Fāilte Ireland
National Tourism Development Authority

Guidance Note
Cash Burn and Cost Reduction

Introduction

This Guidance Note highlights the importance of critically assessing the cash burn rate and the cost structure in your business. It is accompanied by a series of sectoral Checklists to help you think about where you can reduce costs. The key topics in this note are:

- Borrowing Application Checklist
- Explanation Notes

Cash Burn Rate

Cash Burn Rate is the rate of depletion of a business's cash pool in a loss-generating scenario. It is an important metric to understand and know. Within a seasonal business, for example, knowing the cash burn rate will help the business determine if it is worthwhile opening during the low season.

A high burn rate could suggest that the business is depleting its cash supply at a faster rate and may indicate a higher likelihood of entering a state of financial distress. Understanding your burn rate will help you to understand when the need will be to seek financial aid/support from banks or other financial institutions. This may be in the form of working capital funding and will provide an estimated timeline of working capital requirement.

The burn rate within the business may not be the same each month. While the business is closed, the costs will predominantly be fixed, however, in advance of the business reopening there will be some 'pre-opening costs' that will need to be established. During each month of operation, the cost base and cash inflow/outflow will be different as business levels will vary.

These pre-opening costs may include payments to creditors, hiring of new staff, employee training, cleaning, health and safety checks, payroll, additional sales and marketing, and purchases such as stocks, for example.

Gross Cash Burn Rate

Gross Burn Rate is a businesses operating expenses or the total amount the business is spending each month. It is calculated by totalling all operating expenses including direct costs, variable costs, fixed costs. The burn rate is typically quoted in months. It does not take revenues into account.

Gross Burn Rate	$\frac{\text{Prior Month Cash Balance}}{\text{Monthly Operating Expenses}}$	=	Months

For example:

Gross Burn Rate (months)	$\frac{\text{March Cash Balance}}{\text{April Operating Expenses}}$	=	months

Gross Burn Rate	$\frac{€100{,}000}{€10{,}000}$	=	10 months

(*Based on average operating expense of €10k per month)

We have assumed that the fixed costs of a tourism business during the closed period will be the same each month. However, if there are some months where there is a higher/lower cash outflow then the monthly average (expenses) would be used.

Net Cash Burn Rate

When a business is in operation, you can establish cash burn by determining the Net Burn Rate. This is calculated by subtracting the operating expenses from revenue. It is important to consider that each month you will have fluctuations in revenue. For example, a fall in revenue with no change in costs can lead to a higher burn rate. This is one of the reasons why it is important to understand both your variable and fixed costs.

Net Burn Rate	$\dfrac{\text{Prior Month Cash Balance}}{\text{NOI (revenues-costs)}}$	=	Months

***NOI is Net Operating Income**

For example:

Net Burn Rate	$\dfrac{€100,000}{€7,000}$	=	14 months

*** €12,000 (rev) - €5,000 (costs) = €7,000 (net operating income/NOI)**

The Importance of Conserving Cash

As tourism businesses have a high operating cost base it is important to understand all the costs of the business and if they are necessary. Creating a healthy cash balance within the business is important for long term sustainability, during the low season and for unexpected events.

Please refer to the checklists of cost cutting measures for different tourism businesses which can be explored. This list is a guide and not exhaustive.

As you carry out your business and negotiate terms and conditions with new and/or existing suppliers it is important to record these to ensure there are no discrepancies with future suppliers.

As you make business decisions relating to cash or cost savings, analyse and track these for a number of reasons.

1. Financial institutions may seek to understand if your business is operating efficiently and if there are additional savings to be made.
2. Review if changing suppliers or cost reductions are worthwhile. Quality control will be important to the business and some cost savings may be compromising quality expectations. It is important that these are known before a decision is made.