

FINANCIAL GOALS AND INFORMATION SYSTEMS

I N T R O D U C T I O N

This chapter has two major parts: the first part is about financial goals and the second is about information systems. The section on financial goals discusses mission statements and the objectives and purposes of financial statements. Two financial management goals are then explored: profit maximization and maximization of return on investment, neither of which is a commonly used goal.

Some time is spent on the most commonly used goal, maximization of stockholder wealth. Secondary goals are then discussed, as is management by objectives (MBO). This section of the chapter also includes comments about other goals, such as

social goals, and concludes with developing an action plan to achieve goals.

The second section of the chapter covers information systems. The four levels of an information system are introduced: data production, data sorting, information production, and decision making. Most of this section concentrates on the last two of the four levels, since these are the keys for a company to establish an information system that will allow it to meet its financial goals.

This chapter concludes with comments about the effectiveness of a management information system.

CHAPTER OBJECTIVES

After studying this chapter, the reader should be able to

- 1** Discuss the role of mission statements with reference to financial goals.
 - 2** Discuss the general concept of financial management and list the types of financial and other goals that a company might have.
 - 3** Discuss the pros and cons of wealth maximization as a financial goal.
 - 4** Define MBO, explain how it is used to measure performance, and define the term goal congruence.
 - 5** Discuss social goals.
 - 6** Discuss the role of strategies and tactics with reference to developing an action plan to achieve financial goals.
 - 7** List the four levels in the decision-making process.
 - 8** Explain the ways in which information is obtained in an organization, list the main criteria for information to be useful in the decision-making process, and state how an information system should be judged for quality.
 - 9** Define management by exception.
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FINANCIAL GOALS

Regardless of the type and size of an enterprise in the hospitality industry, financial management will be an ongoing aspect of the overall management of the business. This financial management may be quite unsophisticated in a small, owner-operated establishment and considerably more complex in a large, multiunit organization. Despite the vast range of sizes and types of establishments in the industry, any operation can benefit from an understanding of the value and importance of financial management. Even nonprofit organizations, such as hospitals, must be able to obtain funds and then invest them to maximize benefits; stated another way, they must be able to provide the most benefits at the least possible cost. The concepts of financial management are, therefore, the same for both profit-oriented and nonprofit organizations; the only difference is how the operating or financial results are measured against the objectives.

MISSION STATEMENT

Before developing financial goals, some large hospitality corporations first prepare the organization's mission, or purpose, in a statement. A **mission statement** is sometimes referred to as a statement of business purpose. This statement should be definable and measurable and should consider customer needs. For example, a mission statement for a resort hotel might read as follows:

The Redwood Resort will position itself as the dominant luxury hotel in its area. Its prime weekday market will be corporate meetings and conference groups who will patronize both its guest rooms and food and beverage facilities. The hotel will offer a combination of first-class meeting, guest room, food and beverage, and recreational facilities in a relaxing resort environment. The major sales strategy will be to seek out meeting planners and organizers and use a personal sales approach to obtain their business.

At weekends and during holiday periods, its market will include the upper end of the social scale. To satisfy the entertainment needs of both the corporate and society markets there will be nightly live entertainment.

Its pricing strategy will be to establish high prices that reflect the quality of its facilities and that the market segments selected can afford to pay. Prices will be set to yield an average minimum year-round guest room occupancy of 75 percent and allow overnight guests free use of all the resort's recreational amenities.

In comparison, the following is the mission statement of a major restaurant chain (Domino's Pizza, Inc.):

Exceptional people on a mission to be the best pizza delivery company in the world utilizing the company's guiding principles, which are:

At the moment of choice . . .

1. We demand integrity.
2. Our people come first.
3. We take great care of our customers.
4. We make "Perfect 10" pizzas everyday.
5. We operate with smart hustle and positive energy.

As well as being the focus for developing financial goals, the mission statement establishes a sense of direction for an organization by defining what the organization is, what it does, how it does it, and for whom it is being done. In

other words, a mission statement is a philosophy for doing business. Mission statements for an organization can do any or all of the following:

- Provide a brief statement of its current market position.
- Show which customer groups will be its targets for the marketing plan.
- Provide guidelines for allocation of its resources.
- Indicate where its future growth will occur.
- Give an indication of how its products differ from its competitors' products.
- Focus management's attention on marketing opportunities that conform to its mission.
- Serve as a basis for internal communication.
- Provide a direction to all its employees by alerting them to a common goal.
- Provide a basis for its control and evaluation.

OBJECTIVES OF FINANCIAL MANAGEMENT

Any business, at any particular time, must have funds available to conduct its operations. These funds come from creditors who lend the company money, from owners or stockholders who invest in the company or who own shares in it, and from earnings (profits) retained in the business. These funds may be kept in the business in a very liquid form, such as cash or marketable securities. They can also be tied up in food, beverage, and other inventories or in accounts receivable, or they can be invested in long-term assets, such as land, buildings, and furniture and fixtures.

At any particular point, the balance sheet will give a picture of the business's financial position. At a later date, another balance sheet will probably indicate a different financial position, because the position is never static. Funds are constantly flowing into and out of the business. The mix between the various sources of funds and the various uses of funds is constantly changing. The mix of sources and mix of uses, according to some overall plan, are what financial management is all about.

In large organizations, this plan is usually coordinated by a financial manager, who works closely with the general manager. In a smaller operation, the general manager and financial manager are the same person.

Generally, financial management has three objectives:

1. To establish goals, such as how large the company will be, how rapidly it will expand, and how it will measure its success in meeting these goals.
2. To decide on the sources of needed capital and to obtain the funds required by the firm to meet its goals.

3. To allocate these funds effectively to the various assets of the company, again with the company's goals in mind.

Only with clearly stated goals can an organization effectively manage its finances. Without them, a business operates without a plan. In a small owner-operated enterprise, a goal may be expressed in simple terms, such as that the owner wishes to make enough net income in the first 11 months of the year to take a vacation in the twelfth month. In a large or chain operation, goals would be established in a much more formal way by the board of directors. Goals are frequently expressed in monetary terms. Some of these financially measurable goals are discussed next.

PROFIT MAXIMIZATION

Profit maximization, or making the most amount of money in the shortest possible time, is one of the commonly considered objectives or goals of a company. It is argued that the total amount of profit or net income is not a realistic measure, since one can always sell more shares and invest the proceeds in marketable securities, thus increasing total net income. Because of this, maximization of earnings per share may be a better way to measure net income. In either case, however, the time element is important because of the time value of money. Most people would agree that \$100,000 net income in the first year and nothing in each of the following 9 years is preferable to \$10,000 per year for each of 10 years. The reason is that the entire \$100,000 could be invested in the first year and continues to accumulate interest until the end of the tenth year, thus maximizing net income.

However, one of the problems with profit maximization as a goal is that it may ignore the possible risks of an investment. An international hotel corporation could open new, profitable hotels in countries with politically unstable governments, ignoring the threat of future government expropriation of the investment. Is the immediate potential net income worth the risk?

The profit maximization goal also ignores investment financing risks. A company might become highly levered by borrowing large amounts of debt money at high interest rates in pursuit of some extra net income. Owners of shares, perceiving the risk, might begin selling their shares, thus reducing the market value of the shares. Alternatively, the company might issue new shares to obtain the financing (considerably reducing debt leverage), thereby diluting the value of present stockholders' shares. In other words, profit maximization as an objective might tend to ignore the company's commitment to its stockholders and create a rift between them and the company's management.

Profit can also be maximized by not paying dividends or by making dividend policy a less important goal. This, too, would probably engender a negative reaction from stockholders.

Finally, if management is being measured by profit maximization, it might tend to emphasize very profitable but short-run investments while ignoring long-run, more consistently profitable investments.

Thus, while a business must have profits, profit maximization as a sole goal is generally shortsighted, particularly if the company has many stockholders.

MAXIMIZATION OF RETURN ON INVESTMENT

The maximization of percentage return on investment is a variation of the profit maximization goal. To meet this goal, the company's management attempts to use its funds so that each dollar invested returns the most dollars of net income, or the higher return on investment.

Obviously, no investment would be made if the return were less than the cost of financing. Frequently, a minimum return on investment will be established for the company as a whole, and no individual investment will be made unless it is expected to yield at least this minimum. The return on investment goal, although it has its place, also has many of the disadvantages of the profit maximization goal.

MAXIMIZATION OF STOCKHOLDERS' WEALTH

Generally speaking, most successful larger companies try, over time, to maximize stockholder wealth because this will make stockholders happier than if the wealth were not maximized. One could ask why a company attempts to maximize stockholder wealth and not the wealth of its debt lenders, or the tax department, or employees, or the company's management. The reason is that stockholders are, legally, the owners of the company. All the other groups mentioned must be given their due before the stockholders, as residual claimants, get what is left over.

Maximization of stockholder wealth has as its objective the highest combination of dividend payouts by the company and increase in the market value of the price of the company's shares. With this goal, net income is not as important as earnings per share. The time value of earnings, mentioned earlier, must be a consideration, as must the relative risks of alternative investments and alternative methods of financing those investments. In emphasizing earnings per share, dividend policy and its effect on market price per share must also be considered. Note that maximizing earnings per share may not be the same as maximizing market price per share. The market price shows how well management is doing for stockholders. Dissatisfied stockholders will sell their shares and invest their money elsewhere. If enough of them do this, the market price of the shares will drop.

A company can maximize its earnings per share by never paying dividends, but this would please neither the individual stockholder nor the market for stockholders generally. The market comprises all current and prospective

stockholders who assess the risk of ownership of shares of the company, including potential future earnings, the timing and risk of these earnings, the company's dividend policy, and other factors that are deemed important to establish the price of a share. The individual in the market buys or sells shares according to his or her perception of the firm. The market price is influenced upward by those wishing to buy shares and downward by those selling. It thus serves as a barometer of how well management is doing on behalf of the stockholders.

Management's policies and plans will therefore be established, under the maximization of stockholders' wealth goal, to ensure that wise investments are made, that they are sensibly financed, and that an appropriate dividend policy is established.

One of the disadvantages of this goal is that the market price of the company's shares may be influenced by factors beyond the control of the company's management, such as a general recession. Management could also be so concerned with the goal of maximizing stockholder wealth that it forgets about the business's day-to-day operations, and in the interest of its own short-run survival, management might be unwilling to take reasonable risks, even though the investments would be to the stockholders' advantage. Further, where the company is large and share ownership is separate from control of the company, management might not always operate in the best interest of stockholders, although in the long run this is unlikely to occur. Sometimes managers may attempt to maximize their own wealth at the expense of stockholders, but again, in the long run, if management does not appear to maximize stockholders' wealth, the board can fire it. Note again, however, that the board may be less responsive if stockholders' are widely dispersed, and the absence of effective stockholder representation on the board may decrease the pressure on management to maximize stockholder wealth.

Finally, earnings per share in the hospitality industry might not fully reflect the company's true wealth. In the hospitality industry, a company's value can increase considerably through appreciation of its real estate assets, but it may not be reflected in earnings per share. Nor is it apparent on balance sheets that typically show assets at cost less accumulated depreciation (net book value). For a successful hospitality industry enterprise that has been in business for some years, those cost or net book value figures will not be very meaningful.

SECONDARY GOALS

Even though a favorite goal of many organizations is maximization of stockholder wealth, some consider this goal too broad. For that reason, it is often supported with secondary goals that will help the overall organization reach its objective, something that department heads can relate to. These secondary goals are often translated into such objectives as achieving a certain minimum rooms occupancy or restaurant seat turnover or aiming for a specific minimum level of sales dollars within a budget period. If these secondary goals are achieved, this should ensure that the overall corporate financial goal is also achieved. In

some cases, the secondary goals are not even expressed in monetary terms. For example, a restaurant may only emphasize quality, service, cleanliness, and value for money and achieve its overall financial goal by conforming to those secondary goals.

One problem that secondary goals create is that there may have to be a trade-off between a decision in one department and a decision in another, or a conflict between short-run and long-term earnings. An example is reducing prices to gain a larger share of the market. This may lower short-run profits. Another example is the reduction in housekeeping quality standards, which might improve short-run profits but may cause occupancies to drop over the long run. The general manager's role is to maintain a balance between short-run secondary goals and the long-term financial objectives of the company.

It is important to rank objectives and secondary goals in order of priority and implement only those from the top of the list that are achievable. If too many objectives and secondary objectives are established and all are tackled, both financial and other resources might be spread too thin for any of them to be achieved.

MANAGEMENT BY OBJECTIVES

Achievement of goals in an organization has to be carried out by people. Therefore, an important aspect of secondary goal setting is to have the employees involved in the whole process of setting those goals. This basic concept is known as **management by objectives (MBO)**. MBO is based on the assumption that employees can be committed to their work and allows for maximum involvement and participation in setting secondary goals, personal goals, and performance standards for judging employees' work. The term **goal congruence** is often used in this regard. Goal congruence is the alignment of organizational goals with the personal and group goals of subordinates and superiors.

For example, a hotel might establish as an objective increasing total sales revenue by 10 percent for the coming year. The rooms department manager of that hotel might then set as two of its goals increasing its average room rate by 5 percent and increasing rooms occupancy by 3 percent to help achieve the hotel's overall goal. Goal congruence provides direction so that the activities of each department are working toward achievement of the organization's overall objectives and mission.

There are four important characteristics of MBO:

1. The department head, or department manager, participates in establishing the criteria by which he or she will be judged.
2. The criteria, once established, are known by the person and his or her supervisor before the period begins.
3. Criteria are established in absolute or quantitative terms (i.e., dollars, percentages, or other units), so that results can be measured.

4. Goals should also be expressed relative to desired results to be achieved within a specified time frame.

For example, a restaurant manager might state that her objective is to increase sales by adding a special entrée to the menu each day. This is not an objective because no results have been stated in quantitative terms and no time frame has been established. Instead, the restaurant manager has stated how she is going to achieve something. Stating how something is to be achieved is not an objective. The restaurant manager in this situation would not find it difficult to implement what she says the objective is, but there is no way to measure the results. A more comprehensive objective for this restaurant might be to increase sales by increasing customer average check by \$1 by the end of a 90-day period.

Research has shown that the more objective a performance measure is, the more likely it is that supervisors and those they supervise will work with effort. Accounting systems play a key role in this because they can provide relatively objective performance evaluations. Research further shows that unless those being measured think that their behavior can influence the performance measure, they are unlikely to invest effort to achieve goals.

The measurement criteria, or standards, motivate the individuals to perform according to a clear understanding of expectations. An important aspect of MBO is that the department heads are not judged on a personal basis, but rather, against the mutually agreed upon standards.

If standards are not achieved, the employee is not penalized, but, rather, is assisted by the supervisor in locating problem areas and identifying the cause of the problem. This investigation is then used to assist the department head in future performance or, if necessary, in reestablishing performance standards if the standards are the fault.

OTHER GOALS

The financial goals mentioned to this point, were discussed under the assumption that an individual company will decide on one goal or a combination of goals, clearly spell out the objective(s), and operate toward that objective(s). This is probably true of very large concerns in the hospitality industry, and particularly of those whose shares are publicly traded and for whom the goal of maximizing shareholders' wealth would be most appropriate.

However, many smaller hospitality corporations do not operate with many shareholders. Indeed, they may operate with as few as two. Such companies operate under quite different circumstances. They might find it inappropriate to have as a goal maximization of stockholders' wealth as indicated by market price of the shares, since the shares are not publicly traded. The majority of smaller hospitality industry companies would probably find themselves in this category. They may not even have clearly defined financial goals, and such matters as

maximization of profit or stockholders' wealth are not relevant in their decision making. Internal operating decisions may be made without reference to financial objectives. For example, a hotel sales department might be convinced that accommodating bus tour groups could considerably increase sales. The rooms department manager might think this type of business is too disruptive to normal operations and might cause some regular customers to be denied accommodation when the hotel is full with tour groups. If this hotel had as one of its objectives the maximization of sales revenue (and many companies do establish sales targets as goals), then management would side with the sales department. Management could also decide the issue on a compromise basis, however, agreeing to accept a limited number of tours. This would increase sales revenue and net income, but not necessarily maximize them. It would keep regular customers—and the two departments involved—happy. Management and the stockholders (who in many cases will be one and the same) will still be satisfied with the net income. In fact, this method of operating a business is frequently known as *satisficing*.

Even though companies may not have clear-cut financial goals to rely on for decision making, this should not preclude them from operating toward the other two objectives of financial management: deciding on the sources of funds required by the company and allocating those funds effectively to the various assets of the company to provide a satisfactory net income.

SOCIAL GOALS

Even though the goals discussed so far have been of a financial nature, **social goals** cannot be ignored. Social responsibility embraces such things as protecting the consumer who buys the hotel's or restaurant's goods or services, maintaining equitable hiring practices, and paying fair wages, supporting further education and training of employees, and being concerned about environmental factors.

A resort hotel that owns beachfront property would act in a socially mature way by giving access to the beach to persons other than registered hotel guests. A take-out fast-food restaurant that uses disposable paper or plastic supplies would be socially responsible if it were to hire someone to ensure that the neighboring streets were kept free of litter discarded by customers. Obviously, since they have a cost, many social goals conflict with financial goals. On the other hand, some social goals, even with a cost attached, may improve financial results. For example, in the restaurant situation just cited, the restaurant might find that its business improves considerably as a result of its litter-cleaning decision. More customers might patronize the restaurant because they appreciate its socially responsible action or because they want to visit a restaurant that is in a clean neighborhood. To the extent that the increased net income exceeds the cost of clearing litter, a benefit will accrue.

DEVELOP AN ACTION PLAN

After an organization has developed a suitable mission statement and established financial objectives to conform to that, it must prepare an action plan. An organization's overall mission statement and objectives define what the organization wants to achieve. The *action plan* shows how it is going to get there. Normally, this plan covers all functional areas of an organization, such as managerial, financial, operational, and marketing. It includes matters such as the way the premises are furnished, the theme it wishes to establish, and the types of customers it wishes to attract. At the same time, it requires an understanding of the limitations that any business has. These limitations include the physical size and condition of the property, competition, funding available, economic environment, and many similar factors.

STRATEGIES

An action plan first requires the establishment of strategies to achieve objectives. Objectives and strategies should not be confused. *Objectives* are simply generally fixed statements that, by themselves, cause no changes. *Strategies* are stated plans of action that will cause changes in order to meet objectives. Strategies can also be flexible, whereas objectives are often not, at least in the short run. For example, a restaurant might have as an objective to increase sales by a certain percentage over the next 12 months. Strategies to achieve this might include increasing menu prices, increasing seat turnover, selling more wine with meals, or using any combination of these and other approaches. If the chosen strategy or strategies do not work, then they can be replaced or combined in some other way.

It is also important to ensure that a strategy is not implemented while ignoring other strategic alternatives. For example, it is possible for a strategy to be based on an inappropriate or biased management style that has too narrow a focus. Note also that strategies have a life cycle, just as products and mission statements have. And even where a mission statement may still be appropriate for a particular organization, strategies that were appropriate to that mission statement in early years may no longer be practical for achieving that mission.

TACTICS

Tactics to supplement strategies may need to be developed. Strategies are often long-term (a year or more) in nature, whereas *tactics* (of which there may be several for each strategy) are short-run because they often have to be adjusted to circumstances that are constantly changing. This does not imply that strategies do

not also need to be changed in the short run. Extraordinary, unanticipated events that require both altered strategies and altered tactics may occur.

INFORMATION SYSTEMS

To achieve the objectives established for a company, it is necessary for managers to make decisions constantly. To make rational decisions, they must have information and a system that provides this information.

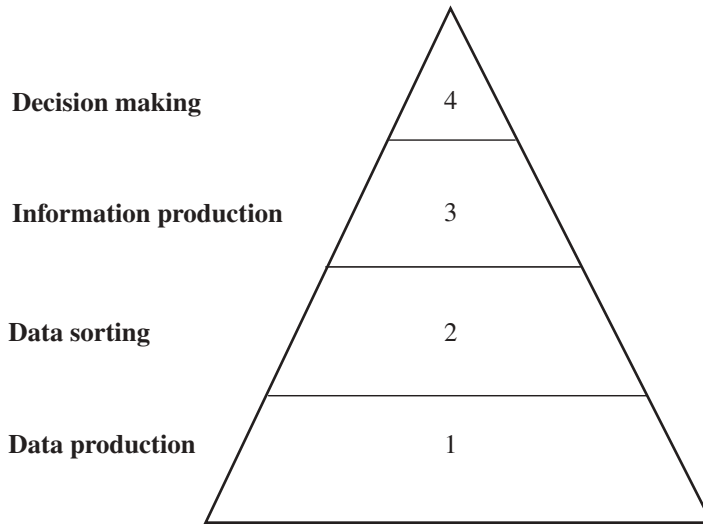
For example, consider a hotel that is contemplating offering its room guests a “free” continental breakfast as a new marketing tactic. This seems like a relatively simple matter. What information is needed? First, the decision maker must have information about the type of guest that is the hotel’s market. Is it the vacationer or the businessperson? Predominantly male or female? If the hotel is an international one, is the nationality of the guest important? Is age relevant? What about average length of stay? Obviously, guest registration cards must be designed to provide these data, and someone must be delegated to sort through these cards to summarize the data into meaningful information.

However, the manager needs further data from suppliers concerning the type of bakery products available, types of packages and their sizes, and information about costs as well as availability of any quantity purchase discounts. Finally, the manager must have information about the added costs of storage and distribution of the food without a kitchen.

For many day-to-day decisions, much of the necessary information already exists in most hospitality enterprises. Some of it is a requirement of the law (for example, the requirement to keep accounting records for income tax filing purposes). Other information exists as a byproduct of carrying out normal business transactions (such as purchasing records and sales invoices). Further information exists as a result of transactions between departments (e.g., requisitions given to the storeroom for needed supplies). But quite a lot of information is available that is not formalized (such as the chef’s knowledge about the best way to tackle each day’s production of food requirements).

FOUR LEVELS OF DECISION MAKING

Four levels can be identified in the decision-making process, and these can be viewed as a pyramid. These four are data production, data sorting, information production, and decision making.



Level 1: Data Production

The base of the pyramid is the production of data. These data are often a byproduct of a regular business activity (cash register tapes, sales checks, guest registration cards). It is important to establish what is to be stored and for how long, and what is to be discarded immediately. For example, are dining room sales checks to be kept for a week, a month, a year, or for five years? While some of these decisions are management's responsibility, the government will have requirements on how long some of these documents must be kept.

Level 2: Data Sorting

The second level of the pyramid is the management of the data where they are sorted, converted, combined, or manipulated into more useful sets of data. In other words, the data need to be classified so specific items can be recalled or retrieved without processing the entire batch. For example, while registration cards can be stored by day and then by month, you may need a system that segregates registration cards for all VIPs so that they can be accessed without having to go through all registration cards for an entire month.

Level 3: Information Production

These converted sets of data in turn provide the information for the third level in the pyramid, the information level. Data are converted into information when they acquire meaning. For example, Exhibit 7.7 in Chapter 7 is a columnar table

of two sets of data, one column showing rooms sold month by month and the second showing wage cost month by month. In Exhibit 7.9, these data have been plotted on a graph and have taken on meaning, since the graph indicates information concerning the fixed wage cost.

Normally, the collection and conversion of data to provide information is a routine process that can often be done by mechanical or computerized means. It is not the manager's job to do this. The manager's task is the interpretation of the information and the actual decision making. Nevertheless, it is the manager's task to be involved in establishing the information-gathering system so it will provide the information that he or she needs to make the kinds of decisions necessary so the company can meet its goals.

As organizations grow, the information system becomes more structured. For example, in a small restaurant, the one and only cook may have the recipes stored in his or her head, but in a large restaurant, recipes need to be formalized so that all cooks follow the same food preparation formulas and procedures. In other words, which system is most desirable really depends on the specific organization of the business and its needs. As the organization changes over time, so will the information system. What is good today might not be of value in five years.

Computerized information systems more readily allow the linking of data from different areas of an operation. For example, a room service department manager could constantly access forecasts of guest room occupancies in order to staff the department more adequately from day to day.

Some sets of data can be compared to provide information (e.g., relating last year's sales to this year's, or this year's sales to a budget). At the very elementary level, such comparisons are not too helpful, since they do not allow for conditions that have changed between last year and this year, or this year and its budget. Also, if, for example, August last year had five Sundays and this year only four, comparisons can be distorted. Comparisons made based on indices or percentages are an improvement over nominal dollars, as is a comparison based on a standard, such as the standard food cost system described in Chapter 5.

Further improvement in information occurs when variances between actual and standard are broken down into differences in quantity, sales volume, and cost or price (see Chapter 9 for a discussion of variance analysis). This breakdown indicates how much of the variance is the fault of poor planning (sales volume variances) and how much is a failure to achieve standards (for example, quantity and cost or price variances in a food cost control system). At this point, the information system has reached the stage of providing a guide to solving problems and making decisions.

What prevents many managers from producing more sophisticated information, and in particular to implementing a computerized system, is that costs of implementing a system are often considered, but no price tag is put on the benefits. In fact, some managers consider that there is, and should be, no cost for information gathering; in other words, there is no cost to compiling a daily

food cost or for producing a manager's daily report. These are simply byproducts of the accounting and/or control system, and to spend money to provide more and better information makes no sense. For many managers the concept that information is not free creates a dilemma that is difficult to resolve.

An information system should be judged by how well it facilitates the achievement of a given goal or set of goals. The main criterion for judging one system against another is costs versus benefits. Systems cost money and benefit an organization by helping decision making. If two systems cost the same, that which provides the most desirable operating decisions is preferable. For example, when choosing between two computerized accounting systems and they both cost approximately the same, this might be the deciding factor.

Level 4: Decision Making

The information that is provided by the system is used to identify and help solve problems that are resolved at the top of the pyramid, or the fourth level (which is the decision-making level). The types of decisions that have to be made dictate the information that needs to be collected; the information indicates the data that are needed, and this, in turn, regulates the data collection system.

Any manager is constantly faced with decisions. These can be routine and simple, often requiring no action, or more complex and important. Most decisions do require the use of information and frequently the use of judgment.

In problem solving, four decision-making steps can be identified:

1. *Define the problem.* Without doing this, information cannot be properly analyzed and alternatives cannot be identified. If the problem is not defined, or is incorrectly defined, time and effort will be wasted.
2. *List alternative solutions.* Creativity is a requirement for this, but that creativity should not be limited to the decision maker's bias or prior experience.
3. *Gather all necessary information about the problem and its alternative solutions.* The information gathered must be relevant, since that increases knowledge, reduces uncertainty, and minimizes the risk of making the wrong decision. It must also be presented in a format that is understood and must be received in good time to affect any decisions made. Note, also, that decision making is often a matter of judgment based on the best information available.

Obviously, the more accurate the information available, the more value it has for planning, control, and decision making. Speed of information and the risk of incomplete information are also factors to be considered. It is sometimes better to have a rough idea of the daily food cost without taking inventory than to have a more accurate food cost 24 hours after taking inventory. On the other hand, in a feasibility study for expanding the business, risk is so high that the extra time involved in preparing an informative study is well spent. In any decision-making situation, the manager, given the constraints of

time and data availability, must have enough important information to consider alternative decisions or solutions. Obviously, however, the more time that is spent on collecting data and information, the greater the cost.

For many decisions, accounting records, forms, and reports are a major source of information. This type of information is verifiable, objective, and quantitative and can provide specific data about an activity, event, or problem. The three most important aspects of accounting information are that it is relevant and appropriate for the problem at hand, that it is current, and that it is accurate within the measurement standards imposed by the needs of the problem.

4. *Make the decision.* Even though the foregoing three steps may be followed, decision making may still be difficult, since important variables of the problem may affect one another.

In some situations, the information can provide its own solution. For example, perpetual inventory cards as an aid to inventory control were described in Chapter 2. These perpetual inventory cards can show, for each storeroom item, the minimum and maximum inventory levels. If the minimum stock level for a specific product is 5, and inventory has dropped to that point, and maximum is 15, then 10 more of that item need to be ordered. However, in such a situation, no attempt is made to relate the purchase to current conditions. What if the consumption for that product is no longer as high as it used to be? Perhaps the maximum inventory of 15 should be reduced to 10 and the reorder point to 2 until conditions change again.

To make such decisions from manual information might be difficult, but computerized inventory systems can be programmed to provide information concerning such matters as rate of consumption of inventory products as well as quantity discounts and inventory holding costs. In a really intelligent computerized system, the idea of fixed reorder points for any items might be completely abandoned, and the computer will consider all the relevant factors item by item and only print a list of items to be ordered and in what quantities.

One type of decision making is known as *management by exception*. With management by exception, small deviations from normal, which do not require any management action, are not drawn to its attention. For example, the standard food cost is established at 40 percent. As long as the food cost variance is only 1 percentage point above or below 40 percent (i.e., from 39 to 41 percent), it is considered acceptable. Only if food cost is below 39 percent or above 41 percent is the change drawn to management's attention.

The question of establishing an item's exception level has to be established on a situation-by-situation basis and company by company. There are no rules, or even guidelines, because of the many variables that differ from business to business.

Although management by exception has the advantage of relieving higher-level management of wasting a lot of time on information when there is no

problem, it can also prevent management from noticing worsening trends (for example, a cost item that is slowly increasing) until that item of information has reached or exceeded its exception level. In other words, if the manager had been made aware of the worsening trend, some corrective action could have been taken before the exception level was reached.

A further refinement in decision making is to examine the assumptions that were made when earlier plans were formulated and then compare not only actual and planned results, but also actual with possible results. Those possible results are opportunity costs. Earlier in this chapter the possibility of a hotel increasing its sales by accommodating bus tour groups was discussed. If bus tour groups are not accommodated, or only a limited number of them are accepted, the revenue from those not accommodated is an opportunity cost, and this opportunity cost (lost sales revenue) could be built into the information system for management comparison with actual results. One difficulty with building opportunity costs into the information/decision-making system is that some bus tour groups who were turned down may have eventually canceled their reservations anyway, even if they had been accepted. But, if effective decisions are to be made, a well-designed information system must be able to respond to some incompleteness of information and possibly suggest where additional data might be collected to make the information more complete. Obviously, at this level of sophistication, information manipulation would be exceedingly complex without the aid of a computerized system.

The way in which an information system is designed and integrated into a hospitality enterprise is a challenge for any manager. The more appropriately it is designed to support decision making, the more effectively will the enterprise be able to compete in the marketplace and achieve its already established financial objectives.

MIS SYSTEM EFFECTIVENESS

A management information system (MIS) must have stated objectives so that its effectiveness can be measured by how it meets those objectives. Management should also be concerned with whether the system is doing everything it could to be effective. There are three ways of determining this.

One way is to review the reports provided by the system to see if any employees using them have made notations or calculations on them. If any of the information had to be recalculated or redrafted in some way to make it meaningful to the user, or if information has had to be added from some other source, this could indicate that the system is not doing everything it could.

A second method is to use test observations to see whether the information system is used for decision making. If information is required for a decision before the formal MIS can provide it or if the formal MIS has to be supported by information from informal sources, then perhaps the MIS is not doing the job it was designed to do. For example, suppose a hotel has a computerized guest

room system that is intended to provide housekeeping and front-office personnel with information about the status of each guest room at any time. If the computer system is so slow that housekeeping and front-office employees pass this information back and forth by telephone, then the formal computer information system is not performing effectively.

The third method is to have those who review system reports list or state which items on a report are relevant and which are irrelevant. If there is consensus that there is a great deal of irrelevant information that is of no use in decision making, then the system is not doing its job. A dramatic test is to temporarily stop producing a report for a while. If there is no protest from those who are supposed to use the report, its permanent discontinuance will simplify but not reduce the effectiveness of the information system. However, removal of a report can have unexpected repercussions. For example, department heads might be receiving the same report as the general manager, even though they make little direct use of it. If the report is discontinued, department heads might feel they have lost status because they are no longer deemed important enough to receive it.

SYSTEM EFFECTIVENESS VERSUS EFFICIENCY

Management must also be aware of the difference between MIS *effectiveness* and *efficiency*. The two terms are not synonymous. With reference to gross profit analysis (see Chapter 6) of menu items, a computerized information system might show that a different set of menu offerings will improve gross profit per guest. However, after the new menu is implemented, total gross profit declines because customers do not like the new menu. The information system was efficient but not effective because it did not consider potential customers' menu preferences.

S U M M A R Y

Before developing financial goals, some large hospitality operations prepare a mission statement. Regardless of the type and size of enterprise in the hospitality industry, financial management will be an ongoing part of the business. Generally, financial management has three objectives:

1. To establish certain goals, such as how large the company will be, how rapidly it will expand, and how it will measure its success in meeting these goals.
2. To decide on the sources of needed capital and to obtain the funds required by the firm to meet its goals.

3. To allocate these funds effectively to the various assets of the company, again with the company's goals in mind.

Profit maximization is one type of goal. This means making the most amount of money in the shortest possible time. Profit maximization emphasizes the short run over the long run and ignores any risks involved.

Maximization of return on investment is a goal that allows no investment that does not yield at least a minimum return on investment. The disadvantages of this goal are similar to those for the profit maximization goal.

The goal most commonly used by business is that of maximization of stockholder wealth. Under this goal, management plans to ensure that wise investments are made, that they are sensibly financed, and that an appropriate dividend policy is established.

Secondary goals are also often established. These could be for individual operations within a chain and/or for individual departments within an operation. With secondary goals, management by objectives (MBO) is a useful managerial technique. With MBO, managers are involved in establishing their own goals and standards against which their performance is subsequently measured. Goal congruence is an alignment of organizational goals with the personal and group goals of subordinates and superiors.

With any form of goal setting, social goals must not be ignored.

An organization's overall mission statement and objectives define what the organization wants to achieve. The action plan, through strategies and tactics, shows how it is going to get there.

To achieve its financial goals, an organization must have a reliable information system that allows the best decisions to be made. Four levels can be identified in an information system: data production, data sorting, information production, and decision making. The larger the organization, the more structured is this information system.

A well-defined information system is also invaluable in problem solving. Four steps can be identified in problem solving: Defining the problem, listing alternative solutions, gathering all necessary relevant information, and making decisions.

Information is a resource that costs money. When comparing different information systems, a cost/benefit analysis is required. An information system should be judged by how well it facilitates the achievement of a given goal or set of goals.

The way an information system is designed and integrated into a hospital-ity enterprise is a challenge for any manager. The more appropriately it is designed to support decision making, the more effectively will the enterprise be able to compete and achieve its already established financial objectives.

Finally, management also needs to be sure (and determine from time to time) that its information system is effective and be aware that there is a difference between efficiency and effectiveness.

DISCUSSION QUESTIONS

1. Explain your understanding of a mission statement and state four purposes that it can serve.
2. Briefly describe your understanding of the meaning of financial management.
3. Explain how you think a small restaurant operation can practice good financial management.
4. What is your understanding of the term satisficing?
5. In what way might a policy to pay no dividends affect a hotel corporation's market price of shares? If the policy were to pay out all net income in dividends, how might this affect the company's future net income? How might this affect the future share price?
6. Explain why wealth maximization, as indicated by market price of shares, may not be achieved by profit maximization.
7. Would the objective of no net income for a certain period (e.g., three years) be consistent with the goal of wealth maximization? Explain.
8. What is a secondary goal? Give an example that might be appropriate for the housekeeping department of a hotel.
9. Define MBO and explain how it is used in an organization. What is goal congruence, and how does it fit in with MBO?
10. Explain why a resort hotel that is the only one in the area would or would not be likely to practice social responsibility. Do you think such a resort hotel might act differently if it were only one of a number of competitive hotels in that area? Explain.
11. Discuss the need for an action plan to achieve goals and differentiate between strategies and tactics.
12. What are the four steps in the decision-making process?
13. Discuss how you think an information system should be judged for quality.
14. What are the main criteria for information so it is useful in the decision-making process?
15. Define management by exception and give an example of a circumstance where it might be used.
16. Briefly discuss two ways in which the effectiveness of a management information system can be determined.

PROBLEMS

P14.1 Some hospitality enterprise entrepreneurs, even with limited education, have been successfully operating their businesses for many years. They have probably never heard of management by objectives (MBO). Their only goal is to work hard and make an adequate profit. In your opinion, and given examples from your own experience and/or observations where this might be helpful, why are they successful? If they are successful, why should they bother using managerial techniques such as MBO?

P14.2 The following paragraph appeared in a chain motel's monthly in-house newsletter announcing the creation of a trophy that will be awarded to the motel with the most outstanding performance each year:

The trophy will be given to the motel with the best combination of sales percentage increase and net income percentage increase. The actual calculation will be to take the sales percentage increase, add the net income percentage increase, and to divide that total by 2, with equal weight given to both sales and net income growth. Only motels achieving a minimum 15% sales increase will be eligible.

What is your evaluation of the way performance is to be measured in this motel chain? Use 2 or 3 examples to demonstrate your opinion.

P14.3 Following are performance objectives for three different organizations:

- a. A restaurant's manager: "To establish a position in the market by providing top-quality menu items created from the freshest locally grown produce."
- b. Year-round recreational resort hotel's marketing manager: "To establish an image for the resort as an exclusive one providing a luxurious atmosphere and environment."
- c. A hotel's nightclub manager: "To considerably increase visits to the nightclub by residents of the area living within driving distance."

Evaluate each of these objectives. Comment about how each of them does, or does not, satisfy the criteria for a good objective. Rewrite each objective in your own words in such a way that it meets the criteria for a well-stated objective.

P14.4 You are the manager of the maintenance department of a hotel. You are paid a basic salary, plus a bonus. The bonus consists of another \$1,000 each time your expenses are under budget, plus 2 percent of the amount you are able to save. For the past six budget periods, the following are the results. Note that *U* stands for unfavorable, or over budget, and *F* for favorable, or under budget.

<i>Period</i>	<i>Budget</i>	<i>Actual</i>	<i>Variance</i>
1	\$80,000	\$82,000	\$2,000 <i>U</i>
2	80,000	79,000	1,000 <i>F</i>
3	78,000	74,000	4,000 <i>F</i>
4	72,000	74,000	2,000 <i>U</i>
5	72,000	73,000	1,000 <i>U</i>
6	72,500	72,000	500 <i>F</i>

- a. Using this information, as a rational person what would you do if you were the department manager running the maintenance department over again from period one? Use a numerical example to prove your point.
- b. If you were the hotel's general manager, what would you recommend be done, if anything, to this hotel's maintenance department's bonus system?

P14.5 A small resort hotel that caters primarily to the family trade set as an objective an increase of 5 percent in its rooms occupancy over the next 12 months. Its strategy for achieving this was to convert some unused ground-floor storage space into a conference room that could seat about 30 people. It then marketed the resort property to businesses and organizations that agreed to hold two- or three-day meetings and use the guest rooms overnight. During the first conference that the hotel booked, the conference organizer complained severely about noise from children using the outdoor swimming pool and recreation facilities immediately outside the window area of the conference room. Furthermore, the conference room delegates found there was no provision to have an evening meal served to them in the meeting room so that they could continue their discussions in private. Conference delegates were obliged to use the resort's regular dining room, where other residents were also seated. When subsequent conference groups arrived, they made the same complaints, and the resort found that negative word-of-mouth publicity had created difficulties for them in booking further conference groups. As a result, they did not achieve the desired increase in occupancy. Discuss the resort's problem with specific reference to the strategy it used to achieve its objective.

P14.6 The concierge's department of a large hotel normally has a head concierge and nine concierges on duty during the day shift for the peak tourist months. During the past peak month, there have been far more than the normal number of guest complaints about the slow service received, creating a problem for the rooms department manager.

The following are descriptions of several situations or events pertaining to the concierge service department. For each separate item, state

in which of the four areas of the problem-solving process the item belongs. The four areas are defining the problem, identifying alternatives, gathering information, and making the decision.

- a. Several guests have complained to the front office manager that they are experiencing a longer than usual wait for service or that they have been receiving poor service.
- b. The bell service department has priorities for jobs. The check-out baggage of guests is handled first. Second is guest check-in baggage. Third is delivery of other items to guest rooms. Fourth is the sale of airport limousine, bus tour, and theater tickets. Fifth is other requests for service.
- c. One guest complained that their theater tickets were for the wrong night.
- d. One guest suggested replacing the head concierge with a better organizer.
- e. One guest complained that a request to have flowers purchased and delivered to another guest's room was never carried out.
- f. The paging system that allows the head concierge to signal to concierges when they are away from the service area has malfunctioned three times in the last month and has taken as long as 24 hours to repair.
- g. One of the desk clerks suggests that the sale of theater and bus tour tickets be handled by a new person who will operate strictly on a commission basis.
- h. The rooms department manager will consider having a commission arrangement for next summer, since it is too late to do anything about it this year.
- i. The head concierge suggests hiring one more concierge.
- j. One concierge has been away sick for the past two weeks.
- k. A sick concierge was replaced by a temporary employee who was not familiar with the hotel and its operating procedures. The replacement's work was marginal.
- l. Guests who complain are advised of the concierge desk's order of priorities.
- m. During the past month, the hotel's occupancy has been 10 percentage points above normal for that month, creating extra demands by guests for service.
- n. The rooms department manager has approved the hiring of one extra temporary concierge for as long as occupancy stays above normal.
- o. A new paging system will be purchased with a maintenance contract guaranteeing instant service.

P14.7 In late January 2006, George Ray, president of Restoration Resort Ltd., is concerned about how he could finance the more than \$200,000 he estimates he needs to convert, improve, and expand the company's resort facilities. The resort has very little cash, and George and his wife have about \$20,000 in savings. The land on which the resort is located has been in the Ray family for 40 years. The 12-unit motel was constructed 25 years ago. The motel is open year-round. Occupancy of rooms in the peak summer months (mid-June to mid-September) is 100 percent, but a lower occupancy during the shoulder and winter months reduces overall annual occupancy to 60 percent. In the winter months, the rooms are rented on a monthly basis.

About 20 years ago, a swimming pool was added along with a change house, snack bar/souvenir shop, and a 20-space trailer park. The trailer park is only open during the summer months (approximately 150 days), and, during that period, spaces are 90 percent occupied.

Although losses occurred in earlier years, the resort is now reasonably profitable. However, the resort has not until now been considered the main business of the Ray family, since both George (who inherited the resort from his parents 10 years ago) and his wife work at other jobs and look at the resort as a part-time business. It has become increasingly apparent to them that, because of the economic times, they will have to make changes to the resort and work at it full time if it is to remain successful.

After considerable thought and discussion, the Rays decided that the following changes would have to be made to bring the resort up to a standard acceptable to today's traveling public:

- a. Add eight fully furnished 400-square foot cabins with a potential of 32 additional overnight guests.
- b. Fill in the pool, which has become badly corroded from minerals in the water. This pool has been fully depreciated.
- c. Construct a new 3,300-square-foot swimming pool.
- d. Renovate and modernize the combined frame change house and snack bar.
- e. Add an extension to the change house that includes shower rooms for trailer park guests and houses the resort's office.
- f. Expand the trailer park area from 20 to 50 stalls and provide electrical and sewer hookup to all stalls.

In addition to the Restoration Resort land, George personally owns land that includes a hill at the back of the property, which has potential for skiing. This piece of land is estimated to be worth about \$50,000 at today's prices. However, George thinks that the investment required to develop it for skiing would not make the project currently feasible, even though it might considerably improve the winter rooms occupancy.

The investment costs for the proposed changes to the property are estimated as follows:

Construction/renovation of buildings	\$128,000
Swimming pool	27,000
Furniture, equipment and fixtures	16,000
Trailer park site improvements	21,000
Contingency	10,000
Total	<u>\$202,000</u>

A balance sheet for the year ending December 31, 2005, follows, as do income statements for the years 2004 and 2005.

Restoration Resort Balance Sheet as of December 31, 2005

Assets

Current Assets

Cash	\$ 8,700	
Inventory	<u>3,000</u>	\$ 11,700

Fixed Assets

Land	\$ 70,200	
Buildings	83,800	
Furniture & equipment	14,600	
Swimming pool	15,400	
Stationwagon	<u>5,600</u>	
	\$189,600	
Accumulated depreciation	(64,200)	125,400
Total Net Assets		<u>\$137,100</u>

Liabilities and Stockholders' Equity

Current Liabilities

Bank loan	\$ 4,300	
Accounts payable	2,100	
Current mortgage	<u>12,800</u>	\$ 19,200

Long-term Liabilities

Mortgage	\$ 24,600	
Loan from shareholder	<u>8,700</u>	33,300

Owner Equity

Capital—shares issued	\$ 40,000	
Retained earnings	<u>44,600</u>	84,600
Total Liabilities & Stockholders' Equity		<u>\$137,100</u>

Restoration Resort income statements:

	Year Ending Dec. 31, 2004		Year Ending Dec. 31, 2005	
Sales Revenue				
Rooms and trailer rentals	\$65,100		\$74,400	
Snack bar/souvenir shop	<u>23,900</u>	\$89,000	<u>26,700</u>	\$101,100
Expenses				
Salaries and wages	\$36,700		\$40,100	
Maintenance and repairs	14,100		16,200	
Supplies and other expenses	9,000		9,900	
Interest	3,200		2,800	
Depreciation	<u>6,900</u>	(69,900)	<u>6,300</u>	(75,300)
Income before tax		\$19,100		\$ 25,800
Income tax		(4,800)		(6,400)
Net Income		<u>\$14,300</u>		<u>\$ 19,400</u>

Restoration Resort retained earnings statement:

	Year Ending Dec. 31, 2004	Year Ending Dec. 31, 2005
Retained earnings beginning of year	\$10,900	\$25,200
Add: net income for year	<u>14,300</u>	<u>19,400</u>
Retained earnings, end of year	<u>\$25,200</u>	<u>\$44,600</u>

Revenue for the year 2006 is estimated to be about 5 percent above year 2005, primarily as a result of a price increase, rather than an increase in occupancy. Expenses are estimated in total to be about 5 percent higher than in 2005.

- Given the balance sheet and income statements, calculate whatever financial ratios (see Chapter 4) you think are appropriate that will indicate the financial health of the Restoration Resort.
- List the information that you would like to have that is not shown on the financial statements, but would make it easier to carry out some financial projections as a preliminary step before going ahead with a complete feasibility study (see Chapter 13) for expansion.



CASE 14

With the possibility of branching out into a second restaurant, Charlie is concerned that he does not have any formal financial objectives, although he does understand that most successful companies do need to have financial, as well as other, objectives. Write a report to Charlie summarizing possible financial objectives that he might wish to consider. Include an explanation of MBO and how it differs from conventional management (where the employee is judged by personal traits such as initiative and integrity) typically used by small businesses. What specific recommendations do you have for Charlie? Support these recommendations with reasons.