Chpt 14 Strategic Cost Management

Case: Hotels and Benchmarking- the Crowe Horwath Annual Hotel Survey

Source:
https://www.crowehorwath.net/IE/news/Crowe_Horwath_are_delighted_to_release_the_20th_Edition_of_the_Annual_Ireland_Hotel_Industry_Survey.aspx

Every organisation changes- sometimes in response to external factors such as changes in competition or customer or market requirements, or they may change in response to a variety of internal factors such as technology, leadership or changes in work practices. Those organisations who wish to embrace change may find that the identification and transfer of best practices is key to successful change. Leading organisations in the industry may present best practice which other wish to emulate. By comparing one's organisation to the best in class, performance gaps can be identified and one can seek to improve to the benchmark standard (ICAEW, 2006).

World class organisations have recognised that to achieve best results from benchmarking, they must go beyond simple benchmarking of numbers. They must dig deep and explore how the process performs and then understand the enabling factors that allow it to perform in such a manner that defines it as best practice. Using benchmarking as a tool will support the firm's analysis and business case for change. Firms select particular areas to benchmark that help them achieve their goals and objectives. Later in this case, we will discuss the *Crowe Horwath Annual Hotel Industry Survey* which allows individual hotels to check their revenue, cost and profit before tax figures against the overall hotel industry average across all hotels as well as against other benchmarks-such as averages by grade of hotel, by region and by size (see Figure 1).

Many types of benchmarking exist- metric, process, strategic, internal and competitive. Metric is the initial step in benchmarking and helps identify a performance gap by gathering numerical data. An example of this is the Fáilte Ireland Diagnostic Indicator, which in Stage 2 requires the 'hard data' or business results of the hotel to be input and benchmarked against the Crowe Horwath data.

Process benchmarking focusses on finding out qualitative information about a business process. It uncovers "why" a certain practice works by focussing on the enablers that answer the question "how". *Technology*, training and senior leadership support are examples of these drivers. An excellent example is the Marriott hotel chain. A tale of how technology excellence and leadership from the Vice President for revenue management were the drivers to improving the revenue figures can explain how it became known as an industry leader in revenue management since before the practice had a name (Overby, 2007). Marriott applied its business wisdom to building an IT system – the One Yield system- that brought improvement in financial metrics <u>as a result</u> of this technology enhancement process: -

> One Yield continues to add value to Marriott's bottom line as users become more experienced with it and suggest new ways to apply it. For instance, the data generated by One Yield *has led to a corporate wide management metric called inventory effectiveness*, which measures the ratio of actual revenue to optimal revenue. One Yield has helped to improve Marriott's ratio of actual revenue to optimal revenue from 83 percent to 91 percent.
>
> (Overby, 2007, p. 4, italics added)

Benchmarking must involve key stakeholders who can drive the change initiative. Therefore, benchmarking is a way of operating the business, not just a one-off exercise. Overby (2007) clearly shows it was led by the VP for Revenue Management in the Marriott example. Strategic benchmarking is the analysis of emerging trends in markets, processes, technology and distribution to identify opportunities to change core business processes (ICAEW, 2006).

Internal benchmarking takes place within one large organisation or within a group and serves to highlight where processes in one part of an organisation are less efficient than those in other parts and need to be improved.

In a good example of internal benchmarking, Parkan (2005) compares the competitive performance of two hotels, who form part of a family company, but due to their different locations, attract different guest profiles. Hotel 1 catered mainly for business travellers at middle management level, staying at the hotel for about two nights, on a modest travel budget. Hotel 2 tended to be mostly tourists, who stayed in the hotel on average five days. The holding company wanted to compare the performances of both hotels with each other as well as with the performance targets set by the prevailing industry standards. Hotel operations involve many activities in the course of providing service, from checking-in guest to cleaning and turning over rooms. Such activities consume input of resources- such as personnel time, materials, space, energy and equipment, and produce both tangible and intangible outcomes. Cost efficiency alone is not sufficient to generate superior overall performance. Therefore, the competence of the hotel’s management in running their hotel’s operations at low cost to generate rich revenues was the criterion used to determine that hotel’s competitive performance (Parkan, 2005, p. 681). A tailored performance measure – Operational Competitiveness Rating- (OCRA) was computed from a weighted basket of cost and revenue categories that were common to both hotels. The results showed that Hotel 1 had performance ratings that were less variable than Hotel 2 in the areas that were benchmarked in common.

The last type of benchmarking- competitive benchmarking- is useful in mining how your company is, compared to the industry. It can be difficult for any firm to directly access competitor information, but in the case of the hotel industry, a hotel consultancy firm, first founded in New York with the arrival of two brothers from Hungary, were to act as intermediaries, carrying out an annual survey that allowed average data to be collected from the hotel industry. Horwath Hotel, Tourism and Leisure (HTL) Consulting also established the *Uniform System of Accounts for Hotels* (USAH)– a system so successful, that it has become the international industry standard for hospitality accounting. The terms set out in Appendix 1 (of this case) derive from the USAH. Chin *et al.* (1995) noted that the widespread use and acceptance of a standard chart of accounts in the form of the USAH, has helped competitive benchmarking.

As specialist hospitality consultants, the *Crowe Horwath Annual Hotel Industry Surve*y serves as a benchmarking tool for the sector. Detailed information can be extracted, such as illustrated in Figure 1 opposite. In the survey, there are some non-financial statistics such as percentage of repeat business, length of stay and number of guests per room. Therefore, benchmarking metrics are available based on *non-financial* as well as financial data such as Average Daily Room Rate and RevPAR.

Crowe Horwath Ireland is a member of *The Horwath HTL* network comprising over 50 offices in 39 countries and carries out the Ireland Hotel Industry Survey. The most recently available one is the *Ireland Hotel Industry Survey 2015*, an adapted extract from which, below in Figure 1, shows the typical metrics that would be reported for the Irish hotel industry, providing average figures for each grade of hotel to perform their own benchmarking exercise. Although shown by grade of hotel the same metrics are reported elsewhere in the survey, by region and also by size of hotel– hotels of 1-49 rooms; 50-99 rooms and 100+ rooms.

The hotelier reading the Survey can fill in his/her own metrics on a special table at the back of the survey booklet, called “Analyse your own Operation” (see for example Crowe Horwath, 2015b, p. 43).

Figure 1 : Overall Performance Measurements: Ireland Hotel Industry Survey 2015

(based on the 2014 season)

	All hotels 2014	Luxury 2014	First class 2014	Mid-price 2014	Economy 2014
Average Room Occupancy	67.8%	68.3%	68.7%	68.7%	62.2%
Average room rate	€82.29	€159.04	€81.71	€62.25	€50.01
RevPAR	€55.79	€108.62	€56.13	€42.77	€31.11
Total Revenue per available room (TRevPAR)	€53,916	€88,121	€57,053	€43,526	€26,346
Gross Operating Profit per available room	€11,902	€20,056	€12,570	€9,574	€5,241
Profit before tax and finance per available room	€9,201	€15,548	€9,821	€7,439	€3,301
Profit before tax and finance per room %	17.1%	14.9%	17.2%	17.1%	12.5%
Gross margin % :					
Food %	69.1	69.9	69.5	68.4	68.8
Beverage %	66.9	68.9	67.0	66.7	65.3
Profit before tax to Room revenue %	44.3	38.2	47.6	46.8	30.0
Profit before tax to Total revenue %	17.1	17.6	17.2	17.1	12.5

Adapted from: Crowe Horwath (2015b, p. 6 and p. 27)

The Average Daily Room Rate or Average Room Rate (ARR) is defined as :

$$\frac{\text{Room sales revenues achieved}}{\text{Total no. of rooms occupied}}$$

and the Average Room Occupancy metric is :

$$\frac{\text{No. of rooms sold}}{\text{Total rooms available in the hotel}}$$

Both of these metrics, on their own, are incomplete measures of sales performance. A higher level of room sales revenues will not result from an increased occupancy level, if the room rate has been disproportionately dropped. Similarly, a higher level of total revenue from rooms will not result, if an increase in the average room rate coincides with a disproportionate decline in the occupancy rate.

To circumvent this incompleteness problem, the manager can link the Average Room Rate (ARR) to occupancy statistics and this is what RevPAR achieves- it aggregates the two metrics.

If we take a hotel with 100 rooms of which 60 rooms are sold for a given day, generating a total revenue of €4200, we can compute RevPAR in either of two ways:-

RevPAR = ADR * Average Occupancy

By dividing the Total Revenue by the Number of rooms sold **(€4200 / 60)**, we get the value of €**70** as the Average Daily Room Rate. Meanwhile, we find a **60 %** Occupancy rate (60/100 rooms occupied).

So, aggregating the ADR by the Occupancy %, we get **(€70 * 0.6)**= €42= RevPAR

An alternative calculation is to divide **(€4200 / 100)**, we also arrive at a RevPAR result of €**42**.

Total revenue per room or TRevPAR is an update to the widely used RevPAR- it is the total revenue earned from all of the guest spend- so it includes the revenue earned from letting the room, but also includes food and beverage spend and spend on spa treatments, tours, parking, gifts etc. TRevPAR is the preferred metric for accountants and hotel owners, because it effectively determines the overall financial performance of a property, while RevPAR only takes into account revenue from rooms. TRevPAR is useful for hotels where rooms are not necessarily the largest component of the business. Outlets such as banquet halls and spas also provide a source of revenue for these hotels.

It is interesting to note that in the adapted extract below (Figure 2), that both RevPAR and TRevPAR are reported.

Figure 2 : Key highlights– All hotels

	All hotels 2014 (Note1)	**All hotels 2013 (Note 2)**	**All hotels 2012 (Note 3)**
Average Room Occupancy*	67.8%	65.9%	63.8%
Average room rate*	€82.29	€77.49	€74.72
RevPAR	€55.79	€51.07	€47.67
Total Revenue per available room (TRevPAR)	€53,916	€49,249	€47,145
Gross Operating Profit per available room	€11,902	€9,977	€9,094
Profit before tax and finance per available room	€9,201	€7,347	€6,497
Profit before tax and finance per available room %	17.1%	14.9%	13.8%
Gross margin % :			
Food %	69.1%	67.9%	67.1%
Beverage %	66.9%	66.7%	65.9%
Profit before tax to Room revenue %	44.3%	39.0%	36.7%
Profit before tax to Total revenue %	17.1%	14.9%	13.8%
Other cost- based metrics:			
Departmental payroll and related expenses as % of Rooms revenue	24%	24.7%	25.1%
Departmental payroll and related expenses as % of Food and Beverage revenue	33.4%	32.9%	34.0%
Undistributed Payroll and Related Expenses as % of Total Revenue	38%	37.8%	39.4%

*Note that average room occupancy and average room rate are also analysed per month in the Survey

Note 1: Adapted from: Crowe Horwath (2015b, p. 6 and p. 27)

Note 2: Adapted from: Crowe Horwath (2014, p. 34 and 35)

Note 3: Adapted from: Crowe Horwath 2013, p.34 and 35)

Taking an overview of the key metrics, the figures in Figure 2 above show that :

- Occupancy levels grew by 1.9 percentage points to 67.8%

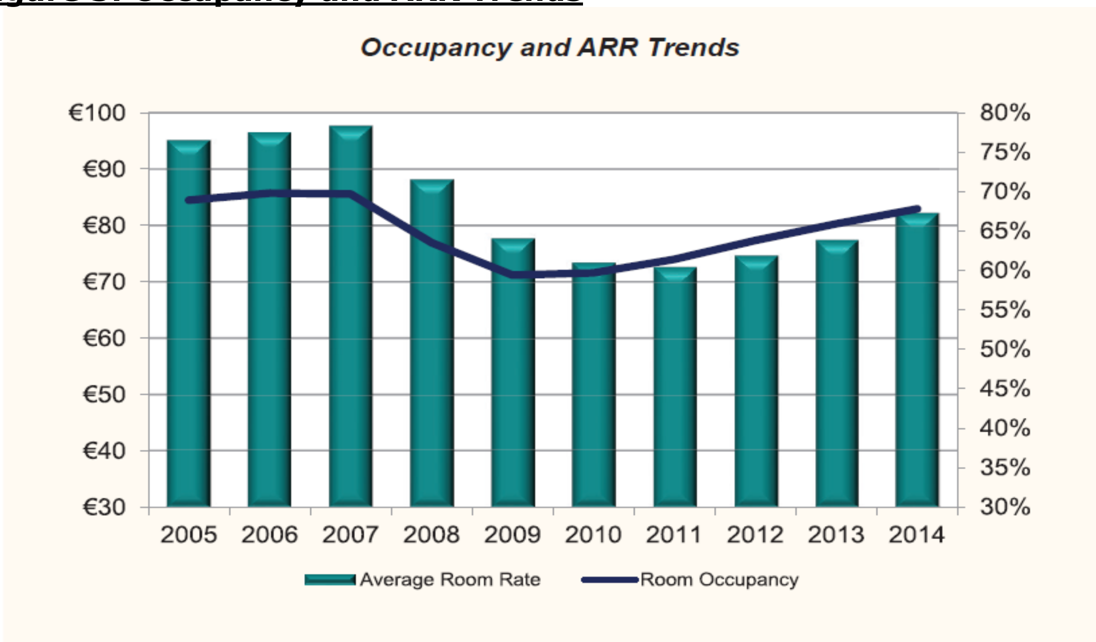
- Average room rate increased by €4.80 to €82.29, up 6.2% on 2013
- Total revenue per room (TRevPAR) grew by 9.5% to €53,916
- Profit margins improved by 2.2 percentage points to 17.1%
- Overall profit before tax and finance per room increased by 25% to €9,201

Cost metrics such as payroll costs as a percentage of departmental revenue (rooms, food and beverage) are also vitally important for monitoring as are utility costs, which form part of Undistributed Operating Expenses. As noted by Crowe Horwath (2015b, p. 11), these costs include gas/oil, electricity, water and waste removal, and while hotels have implemented conservation programmes to reduce the level of usage, prices have been increased by the utility provider.

> While the hotel sector is operating at 15.7% below [pre-recession] average room rate, the unit costs for utilities has vastly increased over the same period (p.11).

Interestingly, the average room rate in 2014 lags the pre-recession (2006) average room rate (see Crowe Horwath, 2015b, p. 8). This can be seen in Figure 3 below. Further analysis of this rate by grade reveals a lag also.

Figure 3: Occupancy and ARR Trends



(Source : Crowe Horwath (2015b, Executive Summary, p. 4) Crowe Horwath grants non-exclusive worldwide rights to use the information specified above in this and all future editions of this text, for all product family, with all languages and in all medias)

Available also on website at:
https://www.crowehorwath.net/uploadedfiles/ie/industries/hotels,_tourism_and_leisure/crowe%20horwath%20hotel%20industry%20report%202015%20-%20executive%20summary.pdf

The use of visuals such as the Occupancy and Average Room Rate (ARR) trend in the above chart (Figure 3) shows the *trend* in these metrics. Such charts could be done by individual hotels to see how their trend compares to the overall trend for the industry.

Fáilte Ireland's [1]Diagnostic Indicator

This diagnostic indicator for hotels serves as the primary tool to help Fáilte Ireland and tourism operators to identify support needs within their enterprises. As part of the diagnosis, hoteliers are encouraged to enter background information in Stage 1, then at Stage 2, enter 'hard' data- mostly in percentage terms, which will give a snapshot of the business and can be compared to external benchmarks such as the *Crowe Horwath Annual Hotel Survey* Results. At Stage 3- performance drivers -the 5 Ps – promotions, performance, profitability, people and processes- are highlighted. This section contains 10 key questions under each of the five headings, the purpose of which is to prompt a discussion on the relevant area in order to determine whether it is an area of excellence or an area of deficiency and needing attention. Stage 4 is the diagnostic summary and priority actions stage, allowing the hotelier to make a summary rating for each of the five areas overall. Clearly, not all areas for improvement can be addressed at once, so it is a matter of prioritising what actions within the five areas will be taken in the short term to address priority challenges.

See more at: http://www.failteireland.ie/Supports/Develop-your-tourism-enterprise/Business-tools/Check-and-compare-your-hotel%E2%80%99s-performance.aspx#sthash.223tySaY.dpuf.

Once the performance gaps are identified at Stage 4, Fáilte Ireland offer best practice advice in the form of templates and questions for the hotelier to ask him/herself.

See more at: http://www.failteireland.ie/Supports/Develop-your-tourism-enterprise.aspx).

Questions

1. Discuss the use of visual trend data in helping to benchmark performance.
2. Review other sources of hotel benchmarking data.
3. What are the possible disadvantages of benchmarking?
4. What other ways can companies promote change?

[1] Fáilte Ireland is the National Tourism Development Authority for the Republic of Ireland.

Appendix 1

Explanation of Terms and Bases used in Crowe Horwath Annual Hotel Survey

(based on standard terms in the USAH chart of accounts)

REVENUE:

Room Occupancy: rooms occupied by hotel guests on a paid daily basis which is total occupied room days divided by total available roomdays (which must be number of rooms permanently available for the days the hotel is open in a year = room days)

Average room rate (ARR) : is defined as room sales achieved divided by the total number of rooms occupied

Revenue per available room (RevPAR): is calculated by multiplying average room rate by annual occupancy level

Departmental profit per room: this is defined as the departmental sales less the departmental costs

Gross Operating profit per room (GOP): total revenue less all departmental and undistributed operating expenses (defined in the next paragraph)

Profit before tax: means gross operating profit less the total fixed charges or profitability after accounting for operational costs but before debt service.

Other metrics that can be benchmarked are:

Rooms revenue- revenues derived from the rental of sleeping rooms at the hotel, net of Value Added Tax and any rebates and discounts.

Typically, a full service hotel will have other sources of revenue such as :

Food revenue- revenues derived from the sale of food, coffee, milk and tea

Beverage revenue- revenues derived from the sale of beverages, including beer, ale, wine and liquors.

Other revenues- revenues derived from all other sources to include Conferencing and Banqueting, Leisure Centre, Health Spa and telephone income etc

COSTS:

Room costs: those costs of the rooms department, such as labour costs such as salaries and wages for front desk, housekeeping, reservations, bell staff and laundry, plus employee benefits. Other operating expenses in the rooms department include linen, cleaning supplies, guest supplies, uniforms, reservation expenses, equipment leases and travel agent commissions.

Food and Beverage costs: are those expenses of the food and beverage department- to include cost of goods sold (food and beverages), labour and related benefits and other operating expenses. Labour costs include departmental management, cooks and kitchen personnel, service staff, banquet staff and bartenders.

Undistributed operating expenses: comprise administrative and general expenses, marketing, franchise fees, utility costs, property operation and maintenance costs. For example, administration and general expense includes office supplies, computer services costs, accounting and legal fees, liability insurance, cash overages and shortages, bad debt expenses, travel insurance and credit card commissions. Payroll costs may be separately shown as this is carefully monitored.

Fixed charges: do not include depreciation, bank loan interest or rent.

They do include- management fees; property taxes, property insurance, leased equipment rental and other fixed charges that relate to the ownership of the hotel or gains or losses from any sale of assets.

(Source: Crowe Horwath (2015b, p. 44) : Crowe Horwath grants non-exclusive worldwide rights to use the information specified above in this and all future editions of this text, for all product family, with all languages and in all medias)

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USAH- see http://www.hospa.org/weblog/2014/06/06/new-edition-uniform-system-accounts-available/#.Vhr7WHpVhBc

Outline Solution Case 2: Hotels and Benchmarking- the Crowe Horwath Annual Hotel Survey

Q1. Discuss the use of trend data in helping to benchmark performance.

Trend data as shown in Figure 3 above can bring figures alive, particularly for non-finance personnel. It is something that is common in hospitality, as YM packages show a lot of visual charts showing booking pace etc.

For instance, by surfing to VisitBritain, one can find the following chart from the England Occupancy Survey - July 2015 :

Source:
https://www.visitengland.com/sites/default/files/july_2015_eos_newsletter.pdf

See:
https://www.visitengland.com/sites/default/files/june_2015_ukos_newsletter.pdf

Q2. Review other sources of hotel benchmarking data.

See for example : http://www.hotstats.com/

HotStats brings Market Intelligence expertise to the hospitality industry, by providing customised information on a confidential basis.
See also STRGlobal: https://www.strglobal.com/

Also Fáilte Ireland's Hotel Performance report and their monthly tourism statistics showing visitor numbers.

Contact :

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See also Tourism Barometer report:

http://www.failteireland.ie/FailteIreland/media/WebsiteStructure/Documents/3_Research_Insights/3_General_SurveysReports/REPORT-Failte-Ireland-tourism-barometer-May-2015.pdf?ext=.pdf

Latest occupancy trends:
http://www.failteireland.ie/FailteIreland/media/WebsiteStructure/Docume

nts/3_Research_Insights/3_General_SurveysReports/Accommodation-occupancy-results-Jan-May-2015.pdf

See Hotel Performance Report : http://www.ihf.ie/content/press-release-89-irish-hotels-and-guesthouses-seeing-upturn-business-2015

Visit Britain's
https://www.visitengland.com/sites/default/files/june_2015_ukos_newsletter.pdf

Q3: What are the possible disadvantages of benchmarking?

The industry average figures, being broad averages, may not be comparable to your hotel establishment and would be unfair comparators. The hotel might not look at other data, such as that of a near competitor. False comparisons can lead to incorrect decisions.

While benchmarking indicates that a company has met the standards of their competitors, it does not reveal the circumstances under which these competitors achieved this level, so masking any constraining or unusual factors or flawed vision that were embedded in the competitor's performance. Thus, there can be inherent uncertainty as regards aligning one's performance with the benchmark company, if all the facts surrounding their performance are not clear.

Many organizations, may, once they have reached or exceeded competitors' standards, adopt a complacent attitude, which is a big danger of benchmarking. Finally, many organizations make the mistake of treating benchmarking as a stand-alone activity. It must be accompanied by a plan to achieve change, as the end is change and benchmarking is only a means to an end.

Overall, its advantages outweigh its disadvantages and it can be beneficial if benchmarking is included as a part of continuous improvement initiatives such as Total Quality Management and Six Sigma.

http://www.brighthub.com/office/entrepreneurs/articles/82292.asx

Q4. What other ways can companies promote change?

They can promote change through enhanced motivation towards change via mentoring or they can incentivise change through the reward structure. Also they can set goals which involve change via the performance measurement system. Such goals can be agreed by the budgetee through dialogue with the manager.

All of these will tie back to the performance measurement and management system, but it may be possible for the company to drive change, which has been agreed in its strategic plan, which may or may not involve benchmarking.

See SWOT analysis, Porter's 5 forces approach, that will involve an intention towards change, through analysis of the internal aspects of the company and the external environment in which it competes.