x 900 A = ₦14,000 - ₦13,575 =₦825 increase

2.4.1 Appraisal of Break-even Analysis

The main advantage of break-even analysis is that it points out the relationship between cost, production volume and returns. It can be extended to show how changes in fixed cost-variable cost relationships, in commodity prices, or in revenues, will affect profit levels and breakeven points. Limitations of break-even analysis include:

- ✓ It is best suited to the analysis of one product at a time;
- ✓ It may be difficult to classify a cost as all variable or all fixed; and
- ✓ There may be a tendency to continue to use a break-even analysis after the cost and income functions have changed.

Break-even analysis is most useful when used with partial budgeting or capital budgeting techniques. The major benefit to using break-even analysis is that it indicates the lowest amount of business activity necessary to prevent losses.

Break-Even Analysis

This type of report is neither one that is automatically generated by most accounting software, nor is it one that is normally produced by your accountant, but it is an important analysis for you to have and understand. For any new business, you should predict what gross sales volume level you will have to achieve before you reach the break-even point and then, of course, build to make a profit. For early-stage businesses, you should be able to assess your early prediction and determine how accurate they were, and monitor whether you are actually on track to make the profits you need. Even the mature business would be wise to look at their current break-even point and perhaps find ways to lower that benchmark to increase profits. The recent massive layoffs at large corporations are directed at this goal, lowering the break-even point and increasing profits.

Break-even is the volume where all fixed expenses are covered. You will start a break-even analysis by establishing all the fixed (overhead) expenses of your business. Since most of these are done on a monthly basis, don't forget to include the estimated monthly amount of line items that are normally paid on a quarterly or annual basis such as payroll, taxes or insurance. For example, if your annual insurance charge is ₦9,000, use 1/12 of that, or ₦750 as part of your monthly budget. With the semi-

variable expense (such as phone charges, travel, and marketing), use that portion that you expect to spend each and every month.
For the purpose of a model break-even, let's assume that the fixed expenses look as follows:

	₦
Administrative salaries	1,500
Rent	800
Utilities	300
Insurance	150
Taxes	210
Telephone	240
Auto expense	400
Supplies	100
Sales and marketing	300
Interest	100
Miscellaneous	400
Total	4,500

These are the expenses that must be covered by your gross profit. Assuming that the gross profit margin is 30 per cent, what volume must you have to cover this expense? The answer in this case is 15,000—30 per cent of that amount is ₦4,500, which is your target number.
The two critical numbers in these calculations are the total of the fixed expense and the percentage of gross profit margin. If your fixed expense is n10,000 and your gross profit margin is 25 percent, your break-even volume must be ₦40,000.

This is Not a Static Number

You may do a break-even analysis before you even begin your business and determine that your gross margin will come in at a certain percentage and your fixed expense budget will be set at a certain level. You will then be able to establish that your business will break-even (and then go on to a profit) at a certain level of sales volume. But your prestart projections and your operating realities may be very different. After three to six months in business, you should compare projections to the real-world results and reassess, if necessary, what volume is required to reach break-even levels.

Along the way, expenses tend to creep up in both the direct and indirect categories, and you may fall below the break-even volume because you think it is lower than it has become. Take your profit and loss statement every six months or so and refigure your break-even target number.

Ways to Lower Break-Even

There are three ways to lower your break-even volume, only two of them involve cost controls (which should always be your goal on an ongoing basis).

1. Lower direct costs, which will raise the gross margin. Be more diligent about purchasing material, controlling inventory, or increasing the productivity of your labor by more cost-effective scheduling or adding more efficient technology.

2. Exercise cost controls on your fixed expense, and lower the necessary total dollars. Be careful when cutting expenses that you do so with an overall plan in mind. You can cut too deeply as well as too little and cause distress among workers, or you may pull back marketing efforts at the wrong time, which will give out the wrong signal.

3. Raise prices! Most entrepreneurs are reluctant to raise prices because they think that overall business will fall off. More often than not that doesn't happen unless you are in a very price sensitive market, and if you are, you really have already become volume driven.

But if you are in the typical niche-type small business, you can raise your prices 4 to 5 per cent without much notice of your customers. The effect is startling. For example, the first model we looked at was the following:

				₦
Volume		15,000		
Direct cost	-	10,500	70%	
			Gross profit	4,500

Raising the prices 5 per cent would result in this change:

				₦
Volume		15,750		
Direct cost	-	10,500	67%	
		Gross profit		5,250

You will have increased your margin by 3 per cent, so you can lower the total volume you will require to break-even.

Self-Assessment Exercise: 2

1. Distinguish between break-even point and break-even price.

2.5 Summary

In the course of this study various definitions of break-even were identified, while the elements of breakeven were examined and finally, the analysis of break-even vis-à-vis project financing. You are in business to make a profit not just break-even, but by knowing where that number is, you can accomplish a good bit: You can allocate the sales and marketing effort to get you to the point you need to be. Most companies have slow months, so if you project volume below break-even, you can watch expenses to minimize losses. A few really bad months can wipe out a good bit of previous profit. Knowing the elements of break-even allows you to manage the costs to maximize the bottom line. Once you have gotten this far in the knowledge of the elements of your business, you are well on your way to success.

2.6 References/Further Readings/Web Sources

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2.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1
Break-even analysis is a useful tool to study the relationship between fixed costs, variable costs and returns. Break-even analysis computes the volume of production at a given price necessary to cover all costs. Break-even analysis indicates the lowest amount of business activity necessary to prevent losses.

Self-Assessment Exercise: 2
A break-even point defines when an investment will generate a positive return and can be determined graphically or with simple mathematics. Break-even price analysis computes the price necessary at a given level of production to cover all costs.

Unit 3 Tourism Project Financial Statement

3.1 Introduction

Cash flow simply means the difference between number of Naira that came in and the number that went out. For example, if you were the owner of a business, you will be very interested in how much cash you actually took out of your business in a given year. How to determine this amount is one of the things we shall discuss in this part of our study.

At the fundamental level, firms do two different things: they generate cash and spend it. Cash is generated by selling a product, an asset or a security. Selling a security involves either borrowing or selling an equity interest (i.e. shares of stock) in the firm. Cash is spent in paying for materials and labor to produce a product and in purchasing assets. Payments to creditors and owners also require the spending of cash. The cash flow identity summarizes the total cash result of all transactions a firm engages in during the year.

In the short term, however, a considerable amount of managerial resources is devoted to day-to-day decision making in respect of working capital. Working capital, which also has an effect on a company's total market value, consists of short-term (current) assets and short-term (current) liabilities which, by definition, have terms to maturity less than one year. Current assets can be funded wholly or in part on a short-term basis, with net working capital measured as current assets less current liabilities. This begins by defining the main components of current assets and current liabilities and by describing the role of working capital in a company's operations.
Attention is then turned to the core element in working capital: the management of cash flows. In long-run analysis, the focus is on annual

net cash flows. In short-run analysis, a key issue is how the current year's net cash flows are expected to take shape on a daily or weekly basis. The expected short-term behavior of net cash flows involves a company in developing strategies to avoid financial distress and bankruptcy, especially if the company anticipates sustained periods over which cash outflows will exceed cash inflows.

Following this, some of the basic principles involved in modeling the components of working capital are described. These relate to the management of cash and marketable securities, inventory and account receivable (or trade debtors). In terms of current liabilities, there are two main components: accounts payable (or trade creditors) and short-term debt financing.

Finally, overall working capital policy is examined in terms of a company's overall level of investment in current asset and in respect of the strategy the company adopts in matching the maturity structure of its assets and liabilities.

3.2 Learning Outcomes

By the end of this unit you will be able to:

- ✓ Describe cash flow statement
- ✓ Explain the various changes occur over the period on the balance sheet
- ✓ Prepare an income statement
- ✓ Describe the core element in working capital: the management of cash flows
- ✓ Explain the basic principles involved in modeling the components of working capital
- ✓ Define the working capital policy
- ✓ Describe the various strategy involved in application of working capital
- ✓

3.3 Cash Flow

Cash flow is an accounting term that refers to the amounts of cash being received and spent by a business during a defined period of time, sometimes tied to a specific project. Measurement of cash flow can be used to:

- ✓ **Evaluate the state or performance of a business or project.**
- ✓ Determine problems with liquidity. Being profitable does not necessarily mean being liquid. A company can fail because of a shortage of cash, even while profitable.
- ✓ Generate project rate of returns. The time of cash flows into and out of projects are used as inputs to financial models such as internal rate of return, and net present value.
- ✓ Examine income or growth of a business when it is believed that accrual accounting concepts do not represent economic realities. Alternately, cash flow can be used to 'validate' the net income generated by accrual accounting.

Cash flow as a generic term may be used differently depending on context, and certain cash flow definitions may be adapted by analysts and users for their own uses. Common terms (with relatively standardized definitions) include operating cash flow and free cash flow.

3.3.1 Classification of Cash flow

Cash flows can be classified into:

- ✓ **Operational Cash Flows**: Cash received or expended as a result of the company's core business activities.
- ✓ **Investment Cash Flows:** Cash received or expended through **capital expenditure,** investments or acquisitions.
- ✓ **Financing Cash Flows:** Cash received or expended as a result of financial activities, such as receiving or paying loans, issuing or repurchasing stock, and paying dividends.

All three together are necessary to reconcile the beginning cash balance to the ending cash balance.

3.3.2 Benefits from Using Cash Flow

The cash flow statement is one of the four main financial statements of a company. The cash flow statement can be examined to determine the short-term sustainability of a company. If cash is increasing (and operational cash flow is positive), then a company will often be deemed to be healthy in the short-term. Increasing or stable cash balances suggest that a company is able to meet its cash needs, and remain solvent. This information cannot always be seen in the income statement or the balance sheet of a company. For instance, a company may be generating profit, but still have difficulty in remaining solvent.

The cash flow statement breaks the sources of cash generation into three sections: operational cash flows, investing and financing. This breakdown

allows the user of financial statements to determine where the company is deriving its cash for operations. For example, a company may be notionally profitable but generating little operational cash (as may be the case for a company that barters its products rather than selling for cash). In such a case, the company may be deriving additional operating cash by issuing shares, or raising additional debt finance.

Companies that have announced significant write downs of assets, particularly goodwill, may have substantially higher cash flows than the announced earnings would indicate. For example, telecoms firms that paid substantial sums for 3G licenses or for acquisitions have subsequently had to write-off goodwill, that is, indicate that these investments were now worth much less. These write-downs have frequently resulted in large announced annual losses, such as Vodafone's announcement in May 2006 that it had lost £21.9 billion due to a write down of its German acquisition, Mannesmann, one of the largest annual losses in European history. Despite this large "loss", which represented a sunk cost, Vodafone's operating cash flows were solid: "Strong cash flow is one of the most attractive aspects of the cellphone business, allowing operators like Vodafone to return money to shareholders even as they rack up huge paper losses."

In certain cases, cash flow statements may allow careful analysts to detect problems that would not be evident from the other financial statements alone. For example, WorldCom committed an accounting fraud that was discovered in 2002; the fraud consisted primarily of treating ongoing expenses as capital investments, thereby fraudulently boosting net income. Use of one measure of cash flow (free cash flow) would potentially have detected that there was no change in overall cash flow (including capital investments).

3.4 Managing Short-Term Net Cash Flows

In the short term, how net cash flow takes shape on a daily or weekly basis has an important bearing on value.

3.4.1 Cash Outflows

Over a year, cash outflows will consist of regular payments to meet wages and salaries, and bills furnished by suppliers. Cash outflows will also occur in respect of tax-demands, interest payments and fees which can be expected at specific times during the year and in respect of the purchase of plant and machinery for long-term capital investment. These constitute what is referred to as the transactions motive for holding cash.
There may also be unanticipated events over a year which requires a company to have immediate access to cash resources. This constitutes the

precautionary motive for holding cash. A speculative motive can exist to enable a company to take advantage of undervalued inputs or equipment which come up for sale due, for example, to a competitor going bankrupt. There is a fourth reason for holding cash known as a compensating balance motive. Here a company's bank may require it to hold minimum balances in its current account in order to indirectly cover the bank's costs of administration. If a company receives no interest on its current account, its bank receives all of the income earned on the company's balances through the bank's own investment strategies. Recently there has been a tendency to move away from compensating balances, with companies negotiating transactions fees with banks and receiving current account interest payments, or investing their surplus cash elsewhere.

3.4.2 Cash Inflows

Where cash inflows are concerned, these can be expected to occur at regular intervals over the year largely as a result of the pattern of sales. This pattern can, however, be uneven if sales are seasonal. For example, in the cases of toy manufacturers, and department stores the majority of sales, and hence cash inflows, can be expected to occur in the months around Christmas. In the case of a clothing manufacturer a significant proportion of orders can be expected during the weeks in which this industry has its national and international fashion shows.

In addition, anticipated cash inflows may be disrupted due to sudden and unexpected change in the economy. If, for example, there is an unanticipated rise in interest rates, short-term trade debtors who also have high levels of bank debt may respond by delaying settlement of their involves, using their own cash inflows to meet higher bank interest charges. Further, a major customer of a company may fail leaving significant amounts of unpaid debts.

3.4.3 Net Cash Flow Policy

Given the opportunity costs of cash, in terms of borrowing and lending rates, it is in the interests of a company to:

- ✓ Delay its expected cash outflows as long as possible, subject to minimizing the risks of jeopardizing input supplies
- ✓ Maximize, at a current point in time, its expected cash inflows, subject to minimizing the risk of jeopardizing customer good will
- ✓ Avoid significant periods when excess cash balances earning no interest are likely to increase as a result of cash inflows exceeding cash outflows; and
- ✓ Avoid incurring costs associated with using short-term bank loans or overdrafts to cover significant periods when cash outflows exceed cash inflows.

In the short-term in order to cope with periods when net cash flows are expected to be negative and to avoid, at other times, holding excessive amounts of idle cash balances, a company can invest in a portfolio of marketable securities which earn interest. Investment in this portfolio is increased when short-term net cash flows are positive. When cash outflows exceed incoming cash receipts, some of the short-term marketable securities are sold to meet the deficit.

There are problems of capital or interest rate, risk involved in holding a portfolio of marketable securities. Consequently, companies, in seeking to avoid financial distress, tend to invest surplus cash balances in short term marketable securities which long-term prices, in response to a given interest rate change, vary less than those of long-term marketable. This minimizes interest rate risk but entails a cost since, with the term structure of interest rates sloping upwards for most periods of time, short-term marketable securities earn a lower rate of return than long term marketable securities.

In general, the optimal level of cash and marketable securities will be determined in a much wider risk-return trade-off context, where the risk of not being able to meet short-term cash outflows is set against the opportunity costs of foregoing investments in long-term physical assets. On average, returns on the latter exceed the returns which companies can earn on both short-term and long-term financial asset.

Self-Assessment Exercise: 1

1. What do you understand by cash outflows?

3.5 Liquidity Management

Liquidity is defined as the ability to realize value in cash. It has two components:

- ✓ The conversion time of an asset, that is, the time lag between deciding to sell an asset and receiving payment for it; and
- ✓ Its conversion price.

Cash has zero conversion time and no conversion price risk. Marketable securities, provided they are actively traded, have zero conversion time but have significant conversion price risk associated with interest rate risk. The optimal level of liquidity, that is, a level which is not too low as to produce significant probabilities of financial distress and bankruptcy, and not too high as to reduce the rate of return on long-term investment,

is difficult to determine. As a rough guide a number of short-term financial ratios can be examined to determine if an optimal liquidity policy is being pursued. Beginning with cash and marketable securities ratios, these are:

Cash + Marketable Securities
Current Assets and
Cash + Marketable Securities
Current Liabilities

Reasonably large values of the former indicate that cash and marketable securities can provide substantial sources of funds to finance any increases in current assets which might occur with increased sales. Reasonably high levels of the latter measure the ability to meet current liabilities without the need to liquidate other current assets, for example inventory, or without recourse to external sources of finance.

It would be wrong, however, to determine the liquidity position of a company purely in cash ratio terms. As indicated, inventory can be sold directly for cash, but it may have a relatively long conversion time and have a conversion price which is significantly less than the inventory's intrinsic value. The latter will occur especially if it is known that inventory is being offered for sale in a situation of financial distress.

Banks and financial institutions provide factoring services in respect of inventory and invoice discounting in respect of accounts receivable so as to eliminate conversion time. Here, a part or a whole of a company's inventory and/or its accounts receivable are purchased by a factoring company which, consequently, provides an immediate infusion of cash. Again, however, the conversion price will be below the intrinsic value of the current asset being purchased since factors earn their returns from obtaining assets at significant discounts and then reselling them or, in the case of accounts receivable, collecting payments due.

Two, more broadly-based liquidity, measures take some of the above points into account. The first is the current ratio defined as:

Current Ratio = <u>Current Assets</u> - Current Liabilities
This encompasses net working capital (current assets less current liabilities) and is a measure of a company's capacity to meet its liabilities, due within one year, out of current assets. Because a substantial proportion of current assets includes inventory which, assuming factoring services are not used, has a positive conversion time and significant conversion price risk, a desirable level for this ratio is taken, on average, to be 2.1. The second liquidity measure is referred to as the Acid Test or Quick ratio. This ratio nets out the effect of inventory and is defined as:

$$\textbf{Quick Ratio} = \frac{\textbf{Cash Assets - Inventory}}{\textbf{Current Liabilities}}$$

On average, its optimal level is considered to be 1:1,

These cash, current and quick ratios are unlikely to give a full picture of a company's liquidity position. Back-up lines of credit which may not be explicitly observable can be important, for example, a bank's willingness to provide it has placed on a company's current account and a bank's willingness to provide additional short-term loans at short notice. These factors will help to determine a company's financing flexibility which, as explained in unit 11, partly depends on the levels of short-term and long-term tangible assets already pledged in existing loan contracts. Indeed, the ability of a company to provide a near-term cash flow forecast, and the variability surrounding near-term cash flows, also play a part in determining the effect of liquidity on a company's market value.

The above introduces a dynamic aspect to liquidity which is not normally picked up in static (at a point in time) short-term financial ratios. The dynamic aspect involves the speed with which a company can alter its short-term position to avoid a crisis. It has been argued that one possible way of accommodating this is by considering a ratio based on a company's earning power, that is, the ratio of:

$$\frac{\textbf{Cash Liabilities – Quick Assets x 365}}{\textbf{Operating Funds Expected to be Generated over a Year}}$$

This ratio gives the number of days required to pay off net current debt, that is, current debt not covered by liquid or quick assets. If, for example, this ratio exceeds 365 a company will be unable to meet its net current obligations out of its current year's expected earnings. Alternatively, if the ratio is significantly below 365 and short-term difficulties arise. The indication may be that additional short-term finance will be obtainable since banks would view such funding as entailing low risk. Expected earnings over the current year are not., however, a substitute for a short-term cash flow forecast which provides better evidence of the ability to repay net current debt.

3.5.1 Managing Inventory

Cash and marketable securities are a form of inventory; therefore, when considering inventory in the wider context of raw materials, finished goods and spare parts, the basic principles used in cash management are applied. Indeed, the Economic Order Quantity Model was developed originally with physical inventory in mind. Here for example, the optimal

level of raw materials over an inventory holding periods is determined in relation to the demand for a company's product and the holding and ordering costs of stock. Holding costs include the opportunity costs of financing inventory and of warehousing space together with any insurance costs.

As in the case of running out of cash, there are costs involved in running out of raw materials spare parts in terms of potential disruptions to production runs and sales patterns. Additional physical inventory costs can include the danger of a deterioration in the quality of inventory if it is held for too long; obsolescence, especially if the inventory is of a technical nature, and lead time variations, that is, the time lag between ordering and receiving new inventory. An important potential benefit from holding inventory is associated with possible price discounts on bulk purchases. Moving beyond the Economic Order Quantity Model, optimal control theory can be used to take account of unpredictability in product demand patterns.

A recent approach to inventory management in companies with repetitive manufacturing systems has involved near elimination of stock holdings. This just-in-time inventory system requires suppliers to provide that relevant inputs, in their relevant quantities, at the precise points in time when they are needed in a manufacturing operation. There are costs in attempting to ensure that the just-in-time system works. These involve developing co-coordinating and monitoring operating plans between a company and its suppliers.

$$\text{Inventory Turnover} = \frac{\text{Costs of Goods Sold}}{\text{Inventory}}$$

A relatively high inventory turnover ratio may suggest that a company is managing this current asset relatively efficiently. It could suggest, for example, that excessive amounts of stock, which would incur a significant probability of obsolescence and high warehousing costs, are not being held. On the other hand, a relatively high ratio could indicate that not enough stocks are being held to support future potential sales growth. In effect, a company's inventory turnover ratio should be judged in relation to the nature of the stock being held and in respect of a base point, such as the average inventory turnover ratio for the industry in which the company is located.

3.5.2 Managing Accounts Receivable

A company which grants trade credit to its customers creates current assets in the form of accounts receivable or trade debtors. It also influences its average collection period, that is, the average time lag

between supplying customers and receiving cash payments in settlement of invoices. As explained, granting trade credit can have an important effect in stimulating a company's sales and thus, given its average collection period, its sales revenue.

The average collection period is important in an opportunity cost sense since it involves a company in foregoing interest on cash which could have been invested in marketable securities. An important additional factor in offering trade credit is the probability of incurring bad debt that is, selling to customers who significantly delay or even default on their payments. Granting trade credit can be analyzed in terms of net present value (NPV).

As an investment decision, while the factors influencing the trade credit decision are complex, two simple examples are presented below to illustrate the basic principles.

This is followed by a brief discussion of consumer credit evaluation.

Looking at the average collection period, one way of reducing this is by changing or introducing, if not already in existence, discounts on the list price of goods sold, the discounts only being available to customers who settle their accounts within a specified period. (Such a policy can also influence sales). While a reduction in the average collection period has a benefit in that it reduces interest foregone on accounts receivable, it has a cost to the extent that discounts are taken up by customers and, consequently, profits from increased sales are reduced.
To illustrate these concepts, consider a company which has monthly sales of N2m and annual sales of N24m. Its average collection period is 30 days, indicating that there is approximately one month between it supplying its products and receiving payments for them. The company has therefore, an average investment in accounts receivable of N2m. in terms of its annual sales the company has an accounts receivable turnover ratio.

Receivables Turnover =	Annual Sales	= ₦24m
Average Receivables Balance	₦2m	= ₦ 12

Note, that the ratio for the average collection period is formally defined on 365 days in the year, as:

$$\text{Average Collection Period} = \frac{\text{Accounts Receivable}}{\text{Sales}} \times 365$$

In the present example this ratio is (365) (₦2m / ₦24m) = 30.4 days.
Normally in accounting terms this would be rounded to 31 days.

3.5.3 The Cash Operating Cycle

Having introduced some of the ratios associated with current asset and liability management, it is useful to return to cash management and consider the cash operating cycle. This indicates the net time interval between cash inflows from goods sold and cash outflows for the purchase of resources. It is a measure of the length of time a company has funds tied up in working capital, an increase (decrease) in the cycle indicating an increase (decrease) in working capital needs.

A company's cash operating cycle is equal to:

- ✓ The average number of days a given inventory is held, measuring the length of time required to purchase and sell its product: plus
- ✓ The average collection period on its account receivable, measuring the length of time required to collect sales revenue; minus

Table 3.1: The cash operating cycle

Annual	₦100,000				
Cost of goods sold	₦40,000				
Balance	**₦**		**Ratios**	**₦**	
Inventory	5000	Inventory	***Cost of goods***	**40,000**	8
			Inventory	**5000**	
Accounts	10,000	***Receivable***	***Sales***	**100, 000**	10
Receivable	Turnover		Receivables	**10,000**	
Account	5,000	***Debtor***	***Sales***	**100,000**	10
Payable	Turnover		Account Payable	**10,000**	

* The average period of its accounts payable, measuring the length of time payments can be deferred on its purchase of resources.

This is, the cash operating cycle is equal to:

$$365 \left[\frac{1}{\text{Inventory Turnover Ratio}} + \frac{1}{\text{Receivables Turnover Ratio}} - \frac{1}{\text{Debtor Turnover Ratio}}\right]$$

Since each of these ratio measures, respectively, the number of times in a year that inventory, accounts receivable and accounts payable are 'turned over', dividing each ratio into the number of days in a year measures the average number of days each of these components of working capital is held.

To illustrate, consider a company which has average annual sales of £100,000 at an average annual cost of goods sold of £40,000. given the average balances in its inventory, accounts receivable and accounts payable and the relevant ratios, the cash operating cycle is:

365 1 + 1 - 1

8 10 10 = 365 [0.125 + 0.1 - 0.1] = 45.6 days

If for example, the company reduced its investment in accounts receivable there would be, all other things being equal, an improvement in liquidity as measured by the cash operating cycle. Assuming accounts receivable are reduced to £6000, the receivable turnover ratio falls to £100,000/£6000 = 16.7. Thus, the cash operating cycles reduced from 45.6 days to 31 days: that is, in the latter case:

365 1 + 1 - 1

8 16.7 10 = 365 [0.125 + 0.06 - 0.1] = 365[0.085] 31days

3.5.4 Overall Working Capital Policy

To bring this unit to a close it is important to consider the overall policy which a company might adopt in respect of its working capital. There are two aspects of this, one involving the investment decision and the other involving the financing decision. The former is examined first.

Current Asset Policy

In an earlier part of this unit, when discussing cash and marketable securities, the importance of the risk-return relationship was identified. It was argued that the benefits of liquidity, in terms of producing low risk but low returns, should be weighed against relatively higher returns but higher risk produced by investing in long-term physical or fixed assets.

This risk-return principle applies to a company's investment decision in respect of its overall current assets. In this context, there are three alternative strategies which can be adopted. They involve average, conservative and aggressive approaches to risk management. Under the conservative strategy, relative to the average, there is a relatively high proportion of investment in current assets. This produces below average risk and below average total return. Under the aggressive strategy, relative to the average, there is a relatively low proportion of investment in current assets, producing above average risk and above average total returns.

The choice of strategy varies from industry to industry depending on the nature of the product and/or service being supplied and, among other factors on sales variation and the degree of operating leverage. Sales variation and operating leverage determine business risk and hence the variation in net cash flows. The overriding objective should be to determine the ratio of current assets to total assets which maximizes the total market value of a company.

Current and Long-Term Liability Policy

Once the investment decision has been made, strategies for financing current assets must be addressed. These strategies involve choosing the term structure of liabilities appropriate to a given term structure of assets. The analysis is aided by considering a company's cumulative capital requirement at a given point in time, that is, the total capital necessary to fund a company's total investment. The cumulative capital requirement is determined by fixed, or long-term, assets, permanent assets; and spontaneous, or fluctuating current assets.

The division of current assets into permanent spontaneous components arises to the extent that a company can predict its long-term trend in sales. To the extent that it can
do this, the proportions of its current assets necessary to support this trend can be considered to be long-term and, therefore, effectively permanently. The remaining proportions of current asset investments (in cash and marketable securities, inventories and accounts receivable) are spontaneous. They are spontaneous in that these current assets fluctuate to facilitate unanticipated changes in sales and as a result of the innate variation in the current asset components themselves. The cumulative capital requirement is illustrated in figure 3.1.

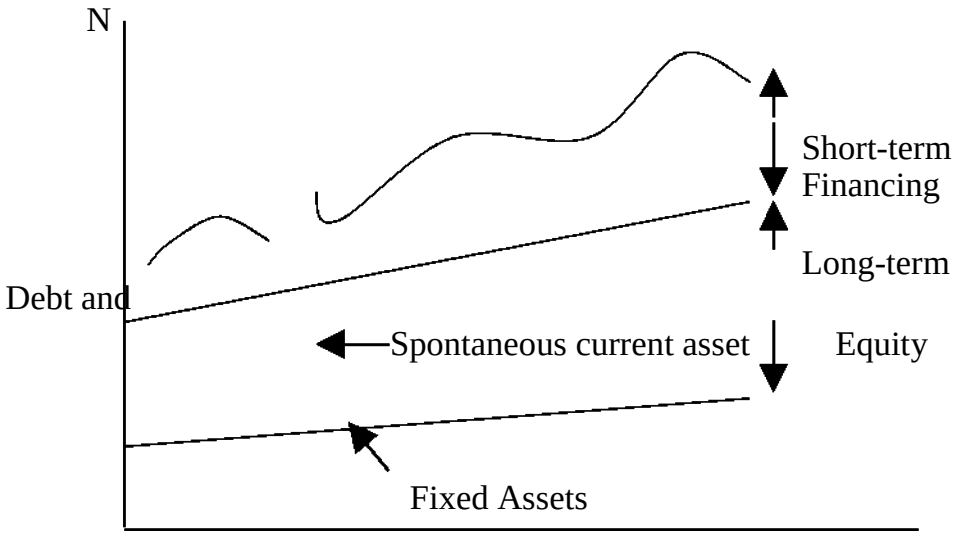

Figure 3.1: The Cumulative Capital Requirement and Average Hedging

There are three alternative financing strategies which involve average, aggressive and conservative hedging approaches to financial risk management. The average hedging approach consists of marching the maturity structure of assets and liabilities, on the assumption that permanent current assets can be treated as long-term investments. Here all fixed and permanent current assets are funded by long-term debt and equity, with spontaneous current assets being financed by short-term debt and accounts payable. This approach exposes a company to 'average' risk with 'average' risk with 'average' expected returns.

3.5.5 Forecasting Working Capital

A company may occasionally require a forecast of the amount of working capital needed to finance an increase in output or introduction of a new product. In preparing a working capital forecast, the factors to be considered include anticipated production level and production costs, length of production cycle, planned stock levels and credit terms.

Illustration:
The following information relates to XYZ plc.

Turnover	**N3million**
Cost as a percentage of turnover:	
Direct material	30%
Direct labor	25%
Variable overhead	10%
Fixed overhead	15%
Selling and distribution overhead	5%

Note: On average, debtors take $2^{1/2}$ months before payment. Raw materials are in stock for 3 months. Work-in-progress represents 2 months half produced goods. Finished goods represent one-month production.

Credit is taken as follows:

Direct material	2 months
Direct labor	1 week
Variable overheads	1 month
Fixed overheads	1 month

Selling and distribution overheads $^{1/2}$ a month.
Work in progress and finished goods are valued at material, labor and variable expense cost.

You are required to compute the working capital requirement of XYZ plc (assume 50 working weeks in a year).
Hint: Estimate the total amount of debtors and creditors.

Solution

1. Debtors = $2^{1}/_{2}$ /12 x ₦3m =₦625,000
2. Direct materials cost = 30% x ₦3m =₦900,000
3. Stock of raw materials = 3/12 ₦900,000 =₦225,000
4. Valuation of Work-in-progress:

Raw material = 2/12 x ₦900,000 = ₦150,000
Direct labor = 2/12 x ₦750,000 = ₦ 62,000
Variable overhead = 2/12 x 0.5 x ₦300,000 = ₦25,000
Total = ₦237,500

5. Valuation of Finished Goods:

Raw materials	= 1/12 x ₦900,000	= ₦75,000
Direct labor	= 1/12 x ₦75,000	= ₦62,500
Variable overhead	= 1/12 ₦300,000	= ₦25,000
Total		₦162,500

Total Stock = ₦ (225,000 + 237,500 + 162,500) = ₦ 625,000

6. Creditors:

Direct materials = 2/12 x ₦900,000	= ₦150,000
Direct labor = 1/50 x ₦750,000	= ₦ 15,000
Variable overhead = 1/12 ₦300, 000	= ₦ 25,000
Fixed overhead = 1/12 x 450,000	= ₦ 37,500
Selling and distribution = $1_{/2}$ /12 x ₦150,000	= ₦ 6,250
	= ₦233,750

Therefore, working capital required = Stock + Debtors – Creditors
W.C. = ₦ (625,000 + 625,000 – 233,750)
= ₦1,016,250

Self-Assessment Exercise: 2

2. As a prospective tourism project financial manager, what 2 concrete suggestions would you provide to your overall manger on network cash flow policy?

3.5 Summary

This unit critically discussed cash flow statements, income statement sources and uses of cash, working capital management in terms of cash management, inventory management and how to forecast working capital for an organization. Cash flows can be classified into: Operational cash flows: Cash received or expended as a result of the company's core business activities; Investment cash flows: Cash received or expended through capital expenditure, investments or acquisitions. Financing cash flows: Cash received or expended as a result of financial activities, such as receiving or paying loans, issuing or repurchasing stock, and paying dividends. All three together are necessary to reconcile the beginning cash balance to the ending cash balance.

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3.7 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

Cash outflows consist of regular payments to meet wages and salaries, and bills furnished by suppliers. They can occur in respect of tax-demands, interest payments and fees which can be expected at specific times during the project year and in respect of the purchase of plant and machinery for long-term capital project or investment. These constitute what is referred to as the transactions motive for holding cash.

Self-Assessment Exercise: 2

- ✓ Delay its expected cash outflows as long as possible, subject to minimizing the risks of jeopardizing input supplies
- ✓ Maximize, at a current point in time, its expected cash inflows, subject to minimizing the risk of jeopardizing customer good will
- ✓ Avoid significant periods when excess cash balances earning no interest are likely to increase as a result of cash inflows exceeding cash outflows; and
- ✓ Avoid incurring costs associated with using short-term bank loans or overdrafts to cover significant periods when cash outflows exceed cash inflows.

Unit 4 Tourism Project Budgeting Techniques

4.1 Introduction

Planning for and controlling the use of cash are important tasks. Failure to properly anticipate cash flow can lead to idle cash balances and lower rate of return on one hand and to cash deficit on the other hand. Cash budget is a device that all financial managers plan for and control the use of cash. It is a work sheet that shows cash inflows, outflows and cash balances over some budgeted time period. Its importance includes:

1. It helps to determine operating cash requirements
2. It helps to anticipate short-term finances 3. it helps to manage money market investment.

The time frame work of a cash budget is usually short-maximum one year. Within this time frame work the firm will forecast cash inflows, outflows and cash balances typically on a monthly or weekly basis.

4.2 Learning Outcomes

By the end of this unit you will be able to:

- ✓ State the purposes of cash budgeting
- ✓ Discuss the various types of cash budgeting
- ✓ Compute a cash budget

4.3 Purposes of Cash Budgeting

Properly preparing your cash budget will show how cash flows in and out of your business. Also, it may then be used in planning your short-term credit needs. In today's financial world, you are required by most financial institutions to prepare cash budgets before making capital expenditures for new assets as well as for expenditures associated with any planned expansion. The cash budget determines your future ability to pay debts as well as expenses. For example, preliminary budget estimates may reveal that your disbursements are lumped together and that, with more careful

planning, you can spread your payments to creditors more evenly throughout the entire year.

As a result, less bank credit will be needed and interest costs will be lower. Banks and other credit-granting institutions are more inclined to grant you loans under favorable terms if your loan request is supported by a methodical cash plan. Similarly, businesses that operate on a casual day-to-day basis are more likely to borrow funds at inopportune times and in excessive amounts. Without planning, there is no certainty that you will be able to repay your loans on schedule. However, once you've carefully mapped out a cash budget, you will be able to compare it to the actual cash inflows and outflows of your business. You will find that this comparison will go a long way in assisting you during future cash budget preparation. Also, a monthly cash budget helps pinpoint estimated cash balances at the end of each month, which may foresee short-term cash shortfalls.

Self-Assessment Exercise: 1

How can you describe cash budget?

4.3.1 Consistent Budgets

Cash budgeting is a continuous process that can be checked for consistency and accuracy by comparing budgeted amounts with amounts that can be expected from using typical ratios or financial statement relationships. For example, your treasurer will estimate the payments made to your suppliers of merchandise or materials, the payments to employees for wages and salaries, and the other payments that you are obligated to make. These payments can be scheduled by dates so that all discounts will be taken, and so that no obligation will be overlooked when it comes due. Cash collections from customers can also be estimated and scheduled by dates along with other expected cash receipts. With careful cash planning, you should be able to maintain a sufficient cash balance for your needs and not put yourself in the position of holding excessive balances of non-productive cash.

In the normal course of operations in a merchandising business, for example, merchandise is purchased and sold to customers who eventually pay for the merchandise sold to them. Usually there is a time lag in business operations. It may be necessary to pay the suppliers for merchandise before the merchandise is sold to the customers. Before and during a busy selling season the demand for cash may be higher than the inflow of cash from operations. In this case it may be necessary to arrange

short-term loans. When the selling season is over, cash collections from customers will be relatively large and the loans can be paid off.

4.3.2 Computation of Cash Budgeting

FORMAT OF CASH BUDGET:

	Jan.	Feb.	March	April	May	June
A. **ESTIMATED CASH INFLOW:**						
Cash Sales	XX	XX	XX	XX	XX	XX
Receivable Collection	XX	XX	XX	XX	XX	XX
Sales of Marketable Securities	XX	XX	XX	XX	XX	XX
Other Cash Receipts	XX	XX	XX	XX	XX	XX
Total cash inflow (A)						
B. **ESTIMATED CASH OUTFLOW:**						
Cash Purchase	XX	XX	XX	XX	XX	XX
Payment of loan	XX	XX	XX	XX	XX	XX
Interest on loan	XX	XX	XX	XX	XX	XX
Taxation and dividend paid	XX	XX	XX	XX	XX	XX
Payable payment	XX	XX	XX	XX	XX	XX
Other payments	XX	XX	XX	XX	XX	XX
Total cash Outflow (B)						
C. NET CASH FLOW						
(A-B)	XX	XX	XX	XX	XX	XX
Opening cash balances	XX	XX	XX	XX	XX	XX
Closing Cash Balances	XX	XX	XX	XX	XX	XX
Less: Min. Closing Balance	(XX)	(XX)	(XX)	(XX)	(XX)	(XX)
Cash Surplus / Deficit	XX	XX	XX	XX	XX	XX

Example 1

The expected sales and purchases figure of Great Atlantic Ltd. from November 1995 to June 1996 are as follows:

Month	Sales	Purchases
	₦	₦
Nov. 2005	3,000	2,000
Dec. 2005	3,500	1,000
Jan. 2006	2,500	800
Feb. 2006	2,000	1,000
Mar. 2006	2,500	1,200
April 2006	3,000	1,400
May 2006	3,500	1,500
June 2006	3,800	1,500

The company has established a sale policy of 20% cash and 80% credit, 40% and 60% of credit sales are collectable in the first and second month after sales respectively. The company suppliers granted credit purchases of 1 month. All company's purchases were on credit. The company has budgeted for a capital expenditure of ₦1500 and ₦300 for the month of March 2006 and April 2006 respectively. Dividend of ₦1200 is to be paid in three installments starting from April 2006. an outstanding tax liability of ₦250 is planned to be paid in May 2006. The company has a begin cash balance of ₦100 and intend to maintain a minimum cash balance of ₦1500 in each month. Salary for each month will amount to ₦500.
Required:

Determine the cash position of the company from Jan. 2006. Also indicate how much the company has to withdraw from his saving account every month or how much the company must be saved every month?

Solution

A. **ESTIMATED CASH INFLOW:**

	Jan.	Feb.	March	April	May	June
	₦	₦	₦	₦	₦	₦
Cash Sales (Note 1)	500	400	500	600	700	760
Receivables (Note 2)	2560	2480	1840	1760	2160	2560
Total Cash Inflow (A)	3060	2880	2340	2360	2860	332

B. **ESTIMATED CASH OUTFLOW:**

Creditors	1000	800	1000	1200	1400	1500
Capital Expenditure	-	-	150	300	-	-
Dividend paid	-	-	-	400	400	400
Tax liability	-	-	-	-	250	-
Salary	500	500	500	500	500	500
Total cash Outflow (B)	1500	1300	3000	2400	2500	2400

C. **NET CASH FLOW**

(A-B)	1560	1580	(660)	(40)	310	920
Opening cash balances	100	1660	3240	2580	2540	2850
Closing Cash Balances	1660	3240	2580	2540	2850	3770
Less:						
Min. Closing Balance	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)
Cash Surplus / Deficit	160	1740	1080	1040	1350	2270

WORKINGS:

Note 1- Expected sale

Month	Total Sale	cash sale (20%)	credit sale (80%) sales' payment 40% = a month after 60% = 2 months after
Nov 2005	3000	600	2400 -
Dec.	3500	700	2800 960
Jan 2006	2500	500	2000 1440 + 1120 = 2560
Feb.	2000	400	1600 1680 + 800 = 2480
March	2500	500	2000 1200 + 640 = 1840
April	3000	600	2400 960 + 800 = 1760
May	3500	700	2800 1200 + 960 = 2160
June	3800	760	3040 1440 + 1120 = 2560
July	-	-	- 1680 + 1216 = 2560
August	-	-	- 1824

Note 2 - Expected Purchase

Month	Total Purchase credit purchase payment	Cash Purchase
Nov 2005	2000	- -
Dec.	1000	- 2000
Jan 2006	800	- 1000
Feb.	1000	- 800
March	1200	- 1000
April	1400	- 1200
May	1500	- 1400
June	1500	- 1500
July	-	- 1500

Self-Assessment Exercise: 2

State two (2) purposes of cash budgeting to tourism business owners.

4.4 Summary

In the course of our study in this unit we were able to discuss the purpose of cash budgeting, various types and forms of cash budgets, format of cash budget and computation of cash budget. Thus, cash budget is a financial plan that

considers both future income and expenditures and should be given adequate attention.

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4.6 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1

Cash budget is a device that all financial managers plan for and control the use of cash. It is a work sheet that shows cash inflows, outflows and cash balances over some budgeted time period.

Self-Assessment Exercise: 2

The cash budget determines future ability to pay debts as well as expenses.

Cash budget shows cash flows in and out of business.
Cash budget helps pinpoint estimated cash balances at the end of a period (weekly, monthly, quarterly or yearly) which may foresee short-term cash shortfalls.

Unit 5 Tourism Business Investment Evaluation: Techniques and Tools of Analysis

5.1 Introduction

Project analysis may be defined in several ways. Square and Van der Tak (1975) define it as "...one method of evaluating alternatives... It assesses the benefits and costs of a project and reducing them to a common yardstick". Project analysis refers to the study carried out during any part of the project cycle, which is intended to clarify one or several aspects covered by the terms, costs, benefits and feasibility. Project analysis may be defined as the compilation, processing, and critical examination of a variety of economic, financial and technical data in respect of a proposed capital investment with a view to determining whether its economic advantages and disadvantages justify the commitment or allocation of scarce resources.

Project analysis is thus an investigative study carried out by or for a prospective investor to determine the worthwhileness of the investment and enable a decision to be taken whether or not to go ahead with the investment. The importance of project analysis lies in the fact that it enables scarce resources to be put into the most profitable or efficient uses by ensuring that (a) the project is technically sound, (b) it will provide a reasonable economic and or financial return, and (c) its objectives cannot be achieved by a less costly alternative. Project analysis thus covers investigations that are often referred to as technical and economic feasibility studies.

5.2 Learning Outcomes

By the end of this unit you will be able to:

- ✓ Explain project analysis and its objectives
- ✓ Explain various techniques/tools of project analysis
- ✓ Discuss the superiority of one technique over others
- ✓ Compute for acceptance or rejection of a project proposal.

5.3 Purpose of Projective Analysis

The objective of projective analysis depends on the point of view of the entity for whom the analysis is undertaken. Project analysis may be carried out from the point of view of four entities:

I. The private firm
II. The equity shareholders
III. The debenture holders; and
IV. The nation or the economy as a whole.

The over-riding objective of the firm is to maximize profit: that is to use the optimum volume and combination of resources such that the difference between the discounted stream of economic value created by the project and the discounted stream of the value of resources utilized is maximum. It is simply a measure of the efficiency in the use of resources. The flows of both the output and the resources are valued at market prices, that is, the firm is concerned with the prices it can obtain for its products, and those it must pay for its labor, raw materials, finance, machinery and equipment, spare parts, power supplies, and others. It is little concerned with the benefits and costs it may cause for the economy as a whole, which do not enter into its profit and loss accounts. Thus, a firm is concerned only with the financial analysis and financial profitability of the project.

The equity shareholders are the owners of the business. They are the residual recipient of any profit made by the enterprise after all debt obligations have been settled. For this reason, they bear most of the risks associated with the project. The objective of the equity shareholders is therefore to maximize the financial return on their equity shares with all costs and benefits measured in financial terms, that is, using market prices. Thus, like the firm the equity shareholder is concerned only with financial profitability of the project and the return to equity.
Like the equity shareholders, the debenture holders are interested in the financial soundness and profitability of the project and its ability to pay its debts when due. In the case of the nation, the objective of the economy as a whole is the maximization of the welfare of its citizens. Welfare

maximization is translated into a number of operational objectives, three of which being (i) maximization of aggregate real output, this is usually referred to as the economic efficiency objective; (ii) a more equitable distribution of income and (iii) self-sufficiency objective which may be interpreted as autarky, or balance of international payments. These last two objectives are often referred to as social objectives.

The benefits and costs of a public sector project are defined and measured in relation to these objectives, and are valued by the use of shadow or accounting prices which are not generally observed. The benefits from these multiple objectives are then made commensurable and together with the costs, are summarized into the economic and social profitability index of the project. This analysis is commonly referred to as economic and social cost benefit analysis. Thus, the objective of project analysis from the nation's point of view may be regarded as the maximization of economic and social profitability.

However, the starting point of the economic and social analysis which is the financial analysis is very important. Financial profitability analysis is an essential part of economic and social cost-benefit analysis because a financially unprofitable project which is socially profitable would have to be subsidized if executed, or made financially profitable by protection. This would raise important issues involving the fiscal authorities. Without the financial analysis, the wide fiscal implications would not be known. Furthermore, foreign lenders usually generally insist on a financial profitability analysis as it offers some assurance of the security of their loan, even though they know that this is more affected by the soundness of government policies and the balance of payments position of the country.

5.4 Techniques/Tools of Tourism Project Analysis

Turning to the main appraisal techniques, the analysis begins by considering the NPV and IRR approaches, both of which are based on the discounting principles developed in the unit above on the Time Value of Money.

5.4.1 NPV and IRR

Obtaining the NPV of a project involves estimating its future net cash flows; discounting these at the appropriate opportunity cost of capital to obtain their present value; and subtracting the initial capital cost, or net investment outlay, at the beginning of the project. Formally,

$$NPV = \sum_{t=1}^{n} \frac{NCF_t}{(1+r)^t} - I_o$$

Where,
NCF is the net cash flow received at the end of each year or period t, t = 1, 2, ...,n.
r is the project's opportunity cost of capital. I_o is the net investment outlay in time zero
Expressing Equation 6 .1 in terms of present value interest factors:

$$NPV = \sum_{t=1}^{n} (NCF_t/PVF_{t_r}) - I_o$$

The IRR on a project is based on the NPV concept and is found by solving for the discount rate which makes the NPV on a project equal to zero. In a more formal sense, the IRR is the discount rate which, if applied to the future NCF series, equates the present value of that series to the initial or net investment outlay.

$$NPV = \sum_{t=1}^{n} (NCF_t) - I_o = 0$$
$$(1+ IRR)^1$$

or

$$NPV = \sum_{t=1}^{n} (NCF_t) = I_o$$
$$(1+ IRR)^1$$

5.4.2 A Conventional NPV Schedule

To obtain a clearer understanding of these two methods, it is useful to consider the NPV schedule, defined in relation to a standard or conventional project. A conventional project is one which always generates positive future NCFs, subject to the usual initial negative net investment outlay.

Consider project B, detailed in Table 5.1, which has an initial net investment outlay of 700 and which produces a series of NCFs over a subsequent five – year period. Given r, the NPV for this project is:

$$NPV = 200 + \frac{50}{1 + r} + \frac{200}{(1-r)^2} + \frac{200}{(1 + r)^3} + \frac{600}{(1+r)} - \frac{700}{(1+r)^5}$$

Table 5.1: Net Investment outlays and NCFs for three independent projects

Projects	A	B	C	Year	s	s	s
0	-200			Net Investment	PVIFs @ r = 8		
				Outlay			
		-700	-700	1.00			
1		200					
2		500					
3		400					
4		600					
5		500					
NPV	-287	30	327.91	598.25			

@ 8% 294% 21 29% 30.09%
IRR

As an illustration of the relationship between NPV and r, the following four discounts rather are applied to project B: 0.00%, 10%, 20% and 25%. If the discount rate is zero the NPV is simply the sum of the future NCFs minus the initial net investment outlay, that is NPV = 650. At r = 10% the NPV = 265.20; at r = 20% the NPV 24.15, and at r = 25% the NPV = -63.07. Thus, for this project, and its standard type, the NPV is inversely related to the discount rate: the higher the discount rate the lower the NPV. From the NPV schedule, the IRR is clearly illustrated. Since the IRR is determined as the discount rate which makes the NPV of a project zero, the IRR always occurs where the NPV schedule of a conventional project crosses the horizontal axis. In the case of project B, this point is achieved at a discount rate of 21.29

5.5 Selecting Independent Investments

Under the NPV investment selection rule, all independent projects are acceptable provided that, for each project I, NPV ≥ O. That is, all independent projects which at the chosen discount rate have positive, or at minimum zero, NPVs should be accepted. A project with a negative NPV is automatically rejected. In the specific example of project B above, providing the opportunity cost of capital, or discount rate, is not in excess of approximately 21%, a positive NPV would occur and the project would be accepted.

The reasoning behind the NPV is straightforward. It measures the extent to which outflows and, therefore, the extent to which shareholder wealth will be increased if the project is accepted. A company is indifferent to a project with a zero NPV since the funds that a zero NPV projects generates are just capable of covering the project's net investment outlay and meeting the company's required rate of return. Zero NPV projects do not, however, make a net contribution to wealth. Projects with negative NPVs would reduce value, if accepted. In general, under the IRR investment selection rule, all independent projects are acceptable provided that, for each project 1, IRR, ≥ r

That is, only independent projects whose IRRs exceed, or at minimum are equal to, the cost of capital would be acceptable. In the specific example of project B. if the cost of capital is greater than 21.29%, the project would be automatically rejected. If the cost of capital is equal to, or below, this cost of capital the project would be acceptable. Since the IRR is determined from the NPV schedule, its accept/reject decision rule has implication for wealth creation similar to NPV. Generally, when the IRR exceeds the cost of capital, NPV > O; when it falls below it, NPV < O.

There are, however, some problems with applying the IRR rule to be discussed in the next section.

To illustrate the above two investment appraisal rules, consider all three independent projects in Table 5.1 and assume an opportunity cost of capital of 8%. The PVIFs at r = 8% are given in the final column of the table. The NPVs of projects B and C are positive and both would be accepted; however, with a negative NPV, project A would be rejected. Similarly, projects B and C would be accepted using the IRR decision rule since each one's IRR exceeds the cost of capital of 8%. Project A would be rejected, however, since its IRR is less than 8%.

Table 5.2: Mutually exclusive projects are incremental cash flows

Mutually Exclusive Projects		*Incremental project*	
	D s	**E s**	Zs
		Net Investment Outlay	
0	-800	-800	0.00
		Net Cash Flows	
1	100	400	-300.00
2	200	300	-100.00
3	300	100	100.00
4	400	400	0.00
5	1000	500	500.00
NPV			
@ 8% IRR	597.42	541.26	56.16
	25.08%	30.35%	12.69%

One of the advantages of using NPV is that it conforms to what is referred to as the value additivity principle, since the overall NPV of a set of independent projects is simply the sum of the individual project NPVs. In the present example the overall NPV of accepting projects B and C is: 327.91 + 587.25 = 915.16.

Self-Assessment Exercise: 1

Identify two (2) major techniques/tools of tourism project analysis

5.5.1 The Technical Superiority of NPV

For technical reasons the NPV investment selection rule is superior to the IRR rule, especially in a situation where a choice has to be made between a set of mutually exclusive projects. In the mutually exclusive case, when using NPV, the project with the highest positive NPV is chosen. Under the IRR method, the project with the highest is chosen, provided the project's IRR is at least equal to the opportunity cost of capital. If, for example, the projects in Table 5.1 were mutually exclusive, instead of independent, project C would be selected by both methods. In the case of mutually exclusive projects, however, a straight application of the IRR method can produce an incorrect project choice.

This is exemplified in Table 5.1 where the net investment outlays and future NCFs are recorded for two mutually exclusive projects: D and E. The discount rate is 8% which, assuming certainty and perfect capital markets, is the market determined opportunity cost of borrowing and lending.

If the two projects had been independent there would be no ambiguity, since both projects would have been acceptable using either NPV or IRR. Both projects have positive NPVs and each project's IRR exceeds the opportunity cost of capital. Since the two projects are mutually exclusive, however, there is an obvious problem. Under the NPV rule, project D with its higher NPV would be chosen in preference to project E. Using the IRR rule, project E with its higher IRR would be chosen in preference to project D. The correct choice is made on the basis of NPV.

The conflict between the two decision rules arises because, in diagrammatic terms, the NPV schedules of two projects cross over. The cross over point occurs at a discount rate of 12.69%. If the opportunity cost of capital had been above 12.69%, the NPV method would have yielded the same project choice as the IRR method. The opportunity cost of capital of 8% is below this, giving rise to alternate choices under each selection method. The problem is that, while NPV changes as the opportunity cost of capital changes, the IRR is constant and independent of the cost of capital.

5.5.2 Non–Discounting Appraisal Method

There are two other prominently used methods of investment appraisal, the Pay – Back (PB) and the Accounting Rate of Return (ARR). These methods, which do not take the time value of money into account, are examined next.

Pay Back

The PB method of appraisal is based on the number of periods taken for the future NCFs on a project to pay back the initial net investment outlay. Normally, in formulating PB decision rules a maximum payback period, PB^{max}, is specified.

All independent projects under consideration are acceptable providing that, for each project i, PB δ PB^{max}

To illustrate, consider the four projects specified in Table 5.3. If these are independent, and PB^{max} has been set at four years, project F will be rejected, and the other projects accepted. Under the NPV decision rule, however, with a discount rate of 10%, project I would be rejected but project F accepted. If, alternatively, the four projects are assumed to be mutually exclusive, project H, with the smallest PB of three years, would be the preferred option. Under the NPV decision rule, however, project F would be preferred.

The PB method is defective on a number of counts. First, by not considering the time value of money, it gives equal weight to all future NCFs over each project's PB period. Consider the case in respect of projects G and I which have equal PBs of four years. The PB selection method is incapable of recognizing that, in early years, the large NCFs on project G, relative to project I, are more valuable than the latter. Second, once the PB period on a project has been determined, subsequent NCFs which occur beyond this period are ignored in their entirety. This is particularly important in project I's case where the NCFs in the last two years are negative. Third, there are no objective criteria for determining PB^{max}. Fourth, there is ambiguity in respect of defining the initial period of net investment outlays. If, for example, net investment outlays on one project occurred only in year zero, but on another project over the first three years of its life, there is no guidance on the point in time at which counting the number of PB periods should begin.

Table 5.3: Vet Investment Outlay

	Project				***Discounted NCFs Project G @ 10%***
	F	***G***	***H***	***I***	
Year	***s***	***s***	***s***		
	Net Investment Outlay				
0	-1000	-1500	-2000	-1500	-1500
1	200	1000	500	100	909
2	400	400	400	400	330
3	100	50	1100	500	38

4	200	50	300	700	34
5	100	150	500	-50	93
6	2000	200	100	-100	113

Some attempt has been made to partially accommodate the time value of money in the PB appraisal method, with the suggestion that discounted PB should be used. Here the PB on a project is based on its discounted future NCFs; however, this simply reduces the amount of future NCFs which are ignored, subsequent to the discounted PB period. As an example, the NCFs for project G are discounted at 10% and presented in the final column of Table 5.3. The discounted PB for project G is 5.85 years compared to its standard PB of four years.

Accounting Rate of Return

The ARR is based on a definition of the average annual accounting profits from a project divided by a definition of the annual average investment outlays over a project's life. The ARR is then compared to some hurdle rate arbitrarily set by the company. The ARR, as a non – discounting method, is subject to the same types of criticism as the PB, although the ARR does give consideration to all the accounting profits over the life of a project. There is a serious additional problem with the ARR, arising from the possibility that the use of accounting numbers may give a misleading view of the NCFs generated by a project. This partly arises because depreciation of the initial capital costs over the future life of a project are treated as explicit cash costs. Further, the accounting definition of profit and the accounting treatment of investment outlays will depend on the accounting convention operated within individual companies and on the accounting standards which happen to be in force at the time when particular project appraisals are being made. These issues are more fully discussed below, when the factors which should be taken into account in formulating a project's NCF profile are specified. Before considering these factors, however, it is useful to reflect on the general superiority of NPV as an investment appraisal method.

5.5.3 The General Superiority of NPV

The NPV approach to investment appraisal has been shown, in a technical sense, to be superior to the IRR approach and now, in a general sense, to be superior to the other commonly used approaches of PB and the ARR. The merit of the principle of NPV is that it measures the net wealth – creating potential of capital projects, and investments in general, by considering all of a project's NCFs and discounting these at the project's opportunity cost of capital. Maximizing the NPV of project investment maximizes shareholders' wealth. Even in the presence of risk and

imperfect capital markets, the most appropriate investment choices are made using investment appraisal techniques which are founded on the NPV principle. Some of these are discussed in the next chapter.

Despite the theoretical superiority of NPV, surveys which have investigated the appraisal techniques used in practice indicate that all four methods appeal to corporate executive. Looking across a wide range of these surveys, there is even the suggestion that, on balance, the PB approach is most favored. The PB is followed in order of preference, by the ARR, the IRR and finally the NPV. The preference ordering does, however, appear to vary with the size of company, with very large companies undertaking highly sophisticated investment appraisals based on NPV; although even here the other techniques might have a supplementary usage.

One argument in favor of using the IRR is that as a percentage rate of return it is conceptually more familiar than NPV which, as an absolute measure, is somewhat abstract. The rate of return concept combined with management's familiarity with accounting numbers can explain use of the ARR.

In the case of PB it may be used as a convenient screening device to make an initial selection of projects which would then become subject to detailed formal appraisal using NPV. In addition, since capital projects are medium to long-term, full appraisal involves forecasting all future NCFs. Forecasting, even in the short-term, can be problematic. (Just consider the difficulties in using macro-economic models to forecast short – term behavior in the UK economy).

Consequently, in those situations where management believes that a very low level of confidence can be placed in forecasting revenues and costs which occur in eight, nine- or ten-years' time, there may be a rationale for using PB (or better still, discounted PB). If a project can pay back the net investment outlay over the early years of its operation, when NCFs can be measured with a reasonable level of confidence, the project is acceptable. By monitoring the project once it is operational and gaining more information as time passes, on the likely future NCFs beyond the initial PB period, abandonment or continuation decision can be made at a later date.

Fervent supporters of NPV might well view this as heresy. The argument would be that NPV should always be used, if necessary, in combination with simulation and sensitivity analysis. Here, probabilities are assigned to future outcomes and changes in a project's NPV analyzed as assumptions about the future are varied. Such an argument is correct, provided decision makers are operating in an environment of risk where,

as Knight (1921) argues, probabilities can be measured objectively or subjectively. Using Knight's distinction between risk and uncertainty, this is not possible in the latter situation since, by definition, uncertainty exists where numerical probabilities (either objective or subjective) cannot be assigned to future outcomes.

5.6 Project Analysis and Other Techniques of Optimizing Behavior

It is obvious from the foregoing discussion that project analysis involves two techniques of optimizing behavior: (i) the classical theory of the firm in the case of private sector projects, and (ii) economic and social benefit-cost analysis for public sector projects. In the classical theory of the firm, the business firm is represented as maximizing profits; that is, the difference between the discounted stream of revenue and the discounted stream of costs, both revenue and costs being measured in financial terms. The revenue includes only the value of those benefits which the firm can market and costs include only those that the firm bears.

The benefit-cost analysis of s public investment resembles the analysis of profit maximizing firm. The difference between the two lies in the identification and measurement of benefits and costs, the problem of incorporating the multiple objectives of the public sector in the analysis, the determination of social discount rate and shadow or accounting prices where market prices do not reflect the true value of the good or service to the economy.

Both the financial and the benefit-cost analyses are optimizing techniques because (i) they consider alternative projects that will satisfy the same objectives before choosing the best, and (ii) for the chosen project, they consider alternative sizes and locations before choosing the best that satisfy the stipulated objectives. Thus, there is no known alternative that can yield a better result. The long-run average cost curve and equilibrium analysis of the firm exemplifies this optimizing technique.

Project analysis may be contrasted with two other techniques of maximizing behavior; cost-effectiveness analysis, and classical operations analysis. Cost-effectiveness analysis is specifically directed to problems in which the output cannot be evaluated in market prices, but where the inputs are substitutable at exchange relationships developed in the market. It addresses itself to maximizing effectiveness subject to a generalized resource constraint measured in financial terms (Odufalu, 2000).
Cost-effectiveness analysis is appropriate in situations where there is no market evaluation of alternative outputs; as in defense sector, and where the resource inputs can be appropriately evaluated at market prices.

Classical operations analysis is addressed to problems of maximizing effectiveness, subject to a set of specific resource constraints which are measured in the amount of the several types of resources available. The analysis can be conducted entirely in physical and other non-monetary terms. Such analysis is appropriate where there is no market evaluation of either input or output, for example, as in the scheduling of production with a given set of production resources.

Self-Assessment Exercise: 2

Identify two (2) major techniques of optimizing behavior in tourism project analysis.

5.7 Summary

In the course of our study in this unit we were able to discuss the objectives of techniques or tools for analyzing proposed project, enumerate the use of various techniques such as discounted cash flow methods and non-discounted cash flow methods. Thus, Net Present Value method was found to be most useful because it considered time value of money. However, it is very important for analysts to make use of the foregoing method for effective and efficient analysis of any proposed project.

5.8 References/Further Readings/Web Sources

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5.9 Possible Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise: 1
i. Net Present Value (NPV)

ii. Internal Rate of Return **(**IRR)

Self-Assessment Exercise: 2
(i) The classical theory of the firm in the case of private sector projects
(ii) Economic and social benefit-cost analysis for public sector projects