8 Performance measurement

About this chapter

Tools and techniques for assessing business performance are essential requirements for understanding results, controlling revenues and costs and directing a business for the future. This chapter reviews the range of performance measures typically used and provides guidance on current practice in terms of both financial and nonfinancial performance measures widely used in the hospitality, tourism and leisure industries.

Learning objectives

On completion of this chapter, you should be able to:

- ☐ Understand and apply the range of operational measures used in the hospitality, tourism and leisure industries
- ☐ Understand and apply performance measures for assessing profitability, liquidity, asset usage and share performance
- ☐ Explain the factors to be considered when designing performance measurement systems

Introduction

The measurement of performance is central to control in both profit making and nonprofit making service organisations. It is essential to know **what** has happened, **why** it has happened and **what** can be done now to improve future performance. The details in the monthly management accounts should enable the management team to identify the strengths and weaknesses in the business and develop action plans for implementation to improve revenues, control costs and maximise profitability.

In the hospitality, tourism and leisure industries financial key performance indicators are used alongside non-financial measures to add a valuable additional dimension by providing information which attempts to quantify the competitive positioning of the business. As a result, many operations now try to use a mix of financial and nonfinancial measures, where intangibles such as quality and flexibility can be measured along with more traditional measures such as profitability and return on investment. The structure and size of the organisation clearly has implications for the scale and range of measures which are appropriate, with particular problems arising as organisations increase in size and change in structure.

Standards for performance measurement

There are generally five standards against which performance is normally measured.

- Performance of same unit or department in previous time periods
- Performance of similar units or departments both internal and external to the organisation
- Estimates of expected performance in the form of budgets and forecasts
- Estimates of what might have been achieved, set after the event
- Performance necessary to achieve desired goals.

The problem with setting standard targets for performance is that the process assumes that the environment remains the same throughout the period. In practice, changes in trading conditions may render the process of comparison useless. As a consequence, a system of this type is often perceived by managers as not being fair. Additionally, the process can fail to take into account what is achievable, with standards being set based on best performance rather than the average performance. This coupled, with the multiple natures of the objectives set, can lead to obsessive behaviours on the part of managesr as they attempt to meet all the targets, many of which are in conflict with each other.

To summarise, to develop effective processes for performance measurement it is important to consider the following major issues:

- Organisational objectives can be complex and not easily be summarized with a single measure of performance, such as the return on capital employed.
- Some aspects of performance, such as service levels, are difficult to measure in quantitative terms.
- Many organisational activities are interdependent and require cooperation between divisions, units or departments, and as a result performance measures should be tailored to the requirements of the organisation.
- The evaluation of performance must involve the exercise of judgment.

Financial measures of performance

Single ratio analysis, sometimes referred to as univariate analysis, is based on the calculation of individual ratios using data from the departmental operating accounts and the balance sheet. These ratios may then be used for comparison with previous trends, budget or with other similar operations. Ratios can be divided into those that can be used by any business in any sector and those which have been devised specifically for the hospitality, tourism and leisure sectors.

Ratios by type

Traditionally, financial ratios may be classified into five groups as follows.

- Profitability and operating ratios
- Asset utilisation
- Liquidity (control of cash and other working capital items)
- Capital gearing ratios
- Shareholders investment ratios.

The constituent ratios for each of these groupings are shown in more detail in Table 8.1.

Profitability and operating ratios
Return on net assets
Return on capital employed
Gross profit margin
Departmental operating income
Gross operating profit
Earnings before interest, tax, depreciation and amortisation
Net profit margin
Asset utilisation
Net asset turnover
Stockholding period
Debtor collection period
Creditor payment period
Capital gearing ratios
Debt to equity ratio
Number of times interest earned
Liquidity ratios
Current ratio
Quick assets ratio
Shareholders investment ratios
Return on shareholders funds
Earnings per share
Price/Earnings ratio
Dividend yield
Dividend cover

Table 8.1: Financial ratios for measuring performance by category

Many of these are standard ratios, used throughout many types of industry where benchmarks and guidelines for ratios are commonly cited, however, care should be taken as the magnitude of the ratios can vary considerably from one industry sector to another.

The following section aims to provide some guidance for the calculation and interpretation of these ratios when attempting to analyse company performance. It is worth remembering that ratio analysis is not an exact science and there are often a variety of methodologies quoted for the calculation of one particular ratio.