



Business & Corporate Advisory Services

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"It has been my experience that competency in mathematics, both in numerical manipulations and in understanding its conceptual foundations, enhances a person's ability to handle the more ambiguous and qualitative relationships that dominate our day-to-day financial decision-making"
Alan Greenspan – Former Chairman, US Federal Reserve

Business Performance – Budgets & Forecasts

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Financial year 2009/10 has been one of tentative recovery, however many dangers remain which could cause a second round of upheaval in what is still a precarious global economic environment. The European debt quandary is having a huge affect on global markets, creating volatility as businesses and nations start to wonder about the flow-on affects and possibility of contagion.

With the end of financial year fast approaching, it is an important time for businesses to review their annual performance and to set targets for the coming financial year.

Measuring Business Performance

How did your business perform over the past 12 months? What impact did the Global Financial Crisis have on your business?

If you cannot answer these questions in detail, with information and reports to back it up, you're flying blind. Without measuring performance against set objectives, how can you possibly understand how successful your business is?

Management teams should be reviewing business activity and performance on a regular basis, preferably on a weekly basis. By closely monitoring business performance, management can identify areas of weakness and make the necessary adjustments in order to stem potential losses or inefficiencies. If a negative situation remains unidentified for an extended period of time, it can often lead to major cash flow or structural problems, which can be difficult to rectify after they have occurred.

Another important point to consider is that measuring past performance creates a base for which all future performance can be measured. A number of diagnostic tools can be developed with the benefit of hindsight, which ultimately allows you to establish a stronger and more reliable base from which to create forecasts and budgets.

Business Forecasting

Setting accurate and realistic forecasts is not as simple as looking at last year's performance and adding a growth percentage or plucking a number from thin air. Forecasting future business activity requires detailed research and analysis of key variables in order to achieve meaningful targets to be used as benchmarks against actual performance.

The following items are some of the key variables that should be considered when setting forecasts;

Interest rates

During the financial crisis, interest rates around the world were lowered by central banks as part of their expansionary monetary policy measures designed to encourage spending rather than saving.

In Australia, the official cash rate hit a 60 year low in April 2009 of 3%, as shown in the table below.

Effective Date	Change in cash rate Percentage points	New cash rate target Per cent
5 May 2010	+0.25	4.50
7 Apr 2010	+0.25	4.25
3 Mar 2010	+0.25	4.00
2 Dec 2009	+0.25	3.75
4 Nov 2009	+0.25	3.50
7 Oct 2009	+0.25	3.25
8 Apr 2009	-0.25	3.00

Source: <http://www.rba.gov.au/statistics/cash-rate.html>

Since then, the RBA has raised rates by 1.5% to curb inflationary pressures as the economy improves.

The official cash rate has a direct impact on the capital costs for businesses, which in turn affects all expenditure decisions and rates of return for individual projects.

Factoring in changes in interest rates is a crucial consideration when developing forecasts. By assessing the impact of interest rate movements a business can gain an accurate understanding of their profitability for the coming period.

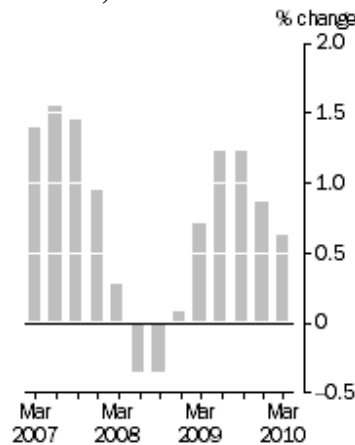
Retail sales

Australia is a nation of consumers. Private household consumption makes up around 60% of Australia's GDP. That's the reason economists and business commentators refer to retail sales as an indicator of relative economic strength.

Even if your business is not classified as a retail business, it is affected by the flow of cash throughout the economy.

The graph below shows the quarterly retail sales results expressed as a percentage compared against the prior quarter.

Quarterly turnover, in volume terms - Trend estimate



Source: <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8501.0>

Although the March 2010 quarter showed a slight level of growth, the rate is still volatile. The recent official interest rate increases have started to flow through into the wider economy and has reduced the disposable income of home and small business owners, which in turn places pressure on discretionary spending levels. The trends in retail sales should be considered when forecasting future business activity.

Consumer Price Index

The Consumer Price Index, or CPI, is a measure of inflation on the purchase price of a range of goods and services. The RBA has a target inflation rate of between 2 and 3 percent per year.

If the economy is growing and unemployment is low the CPI tends to go up due to higher costs of production. The RBA uses interest rates as an instrument to curb the CPI and prevent the economy from overheating.

There are a range of other factors that affect the CPI, including; money supply, currency exchange rates, commodity prices and many more, all of which have an impact on

consumer prices. The important point to remember is, that to develop an accurate forecast, management teams should factor in the CPI and inflation in order to better understand the revenue and expenses that have a bearing on their business's bottom line.

Currency Exchange Rates

Depending upon the type of business you're in, currency exchange rates may have a major impact upon your business.

The Australian Dollar fluctuates in value against the benchmark US Dollar each day. The cost of raw materials from overseas and other input costs is an important consideration for a range of industry sectors.

The AUD has negatively impacted exporters over the past 12 months making our exports more expensive for international customers.

Australian importers have enjoyed a strong Aussie Dollar since the RBA began raising interest rates and as a by-product of the commodities boom, however these macro factors can change very quickly. We've just seen the impact of sovereign risk concerns on the Australian Dollar as a result of the Rudd government's proposed 'Resources Super Profits Tax'. It's essential to measure the currency exchange rate exposure your business and make the necessary adjustments to your forecasts.

Forecasting future performance is a difficult task even in a steady business environment. The factors listed above are just a few indicators that should be considered when developing a forecast. It is also important to remember that most macro-economic factors are interrelated. A change in one factor, more often than not, affects many other factors.

Knowing how your business will perform under various scenarios makes it easier for you to manage change and combat any factors that may adversely affect your operations. To ensure you are working toward your strategic objectives, it is imperative to measure past performance and have accurate forecasts for future performance.

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