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Comparison Reports and Financial Analysis

Learning Objectives

1. To understand the importance of hotel revenue and profit analysis and how they are explained and analyzed.
2. To understand what variation analysis is and how it is used.
3. To learn the key formulas and uses of variation analysis.
4. To understand the format and uses of the STAR Market Report.
5. To understand and be able to use internal and external financial reports.

Chapter Outline

Profitability: The Best Measure of Financial Performance

- Definition
- The Difference Between Analyzing Profits and Analyzing Revenues
- The Impact of Department Profits on Total Hotel Profits
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Variation Analysis

- Definition
- Formulas and Ratios Used in Variation Analysis
- Key Hotel Ratios That Measure Hotel Financial Performance

In the previous chapters we have presented material on numbers and how they are used to measure financial performance. At this point, students should be forming a solid foundation of financial knowledge and a good understanding of what financial analysis is, what it tells you, and how it is used in explaining hotel operations. The next concepts that we will discuss are other financial reports and methods of financial analysis used to compare and analyze hotel operations.

This chapter refers back to earlier chapters that presented basic accounting concepts and methods of financial analysis. A solid foundation of these fundamentals should now be in place. The next step is to learn about some helpful internal and external reports that can be used in analyzing and comparing operating results. Notice that we always start with operating performance, followed by the analysis of the financial results that operations produce.

Internal comparisons are made to company budgets, forecasts, previous months or periods, and established goals or standards. External reports are market or economic reports that are useful in comparing hotel operating and financial results with a competitive set, the industry average, or other external financial information.

Profitability: The Best Measure of Financial Performance

Definition

Profits are defined as revenues minus expenses—a rather simple formula that is very important in measuring financial performance. In actual hotel operations, this formula is used in a variety of ways that result in specific profitability measures. Profits can be measured at several levels of any business. Let's review some of the key profit levels that are included in hotel Profit and Loss Statements (P&Ls):

Department Profit = All of a Department's Revenues − All of a Department's Direct Expenses

Total Department Profits = The Sum of All Hotel Department Profits, Which Is the Same as the Sum of All Revenue or Profit Centers

House Profit or Gross Operating Profit = Total Department Profits − the Total of All Expense Departments

or

Total Department Profits − Deductions from Income

Net House Profit or Gross Operating Profit = House Profit − Fixed Expenses

Profit before Taxes = Net House Profit or Adjusted Gross Operating Profit − Owner Fees or Management Fees

Profit after Taxes = Profit before Taxes − Taxes

Profits are the best measure of financial performance because they include the two major factors of financial performance: maximizing revenues and minimizing expenses. Maximizing total hotel revenues is important, but it is only one step. Controlling and minimizing expenses is also important and is the second step. Maximizing profits requires management to be efficient in both areas. Together, revenue and profit analysis explain virtually everything about the financial performance of a hotel or restaurant.

The Difference between Analyzing Profits and Analyzing Revenues

Analyzing revenues is totally focused on the relationship between rate and volume in the effort to maximize total hotel revenues. It involves establishing rate structures, defining market segments, utilizing yield management information, setting selling strategies, and comparing rate and occupancy results with internal and external reports. Specific hotel managers are responsible for maximizing hotel revenues.

Analyzing profitability not only includes revenue analysis but also expense analysis in all department and expense line item accounts. Each specific expense category is evaluated on the effect it has on the hotel's ability to efficiently provide products and services for its customers. These expenses include fixed and variable expenses, direct and indirect expenses, and operating and overhead expenses. Specific hotel managers have the direct responsibility for managing specific revenue segments and controlling specific expense line accounts to maximize the profits of their departments.

The most important expenses to be analyzed and controlled are food cost and wage cost. These are two big expense accounts and can become major problems and drains on profits if they are not properly managed and controlled. Wage costs are even more important because they directly affect the benefit costs. If wage costs go up and are over budget, benefit costs will also go up and be over budget.

Finally, there are many more expense line accounts to be managed than revenue line accounts. This requires the attention of all hotel managers in every department in the hotel. Each must be effective in managing and controlling expense accounts if hotel profits are to be maximized. If each manager effectively controls his or her department expenses, the total hotel expenses will be in line and total hotel profits will be maximized.

The Impact of Department Profits on Total Hotel Profits

As we mentioned earlier, all department profit dollars are not created equally. This means that each department that is a profit center has a different expense structure. Some have more expenses that result in lower department profits, and some have fewer expenses that therefore result in higher department profit. The larger convention hotels and resorts have more profit departments and profit centers than typical full-service hotels and therefore can generate a larger Total Department Profit.

Let's look at two examples of full-service hotels and identify the profits associated with each department. Remember that a revenue center and profit center are the same and we can use these terms interchangeably. They are two terms that describe operating departments that produce revenues and profits. Also remember that the department profit percentage shows how much of a department revenue dollar will make it to the "bottom line" as a profit dollar.

Profit Center	Full-Service Hotel	Convention Hotel Resort
Rooms department	65%–75%	70%–80%
Banquets/catering departments	25%–35%	30%–40%
Full-service restaurant	0%–10%	5%–15%
Specialty restaurant	None	10%–20%
Bar and lounges	30%–40%	30%–45%
Gift shop	25%–30%	25%–35%
Golf club	None	25%–35%
Spa	None	25%–35%

Let's examine the impact that these examples have on profitability:

1. The Rooms Department has the highest profit percentage because there is no cost of sales. The rooms are re-rented every night, not consumed (like food and beverage items) or purchased (like gifts and clothing); therefore, there is no cost of sales. In other revenue departments, cost of sales can range from 30% to 40% for food and be about 50% for clothing, so it is a major expense category. This explains why the Rooms Department profit is so much higher than the other profit departments.
2. The room rates of the Rooms Department generally are much higher than the average checks in restaurants or gift shops. This also increases the Rooms Department profit percentage.

3. Convention hotels and resorts generally have higher average room rates and higher food and beverage menu prices that help to increase their department profit percentages.
4. The more revenue departments in a hotel, the more sources of profits to increase Total Department Profits, House Profits/Gross Operating Profit, and Net House Profit/Adjusted Gross Operating Profit.
5. Restaurant departments have the lowest profit percentage because of the many expenses required to prepare and serve food. Both food cost and wage cost will run between 30% and 40% each, benefits will range between 10% and 15%, and other direct operating costs will range between 10% and 15%. This leaves little room for error if the restaurant is to be profitable.
6. Specialty restaurants are generally more profitable because they have higher average checks.
7. It is financially beneficial for restaurants to serve liquor because liquor has lower wage costs and lower cost of sales, resulting in higher liquor profitability. This helps the overall financial performance of the total food and beverage outlets including banquets.
8. The Banquet or Catering Department is more profitable because its food functions can be planned with specific prices and customer counts, resulting in more efficient operations and higher profitability. For example, a dinner banquet for 500 people with a set menu and $30 average check can be planned for and produced with greater efficiency than opening a restaurant for the evening and waiting to see how many customers come, what the average check will be, and what the total revenues will be.

The Director of Finance and the General Manager of a full-service hotel generally spend a great deal of their time on the rooms and food and beverage operations for two very different reasons. First, the Rooms Department is important because it generates the most revenues and profits. A well-run Rooms Department means there will be higher cash flow and greater financial resources to operate the rest of the hotel successfully. The Rooms Department is a good example of a department that focuses on maximizing revenues. Second, the Food and Beverage Department is important because of the complexity and detail of its operations. Food and beverage operations have to be well managed to control all of the different expenses to achieve a profit. If this department is not operated well, operations could produce a loss rather than a profit. Restaurant departments are good examples of departments that focus on controlling and minimizing expenses in addition to maximizing revenues.

The different department profit percentages discussed here provide a good example of mix percentages, presented in Chapter 2. One dollar of revenue in each of these departments will produce different dollar amounts of profit. The management team of a well-operated hotel knows and understands this and plans daily operations to consider the department profit that will result from the forecasted department revenues for the week. *To maximize hotel profitability, expenses must be minimized and revenues maximized*.

Maximizing and Measuring Total Hotel Profitability

There is a partnership in a hotel that enables the hotel to use all the operating and financial resources available to maximize profitability. This partnership is between the staff departments and the operating departments. The goal of the four staff departments (Sales and Marketing, Repairs and Maintenance, Human Resources, and Accounting) is to provide specialized support for the operating departments (Rooms, Food and Beverage, Golf, Spas, Retail). The operating departments are responsible for taking care of guests and generating revenues and profits for the hotel. Their focus should be on providing the best products and services to the guests of the hotel and ensuring that the guests want to come back.

The partnership and support that the Accounting Office and the Director of Finance provide are the operating managers is extremely important in successful hotel operations. Because accounting and finance can become complicated and demanding, it is important that the Director of Finance provide these services and knowledge to both department managers and senior management. It is equally important that the department managers provide accurate numbers to the Director of Finance so that together they have all of the knowledge and resources necessary to identify problems and trends, develop corrective action, and determine the best way to implement changes so that improvements are made and goals met. It is a true partnership with specialized knowledge and experience brought to the relationship by each manager and department. A strong financial and operating team is essential to the successful operations of the hotel.

It is also important to understand the services and support the other staff departments contribute to the successful operations of a hotel. The Sales and Marketing Department works hard to establish good rate structures, implement successful selling strategies, attract profitable group business, and develop good marketing and advertising programs. The Repairs and Maintenance Department works constantly to ensure that the equipment in the hotel is working efficiently and that the hotel looks sharp both inside and out. This is a big job! The Human Resource Department ensures that good employees are hired, provides training and development, handles employee problems, and takes care of payroll and benefit administration. If each of these departments does its job, the hotel will be operating at a high level and have a much better chance of meeting the goals and budgets established to measure hotel performance and profitability.

Review of Chapter 2: Foundations of Financial Analysis

Chapter 2 introduced fundamental accounting concepts and methods of financial analysis that are used to analyze numbers and results. We will now use this material and these methods to analyze internal operations, including both revenues and profits. We are also able to use this information to compare individual company performance with industry standards and external reports.

In this chapter, we will now focus on *applying the foundations of financial analysis* presented in Chapter 2 to our company performance. Variation analysis utilizes all of these fundamentals. Let's review them again.

Comparing Numbers/Results to Give Them Meaning

Numbers need to be compared to a standard and to other numbers to give them meaning. Variation analysis expands this definition by providing ratios and formulas that assist managers in comparing a company's monthly, quarterly, or annual performance. Variation analysis helps in two ways. First, it allows for an internal comparison of company performance to last year's results, to established plans such as the annual budget and current forecast, or to the previous month's performance. Second, it allows for an external comparison of performance to averages of like hotels in a company, to industry standards and averages, or to external reports such as the STAR Market Report.

Measuring and Evaluating Change in Financial Analysis

Changes in company performance are identified by comparing actual performance to previous performance or to an established goal or measure. Variation analysis expands this definition by identifying changes in company performance in terms of dollars, units, or percentages. The comparisons mentioned in the previous paragraph identify and calculate the amount of both positive and negative changes. Companies plan on improving their operations and performance from year to year, and actual results are compared to these planned changes (budgets and forecasts).

Percentages as a Tool in Financial Analysis

Percentages measure relationships and changes in operating performance. They always involve two numbers and provide another measurement in financial analysis beside dollar or unit changes. Percentages identify the size of a change compared to a standard. This is very important information. For example, a $1,000 change in revenues compared to $50,000 in revenues is a 2% increase. That same $1,000 change in revenues compared to $200,000 in revenues is only a 0.5% increase. These percentages tell us that the $1,000 change in the first example is a larger and more significant change than the $1,000 change in the second example.

The four types of percentages used most often in financial analysis are cost percentage, profit percentage, mix percentage, and percentage change. Each of these percentages is an important part of variation analysis.

The Importance of Trends in Financial Analysis

Trends are important because they show the size, direction, or movement of business activity, industry averages and standards, and national and world economies. Variation analysis compares the operating and financial trends of a company with the trends of other hotels or restaurants in the company, industry trends, stock market trends, or national or world economy trends. Variation analysis also identifies both positive and negative changes in the operating and financial trends of a company. Particularly valuable is comparing a company's revenue, expense, and profit trends in seeking to improve operating results and financial performance.

Photo: Rancho Las Palmas Marriott Resort & Spa

Sunrise Terrace
Rancho Las Palmas Marriott Resort and Spa
Rancho Mirage, California

This 422-room resort that opened in January, 1979, was the first resort built and operated by Marriott Hotels and Resorts. It is a part of the Rancho Las Palmas Country Club development that included 27 holes of golf, 25 tennis courts, and over 850 club home owners and members. In 1999, a second ballroom was added, bringing the total meeting space to 41,000 square feet. A two-story 20,000-square-foot spa was also added as part of the resort's expansion and renovation. It was also the first resort to open east of Palm Springs and opened the expansion into the Coachella Valley. Today there are more than eight other major resorts including another Marriott, a Renaissance, Westin, Hyatt, and La Quinta resorts.

The original competitive set would have included resorts in Southern California and Arizona. Now the competitive set is located in the Coachella Valley and includes a wide range of amenities, meeting space, and room rates. If you were asked to identify the current competitive set, would you focus on similar room rates, similar number of guest rooms, similar meeting facilities, similar recreational activities, similar room rates, or location? All of the above would be a safe answer, but how would you identify your primary competition and create a valuable competitive set?

Variation Analysis

Definition

Variation analysis involves identifying the difference between actual operating performance and established standards. These standards can be last year's actual performance, the previous month's actual performance, the budget for this year, or the most current forecast. Variation analysis relies on accurate financial information to identify both good and bad variations in operating activities. Therefore, variations can be positive, reflecting better performance than the standards, or they can be negative, reflecting worse performance than the standards.

Variation analysis also includes identifying and examining the causes of changes in operations. It identifies the variations of each line account, which collects all the financial information for a specific expenses category. The variations in the operating results of a hotel or restaurant are described and measured in the line accounts contained in the financial statements produced each month or accounting period.

Variation analysis is used to describe the results in revenue, expense, and profit accounts. Some of these accounts have several variables and some have just one variable. Variables are the different components involved in an account and can be revenue or expense. Two variables mean that two components can be managed and analyzed. Variation analysis shows the impact that each component has on the total of each account. For example, examining average room rates and volume in room revenues or average wage rates and labor hours in hourly wage analysis both include two variables. Let's look at some of the main accounts and the variables that are measured in analyzing revenue and expense accounts.

Account or Line Item	Variable
Room revenue	Average rooms rates and rooms sold/occupancy percentage
	Market segments
	Weekday and weekend
Restaurant revenue	Average check and customer counts
	Meal periods
	Beverage capture rates
Wage cost	Average wage rate and labor hours
	Management, hourly, and overtime wage categories
	Labor hours per occupied room

Most of the remaining expense accounts involve only one variable. Examples are food cost, china, glass, silver, guest supplies, linen, and so on. The total expenses in one variable account involve purchase amounts, inventory variation amounts, and transfer amounts in and out of an account. Larger line accounts such as food cost are more complicated, have many entries, and can be more difficult to manage and control. For example, total food cost for a restaurant could involve more than 100 entries each month to accurately identify the total food cost for the month. Compare that to linen cost, which will probably have fewer than five entries for the month.

Formulas and Ratios Used in Variation Analysis

Five major classifications of ratios are used in financial analysis. Each classification involves one or more of the three financial statements: the P&L Statement, the Balance Sheet, and the Statement of Cash Flow. There are a few ratios that involve information from two of these financial statements. The five classifications are as follows:

1. *Activity ratios.* A group of ratios that reflect hospitality management's ability to use the property's assets and resources. These ratios primarily involve dollars and statistics from the P&L Statement. Consider the following examples:
   a. Total Occupancy Percentage = Rooms Occupied ÷ Total Rooms
   b. Available Occupancy Percentage = Rooms Occupied ÷ Total Available Rooms for Sale
   c. Average Occupancy per Room = Total Guests ÷ Total Rooms Occupied
   d. Food Inventory Turnover = Cost of Food Sold ÷ Average Food Inventory
2. *Operating ratios.* A group of ratios that assist in the analysis of hospitality establishments operations. These ratios are also primarily from the P&L Statement. Examples are as follows:
   a. Average Room Rate = Total Room Revenue ÷ Total Rooms Sold

b. REVPAR = Total Room Revenue ÷ Total Rooms or Average Room Rate × Occupancy Percentage

c. Average Food Check = Total Food Revenue ÷ Total Customers

d. Food Cost Percentage = Total Food Cost ÷ Total Food Revenue

e. Wage Cost Percentage = Department Wage Cost ÷ Department Revenue

3. *Profitability ratios.* A group of ratios that reflect the results of all areas that fall within management's responsibilities. These ratios involve information from three areas: the P&L Statement, the Balance Sheet, and information from publicly traded stock exchanges. Examples are as follows:

   a. Profit Margin = Profit ÷ Revenue (This can be for a department or the entire hotel.)

   b. EBIDTA = Earnings before Interest, Depreciation, Taxes, and Amortization

   c. Return on Assets = Net Profit ÷ Average Total Assets

   d. Return on Owner Equity = Net Profit ÷ Average Owner Equity

   e. Earnings per Share = Net Profit ÷ Average Common Shares Outstanding

   f. Price Earnings Ratio = Stock Price per Share ÷ Earnings per Share

4. *Liquidity ratios.* A group of ratios that reveal the ability of an establishment to meet its short-term obligations. These ratios are from the Balance Sheet and P&L Statement. Examples are as follows:

   a. Current Ratio = Current Assets ÷ Current Liabilities

   b. Acid Test Ratio = Cash and Near Cash Assets ÷ Current Liabilities

   c. Accounts Receivable Turnover = Total Revenue ÷ Average Accounts Receivable

5. *Solvency ratios.* A group of ratios that measure the extent to which the hospitality operation has been financed by debt and is able to meet its long-term obligations. These ratios are also from the balance sheet. Examples are as follows:

   a. Solvency Ratio = Total Assets ÷ Total Liabilities

   b. Debt-Equity Ratio = Total Liabilities ÷ Total Owner Equity

Key Hotel Ratios That Measure Financial Performance

Many ratios are used in analyzing and evaluating the financial performance of a hotel. The main ratios are divided into revenue, profit, and expense categories. We will discuss and prioritize the most important ratios in each category. Notice that most of these ratios were mentioned in the five ratio classifications previously discussed.

Revenue

Variation analysis is used to examine two different aspects of the actual revenues generated by the hotel. It seeks to identify where differences occurred and what caused them.

The first analyzes rate and volume. The second compares actual performance to another standard such as budget, forecast, last year, or last month. The three primary measurements used in revenue variation analysis are rooms sold or occupancy percentage, average rate, and REVPAR. Let's examine rate and volume.

1. *Rooms sold or occupancy percentage.* This is the volume measurement of the revenue equation: Revenue = Rate × Volume. Variation analysis measures the actual number of rooms sold each night compared to the budget, forecast, or last year's rooms sold. The difference between the actual number of rooms sold and the budgeted number of rooms sold, for example, is the rooms sold variation. In our 400-room hotel, if the budgeted number of rooms sold is 360 and the actual number of rooms sold is 375, the rooms sold variation is +15. The hotel sold 15 more rooms than budgeted, which is a positive variation—more rooms sold than the budget anticipated.

   Rooms sold can also be stated in percentage terms, which is the occupancy percentage. In our example, the hotel's budgeted rooms sold prediction of 360 equates to a 90% occupancy rate. The actual rooms sold, 375, equates to a 93.8% occupancy rate (notice that we round to one decimal from the 93.75%). Our analysis of rooms sold variation now has a second measurement—15 more rooms sold, or 3.8% higher occupancy. We have now identified what part of any room revenue variations were the result of volume—selling more rooms.
2. *Average rate.* This is the rate measurement of our revenue equation: Revenue = Rate × Volume. Variation analysis measures the actual average room rate compared to the budget, forecast, or last year's average room rate. The difference between the actual average room rate and the budgeted average room rate is the room rate variation. In our 400-room hotel, if the budgeted average room rate is $75 and the actual average room rate is $74, the average room rate variation is $1. The hotel's average room rate is $1 lower than budgeted, which is a negative variation—a lower average room rate than the budgeted average room rate. We have now identified what part of any room revenue variations were the result of average room rate.
3. *REVPAR.* Revenue per Available Room (or **REVPAR**) combines both rate and volume into one measurement. It is the first operating and financial statistic that managers examine when analyzing total room revenues because it includes both rate and volume—the average room rate and the rooms sold/occupancy percentage. The difference between the actual REVPAR and the budgeted REVPAR is the REVPAR variation.

Let's continue our analysis with the average room rate and occupancy percentage information from our previous examples:

	Actual	Budget	Variation
Rooms sold/occupancy percentage	93.8%	90.0%	+3.8% points
Average room rate	$74	$75	–$1.00
REVPAR	$69.41	$67.50	+$1.91

An analysis of our example shows that actual REVPAR of $69.41 was $1.91 above the budgeted REVPAR of $67.50. Stated as a percentage, the $1.91 variance is 2.8% over the budgeted REVPAR. That is a positive variation. The next step is to identify whether rate or volume or both contributed to this positive variation. In our example, there is a positive occupancy or volume variation but a negative average rate variation. The fact that the overall REVPAR variation is positive tells us that the positive occupancy variation of 3.8 percentage points has a larger impact on REVPAR than the negative average rate variation of –$1.

The second aspect is the comparison of actual performance to a standard. We already started this process in our example. The importance of comparing the actual occupancy percentage, average room rate, and REVPAR to a standard is that it describes the direction and degree of actual performance. Comparing actual performance to last year's performance shows where and how much operations have improved or declined from the previous year. It compares yearly actual financial results. Comparing actual performance to the budget shows how actual results compare to the operating plan or budget for the year. It compares actual performance to planned or budgeted performance. Comparing actual performance to the forecast involves the most current operating plan that includes the current trend and current economic environment. The forecast updates the budget and is the most recent plan, so it should be the most accurate plan. It compares actual performance to the latest plan.

The best financial situation is to have actual operating and financial performance exceed all three measures: last year, the budget, and the forecast. The next best situation is to exceed last year but not meet the budget. This comparison shows that operations have improved over last year, which is always important, but did not improve enough to meet the budget. This could be because an aggressive budget was set. Another good situation is to meet or exceed the forecast. This is because the forecast represents the most current plan or projection. To meet or exceed last year and the forecast is very good financial performance even if the budget is missed. It is important to show improvement in at least one comparison because that indicates operations are moving in a positive direction.

Profit

Variation analysis is used to examine hotel profits at several different levels. The formula for profit is revenue minus expenses. Revenues have already been analyzed at this point, so the focus of profit variation analysis will be on the expense accounts. There are three aspects of profit variation analysis. The first analyzes the impact of revenues and expenses on profit. The second defines what profit level is being analyzed—department profits, house profit or gross operating profit, and net house profit or adjusted gross operating profit. The third compares actual performance to another standard such as last year, the budget, or the forecast.

The first step is to examine revenues and expenses:

1. *Revenues.* This part of profit analysis was completed in the previous section as rate, volume, and REVPAR were examined and compared. Refer to number 1 under "Revenue" for the details.
2. *Expenses.* The next step of profit variation analysis involves examining the different expense categories. The detail of operating expenses are included in the Department P&L and include the major cost categories of cost of sales, wages, benefits, and direct operating expenses.

The second step is to define what profit level is being analyzed. Following are the different profit levels that are examined as a part of variation analysis:

1. *Department Profits.* This is the dollar profit for the revenue/profit centers, and the formula is department revenues minus department expenses.
2. *Total Department Profits.* This is the sum of the department profits for all the revenue/profit centers in the hotel.
3. *House Profit.* This is the dollar profit that measures management's ability to control all the operating expenses in the hotel. The formula is Total Department Profits minus total Deduction Department Expenses/Total Expense Centers.
4. *Net House Profit.* This is the final profit measure that includes all hotel revenues and expenses. The only remaining expense is the distribution of profits between hotel owners and hotel management companies and taxes due. The formula is House Profit minus fixed or overhead expenses.

The third step is to compare the actual performance to a standard. This analysis is the same as described in the revenue section. The actual profit performance at each level is compared to last year, the budget, and the forecast. Any differences or variations are then identified. The revenue variations were identified in the revenue analysis, so the focus is on examining the differences in the expense categories of the different profit levels and the impact that has on each of the profit measurements.

Expense

In the "Profit" section above, we discussed how expenses are analyzed. Managing expenses is a critical part of any hospitality manager's job. Let's look at what she or he will be expected to manage in each of the major expense categories:

1. *Cost of sales.* Managers will be expected to meet the budgeted food cost in dollars and percentages each month and year to date. This will require that they effectively manage food and beverage purchases and inventory levels, assist in taking accurate physical inventories and reconciling these totals with the book inventory, oversee storeroom rotation to ensure quality and freshness, organize transfers to other food departments, and coordinate all numbers and financial information with the Accounting Department.
2. *Wage cost.* Managers will be expected to be able to forecast and control the hourly wage expense given weekly increases and decreases in expected revenue volumes. This includes maintaining productivity levels as well as acceptable customer service levels. Overtime is also an important wage expense to manage.
3. *Benefit cost.* Managers control this major expense category by controlling hourly wages.
4. *Direct operating expenses.* This cost category can have many line accounts that managers must control. This includes purchasing, verifying and processing invoices, taking physical inventory, processing transfers, and critiquing monthly operating expenses compared to budget. Examples of these accounts are china, glass, silver, linen, cleaning supplies, guest supplies, and paper supplies.

A detailed understanding of controlling all expenses and the ability to adjust them up or down given business levels is an important skill for any hospitality manager. There will always be pressure to maintain productivities and stay within the expense budget. A manager's ability to skillfully control expenses will have a major impact on department profits.

STAR Market Report

Definition

The **STAR Market Report** is published monthly by the Smith Travel Research Company. It provides rate, occupancy, and REVPAR information for a specific hotel and its competitive set. The report covers one year and provides a hotel with information to compare its monthly current operations with its **competitive set** and with its previous year's operations. It provides valuable trend information as well as the opportunity to compare a specific hotel's performance with its competitive set.

The competitive set will only include hotels considered **primary competition**. Other hotels that are considered **secondary competition** are not included in the competitive set. Then hotels are not considered direct competition because they offer different services and often have different room rate structures.

What the STAR Market Report Contains

The STAR Market Report contains confidential information regarding rooms sold, room rates, and REVPAR. This confidential information cannot be shared directly among competitors because of monopoly and price-fixing laws. Smith Travel Research Company collects this information for a minimum of five hotels and converts it into averages. This is called the ***competitive set***, and the averages for the competitive set are compared with the actual results for a specific hotel. This will also include information on the **market share** of the hotel and the competitive set.

Any hotel can purchase this service from Smith Travel. A hotel identifies what hotels it wants included in its competitive set and agrees to provide its own monthly actual rooms sold, occupancy percentage, average room rate, and REVPAR information to Smith Travel to be included in the research company's information database. Smith Travel then *combines and averages* the information for the total competitive set. The report that it sends back to the hotel will contain the specific information for the purchasing hotel and the average information for the competitive set. The hotel can then compare its operating results to the competitive set and its own past performance.

We will look at the format for a twelve-month market share report. The format contains the same three categories that P&L Statements contain: title, horizontal headings, and vertical headings.

Hotel Name
Report Name
Report Date

	Each Month January–December Actual Results	Last 12 Months Average	Last 3 Months Average	YTD
Specific Hotel				
Occupancy Percentage				
Average Room Rate				
REVPAR				
Room Supply Share				
Room Demand Share				
Room Sale Share				
Percent Change from Prior Year				
Occupancy Percentage				
Average Room Rate				
REVPAR				
Room Supply Share				
Room Demand Share				
Room Sale Share				

Market

Occupancy Percentage

Average Room Rate

REVPAR

Percentage Change from Previous Year

Occupancy Percentage

Average Room Rate

REVPAR

This sample format shows the amount of information and the detail of the information that is available for hotel managers to use. Notice that this is only a room revenue report and does not include any food and beverage or banquet sales information. The members of the selling strategy team will review this report and look for trends and comparisons that will assist them in developing better strategies and making better decisions to maximize total room revenue.

There are several other market and financial reports available from Smith Travel Research including the Market Position Report.

The hotel will focus on two primary areas. First, it will compare its results for the current month to those from the previous month and to its quarterly and yearly averages. The hotel will focus on the size and direction of change from its previous results. Second, the hotel will compare its results for the current month to the results of the competitive set. The hotel will identify where its results are better or worse than the competitive set and then will determine if the difference is due to a single-month event or an ongoing trend. If the hotel results are below the competitive set, managers will need to ask what improvements are being made, has any progress been identified, or is the hotel still underperforming the competitive set? If the hotel results are above the competitive set, is the hotel maintaining, increasing, or decreasing its advantage? The hotel will be interested in both comparing its actual results to the competitive set and identifying if improvements are being made that reflect good management of the hotel's room revenues.

How the STAR Market Report Is Used

A great deal of operating information is contained in the monthly STAR Market Reports. There are several different types and formats, which provide specific month-to-month and total-year operating information. These include many trends and provide good comparison information. The hotel management team analyzes this information and compares its operating results to the competitive set's operating results. A hotel that is well run would expect its results to be better than the results for the competitive set.

Summary

The ability to effectively manage and critique revenues and expenses is an essential skill for all hospitality managers. Making or exceeding budgeted profits is equally important for maintaining customer satisfaction in the successful operations of a business. Both are important for maximizing profits. Profits are the most examined financial measurement used both internally by the senior management of a company and externally by investors, bankers, and other financial agencies.

Variation analysis is the process of examining financial results to identify differences or variations from expected results and performance. Identifying where variation occurs and determining the size and cause of variations are important elements of financial analysis. Specific ratios and formulas are used to determine the effectiveness of actual operations to the historical performance of established budgets or forecasts. Ratios can be divided into five types: (1) activity ratios, (2) operating ratios, (3) profitability ratios, (4) liquidity ratios, and (5) solvency ratios.

Variation analysis applies the methods of financial analysis presented in Chapter 2 to the actual performance of a company. These key methods of financial analysis are (1) comparing numbers to give them meaning, (2) measuring and evaluating the change in numbers and financial results, (3) using percentages as a tool for describing financial performance, and (4) utilizing trends to evaluate current financial performance.

Management is also expected to use external information to evaluate financial performance. This includes comparisons to like hotels or restaurants within the company, comparisons to industry averages, and comparisons to competitive sets within the company's market. The STAR Market Report includes several types of revenue management reports that enable a company to compare its performance with the average performance of competitors within its primary market. This is called the competitive set, and it provides a specific hotel with average operating information for a group of competitors in its market.

Hospitality Manager Takeaways

1. **A hospitality manager must develop a solid understanding of department and hotel profits. This includes the ability to manage operations to maximize profits and the ability to identify and critique variations from the budget and forecast.**
2. **An important financial skill is the ability to use ratios and formulas in variation analysis. The manager who can effectively identify, explain, and correct operating results will have a major competitive advantage and will possess an important skill for maximizing profits.**

3. **Understanding external reports is essential for hospitality managers to effectively manage their operations. The STAR Market Report provides valuable information about the operations of a specified hotel competitive set.**

Key Terms

Competitive Set—A group of five or more properties selected by individual hotel management. A competitive set enables hotel managers to compare property performance with external direct competition.

Market Share—Total room supply, room demand, or room revenue as a percentage of some larger group.

Primary Competition—A group of similar hotels that compete for the same customer. Hotels that you lose business to are primary competition.

Ratios—Formulas that define relationships between numbers and are used in financial analysis.

REVPAR—Revenue per available room. Total room revenue divided by total rooms available. It combines room occupancy and room rate information to measure a hotel's ability to maximize total room revenues.

Secondary Competition—A group of hotels that offer competition but provide different rates, services, and amenities and therefore are not considered direct or primary competition.

STAR Market Report—Monthly reports published by Smith Travel Research that provide a hotel with rate, occupancy, and REVPAR information for a specific hotel and its competitive set, including trends and comparisons.

Review Questions

1. Name two important variables for maximizing revenues.
2. Name two important variables for controlling expenses.
3. What is the impact of different department profit percentages on total hotel profits?
4. Define variation analysis, and tell why it is an important tool in financial analysis.
5. Name one important ratio from each of the five ratio classifications, and tell why you think it is important in financial analysis.

6. Discuss the relationship of the four elements that make up the foundation of financial analysis and why they are an important part of variation analysis.
7. What key information is provided in the STAR Market Report?
8. How is it used in the operation of and financial analysis of a hotel?