Tourism information series no. 5

Cooperative Extension Service
Michigan State University
Extension Bulletin E-1992
September 1986
90¢

Feasibility Analysis In Tourism

FEASIBILITY ANALYSIS IN TOURISM

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Introduction

Commiting resources, whether time, personnel or money, is always risky. If you are responsible for making resource commitment decisions in today's dynamic economy, you realize the importance of any information that can help reduce uncertainty.

The feasibility analysis is a tool which can shed light on the question: will the expected returns from a proposed venture be sufficient to justify the initial investment? This might mean, is there enough demand for additional campsites to warrant their construction? Will building a new ski lift attract enough new skiers to recover its costs? Will a new swimming pool generate enough additional revenue to pay for the construction, operations and maintenance?

The feasibility analysis helps eliminate part of the uncertainty in such questions, but it by no means guarantees success. Many factors influence the outcome of a proposed venture. Some are predictable, but many are not. For instance, an unexpected change in the weather, the economy, consumer preference or your competition's techniques can have a severe affect on the best thought out plans. The best you can hope for is a thorough analysis of the conditions that exist now, what has happened in the past, and make provisions for change in the future. This is where the feasibility analysis is useful.

The purpose of this bulletin is to enable you to understand better the feasibility analysis process, its components and what you should be concerned with if you decide to have the analysis performed by an outside organization.

Why Perform An Analysis?

The feasibility analysis has had the reputation of being an extremely difficult and expensive task. The size, scope and cost of an analysis varies, however, depending on the total amount of resources to be invested. The greater the investment the greater the risk. The greater the risk, the greater the need for a more thorough and accurate analysis. The more thorough and accurate the analysis, the greater its cost. Thus, cost may be one of the main reasons why the percentage of investment failures in small businesses is greater than that in large businesses. Small businesses often view the analysis as a waste of time and money and neglect it in the planning process. However, a feasibility analysis can pay for itself by early identification of poor risks which otherwise might cost the investor much more than the analysis alone.

Generally, the feasibility analysis is done for one or more of the following reasons:

(1) To evaluate the status of an existing product or service

(2) To evaluate the potential for expanding an existing product or service

(3) To evaluate the potential for a new product or service

(4) To obtain financial backing for a project. This is required to determine whether the project can be justified in economic terms by conventional debt-financing sources (such as lending institutions) and preferred by equity sources (those individuals or companies who would be willing to invest in your idea: stockholders, partners, etc.).

A feasibility analysis should always be undertaken if the outcomes of the alternatives being considered are unknown, or if the entire proposed venture is unfamiliar. If this is not the case, concentrate your efforts in developing the product to meet your customer's needs. Remember, severe constraints such as time, personnel or money may prohibit or restrain the quality of the analysis. Therefore, make sure you *identify the importance* of this process and *justify its need* at the outset to prevent unrealistic expectations.

Criteria

After determining the reason for the analysis, the next step is to establish criteria that constitute feasibility.

Feasibility is demonstrated when it is determined that:

(1) there is a reasonable likelihood of satisfying your predetermined goals through

(2) the implementation of a specific program of activity that is

(3) within the framework of available resources.

Should the investment pay for itself by the end of the year?—in two years? If a certain return on investment is expected, how much?—fifteen percent?—twenty percent? Is an increase in overnight stays expected?—how much and by when? Criteria such as these must be determined to avoid losing perspective of the original purpose.

Components Of The Analysis

The feasibility analysis has two interrelated parts. The first is the MARKETING PLAN. This determines the market feasibility of the project. The second is the FINANCIAL PLAN that determines the financial feasibility of the project. Although these two plans contain different information, they are interrelated because the financial feasibility of the project is dependent to a great extent upon the market feasibility. Without the necessary data to predict demand, there is no way to estimate expected revenue. Without a revenue projection, it is impossible for lenders to assess the potential success of the investment.

The MARKETING PLAN is developed to determine the level of demand for the proposed venture. It helps reduce the element of risk by specifically identifying such things as:

- the product or service provided
- the characteristics of the target market
- the costs associated with the marketing plan
- the competition
- the resources of the community or business
- the general market in present and future terms, and

- factors that could alter the market, for example, developments or elimination of existing facilities such as shopping malls, office complexes, attractions, convention or conference centers.

More specific information about the marketing plan can be found in Extension bulletin E-1959.

The FINANCIAL PLAN is developed to determine financing sources—the rate, terms and conditions necessary to acquire funds—and how the loans, interest and other associated financing costs will be repaid. This component of the overall analysis helps reduce the element of risk by identifying such things as:

- the costs of land, buildings and supplies
- organization, financing and preopening expenses
- working capital required
- capacity utilization
- proposed fees, and rates
- salary, wages, taxes and insurance (including liability insurance)
- other sources of revenue (such as rentals, souvenir sales and storage fees)
- an estimate of equity capital financing (money you have on hand) and/or debt financing (money you need to borrow) required, and a time schedule for capital outlay.

Interpretation of the financial data is probably the most important part of this study. There are many methods used to analyze the data. Some of the most common are:

- *breakeven analysis*—determines the volume of business necessary before any profit may be assumed by the owner
- *liquidity ratios*—relates current assets to current liabilities
- *return on investment* (ROI)—is determined by relating net income to assets.

Another important component of this study is an analysis of the management factors that will become a day-to-day matter if the project is undertaken. Some general areas that should be addressed are:

- the personnel needed to manage or operate the new project
- the qualifications of new personnel should they be needed
- the qualifications of the existing management to successfully undertake the new project should it be determined feasible
- the new project's effect on the roles and workloads of existing personnel.

Who Should Perform The Analysis?

Only you can answer this question. If you have the *time, personnel and knowledge,* you can save money by doing the analysis yourself. A good basic discussion of the steps involved can be found in Extension bulletin E-705 *A Guide for a Feasibility Study.* Topics addressed in that publication include:

- Analyzing the site
- Developing a consumer profile
- Selecting the best alternatives
- Evaluating personal characteristics and objectives
- Estimating resource and investment requirements
- Estimating income
- Analyzing profitability
- Tips for conducting the study.

There are many other sources of assistance and information to help you through the process (see "Sources for Additional Help" at the end of this bulletin). However, realize that there are many factors involved in a thorough analysis you may not be completely aware of or familiar with. For example, if you are not familiar with how to analyze financial data, critical errors could be made leading to false conclusions as to the feasibility of the project! And, as mentioned earlier, you must take into consideration the amount of your investment in relation to your overall net worth. Can you financially afford to make a mistake if your analysis is wrong and the project fails?

Advantages And Disadvantages

When trying to decide whether to hire someone to do the study or to undertake it yourself, consider the following:

If you do the analysis, the advantages are that you:

1) have contacts to call on within the community

2) are more sensitive to your needs and that of your community

3) have a vested interest in the analysis

4) know the most about how your operation runs

5) will make the most use of the analysis

6) can save money.

The disadvantages are that you may not:

1) have the necessary training in the feasibility analysis process

2) be able to provide the needed objectivity necessary to avoid influencing the results (thus causing the analysis to become self-serving)

3) have the time to prepare the analysis

4) have the necessary help to gather the information

5) be able to see it through. In other words, it may become a hot and cold effort.

Hiring someone to do the analysis has the following advantages:

1) they will have past feasibility analysis experience (if they don't have an extensive track record, references that you can call on or examples of previous work are mandatory),

2) as "outside" reviewers, they may provide greater credibility and objectivity (this is very important when trying to obtain loans)

3) sophisticated equipment and access to other information resources may be at their disposal,

4) the task will be completed at a specified time

5) the finished project will be very professional.

The disadvantages are:

1) they may not have a vested interest in the community causing a lack of sensitivity to local community interests

2) they may not understand or be sensitive to the interests of community leaders whose support you may need

3) the cost will be higher than an in-house effort.

It may be possible for you to combine your experience with that of the professional analyst. This might entail you or your personnel gathering relevant data, as determined by the analyst, from internal records or from contact within your community. The analyst would then interpret the data for you and generate the feasibility report. The advantages are that you lower your costs, are assured of the direction and progress of the analysis, and have tighter control. The disadvantage is that the results will be only as good as the quality and accuracy of the information supplied.

If you hire someone to do the analysis, make sure the following contract points are specifically covered before you commit any money:

- **Purpose of the project to be undertaken**—this should be stated precisely and clearly so there are no misunderstandings.
- **Objectives**—a definition of the end product, its execution needs, costs and timeframe estimates.
- **Assumptions**—a statement of the assumptions that will be used in order for the project to be undertaken. For example,

to increase attendance by ten percent within one year, or that only a certain amount of money will be available to implement the proposed plan.

- **Methodology**—a step-by-step guide of the approach to be taken.
- **Support**—a statement on the support required from the client and other areas where necessary. Names of individuals from whom support is required help tie down responsibilities and lessen uncertainty. It is important that you are a part of the data-gathering process and also a participant in ongoing communications and interim reviews with the analyst. This will help uncover potential problem areas.
- **Constraints/Boundaries**—should be identified under which the project will be developed. For example, completion date, your budget or the amount of time you can devote to the research.
- **Alternatives**—those that are being considered as well as those ruled out should be included in the analysis and evaluated as the analysis progresses. Even those that are ruled out should be mentioned briefly in the analysis, including a short discussion of why they were eliminated.
- **Automatic stops**—criteria that automatically eliminate some alternatives—should be determined at the outset. For example, if the use of underground utilities is essential for the aesthetic appearance of a proposed facility, then the alternative of using above ground utilities is automatically ruled out. These types of criteria prevent wasting time and money on unacceptable alternatives.
- **Signatures**—for approval.

Keep the cost of the analysis in line with the total project. It should not be a ton of paper with page after page of confusing data or tables. It should be concise and client-oriented. Remember, *you* are paying for the study. It needs to be complete enough to satisfy potential lenders, but just as important is *your* ability to understand the analysis so that *you* can implement it. If you can't understand it, you can't use it!

Conclusion

Whether or not you try to perform a feasibility analysis of a proposed venture, or hire someone to do it for you, the important point is that you understand and support the process. The analysis will aid greatly in the creation of some new endeavor or the expansion of some existing project by providing you, the owner, with both a clear plan for internal use, and a valuable tool for obtaining outside funds. It can also pinpoint projects that would likely fail given a certain set of circumstances. Although not a cure for the financial pangs of risk, it can help ease the anxiety. With proper planning and research, you can feel more confident about investing your resources with a sound feasibility analysis at your side.

Selected References

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Sources For Additional Help

- Local Chambers of Commerce
- Michigan State Chamber of Commerce, Lansing, Michigan
- Michigan State University Cooperative Extension Service, East Lansing, Michigan
- Travel Bureau, Michigan Department of Commerce, Lansing, Michigan
- Economic Development Office, Michigan Department of Commerce, Lansing, Michigan
- Other state and local agencies important to various stages of the project, such as:
  - Health Departments
  - Road Commissions
  - Drain Commissions
  - Planning and Zoning Commissions

Tourism Information Series

The Tourism Information Series is for those interested in tourism development. To obtain the series, contact your county Extension office. Look in the white pages under County Government.

1. E-1937, Tourism and Its Significance in Local Development
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Series editor: Maureen H. McDonough, Associate Professor, Department of Park and Recreation Resources.

Produced in Cooperation with the
Michigan Travel, Tourism and
Recreation Resource Center
Michigan State University

Issued in furtherance of Cooperative Extension work in agriculture and home economics, acts of May 8, and June 30, 1914, in cooperation with the U.S. Department of Agriculture. W.J. Moline, Director, Cooperative Extension Service, Michigan State University, E. Lansing, MI 48824.

1P-2M-9:86-TCM-GP. Price 90¢, For Sale Only. File 36.0