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# 4 Comparing and benchmarking performance

## Bases for comparing operating results

The value of producing profit and loss statements is limited if there are no means of comparison to assess the significance of the results. In order to obtain the full benefits of operating information we should take the opportunity to compare current results against some form of predetermined base (yardstick). The main sources of information available for comparison are as follows:

- ◆ Past results
- ◆ Budgeted performance
- ◆ Intra-company results
- ◆ Inter-firm comparison (benchmark reports)

We will briefly consider how each of these potential bases can help in comparing and monitoring the progress of a business.

- ◆ Comparing operating performance with past results give an indication of the changes taken place in an undertaking, for example growth or contraction. Care should be exercised when evaluating changes as previous results may have been abnormally good or poor.
- ◆ Comparing current operating results against budgeted performance can provide an effective basis for controlling revenue and costs. This assumes realistic budgets are set and periodically reviewed and updated.
- ◆ Comparing intra-company operating performance between similar operations within multi-unit organisations can assist in evaluating the relative performance of individual properties. There are issues about size and configuration of business units in order to achieve meaningful comparisons.
- ◆ Comparing or benchmarking operating results on an inter-firm basis using industry norms provides a useful external comparison of operating conditions. Such comparisons rely on operators using uniform accounting systems and the availability of published industry survey (benchmark) reports.

Having considered the four main bases for comparing operating results we can now introduce examples to illustrate and explain how the methods of comparison are carried out.

## Comparing past (or budgeted) results

The method of comparing current results with past results is similar to comparing current results against budgeted results. Either base would provide suitable examples, so we will prepare our comparison with past results to demonstrate the approach.

### Comparative analysis of past results

If we wish to review current operating results against past results of a single business property, such as a hotel, restaurant or visitor attraction, we can compare profit and loss statements by using a simple comparative analysis technique to determine the variances (differences).

Year 2	Year 1	Absolute variance	Relative variance	
£	£	£	%	
<b>Total Revenue</b>	18,270,000	18,000,000	270,000	1.5
<b>Rooms Revenue</b>	12,100,000	11,000,000	1,100,000	10.0
Less: Payroll	1,435,000	1,400,000	35,000	2.5
Other expenses	980,000	895,000	85,000	9.5
Total expenses	2,415,000	2,295,000	120,000	5.2
Dept Profit	9,685,000	8,705,000	980,000	11.3
<b>Food &amp; Beverage Revenue</b>	6,170,000	7,000,000	-830,000	-11.9
Less: Cost of sales	1,848,000	2,100,000	-252,000	-12.0
Payroll	2,562,000	2,800,000	-238,000	-8.5
Other expenses	549,000	610,000	-61,000	-10.0
Total expenses	4,959,000	5,510,000	-551,000	-10.0
Dept Profit	1,211,000	1,490,000	-279,000	-18.7
<b>Gross Operating Income</b>	10,896,000	10,195,000	701,000	6.9
Less UOE	2,625,000	2,500,000	125,000	5.0
<b>Gross Operating Profit</b>	8,271,000	7,695,000	576,000	7.5
Less: Fixed charges	4,678,000	4,690,000	-12,000	-0.3
<b>Net Profit before tax</b>	3,593,000	3,005,000	588,000	19.6

Figure 4.1: London Park Hotel: Comparative profit and loss statements (absolute results basis)

Our example here is of the London Park Hotel, Figure 4.1, a 280-room full-service property, comparing current sterling results (Year 2) with past sterling results (Year 1). Referring to Figure 4.1, the method of comparative analysis is carried out as follows:

- ◆ For example, comparing the London Park Hotel's absolute (sterling) total revenue for Year 1 and Year 2 the variance calculated as follows:

Year 2	Year 1	Absolute variance
£18,270,000	- £18,000,000	= £270,000

The positive absolute (sterling) variance of the hotel's total revenue is obtained by deducting Year 1 total revenue from Year 2. The figure is positive because Year 2 total revenue exceeds Year 1 by £270,000.

**Note:** Deducting past results (Year 1) from current results (Year 2) gives the correct numerical outcome of £270,000 (positive) for the total revenue variance, and *not* -£270,000 (negative) which would be the outcome if the method incorrectly deducted Year 2 from Year 1 results. Why? Because a year-on-year increase in revenue is a positive, *not* a negative outcome!

- ◆ If we want to know a little more about the additional total revenue generated in Year 2 we can add the relative variance which is the absolute variance expressed as a percentage, as follows:

Year 2	Year 1	Absolute variance	Relative variance
£18,270,000	- £18,000,000	= £270,000	1.5%

- ◆ The relative variance is calculated, as follows:

$$\text{Relative variance} = \frac{(\text{Year 2} - \text{Year 1})}{\text{Year 1 (base)}} = \frac{£270,000}{£18,000,000} = 1.5\%$$

**Note:** The relative variance of 1.5% is obtained when the absolute variance £270,000 is expressed as a percentage of the base (yardstick) against which the change is being compared – in this case Year 1 total revenue (past results). The relative variance of 1.5 % tells us more about the result, as follows:

- ◆ Although the £270,000 additional total revenue can be judged a large sum in absolute (sterling) terms, as a percentage increase on Year 1 total revenue of £18,000,000, 1.5% is a modest variance in business terms.
- ◆ In contrast to the change in total revenue of 1.5%, if we compare the smaller absolute decrease of -£61,000 in F&B other expenses, we find this results in a larger relative variance of -10%.
- ◆ As in the case of the London Park examples above, a change in either the absolute or relative variance can prompt a greater or lesser change in the other.

**Note:** Referring to both the absolute and relative variances for assessing sterling changes provides a balanced perspective for the comparison of results and avoids misinterpreting the magnitude of change in either variance.