FINANCIAL RATIOS FOR THE CLUB INDUSTRY

Update: Survey results offer an industry-wide snapshot of 2011 data

By Agnes DeFranco, Ed.D., CHAE and Raymond S. Schmidgall, Ph.D., CPA

The turn of the decade in 2010 was a promising year for the club industry. Hopes were high that the economy would keep straight on the road to recovery, that unemployment would keep on improving, so that club managers could finally come out of the lean times and begin to plan capital improvements, longer terms replacement, renovations and the like. While most clubs are nonprofit in nature, making a "profit" would mean a club can plow back the increase in net assets for the club to expand and/or provide services to its members. Being nonprofit also does not mean the club industry should not be operated like a business. Managers still need to keep a watchful eye on the financial statements to ensure the clubs are being managed professionally.

When there is no increase in net assets, and if needed projects are looming and have been put off for a certain period of time already, the only two major options for club managers may be to defer the projects or to assess its members, and neither is a desirable option. Thus, being proactive and noticing changes in accounts by monitoring the accounts vigilantly against the budget of the club or a set of industry benchmarks is all important. Therefore, it behooves clubs to set a simple dashboard of key financial ratios to assist club managers to evaluate their financial performance in order to make sound operational decisions *(DeFranco and Schmidgall, 2009; Schmidgall and DeFranco, 2005a, 2005b).*

The Club Managers Association of America, the National Club Association, and private firms such as McGladrey & Pullen, LLP and Pannell Kerr Foster (PKF) have all published very useful annual operating statistics *(DeFranco and Schmidgall, 2007).* Their publications all concentrate on operations data and not much on the balance sheet *(Schmidgall and DeFranco, 2005b)*. Balance sheet statistics are important because they provide the extra level of detail about cash flows, ability to pay bills and loans, and management effectiveness. Since 2003, a selected number of financial ratios have been reported. This article is a continuation of this longitudinal study and presents the median of 24 selected financial ratios, and also the ratios of the top 20 percent performers and the low 20 percent performers as ranked by their return on assets (ROA). Nine hundred and sixty members of HFTP who were associated with the club industry were sent the survey and 80 usable responses were returned.

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Respondent Profile

Figure 1.
Titles of Respondents

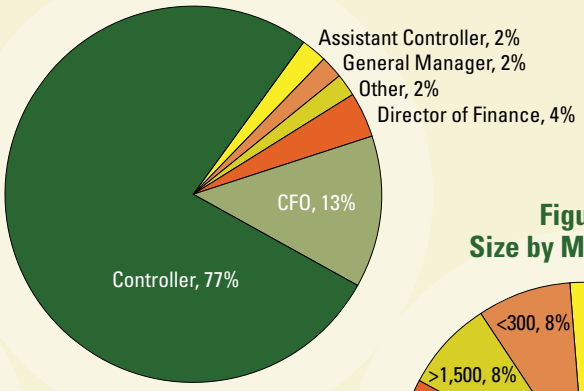


Figure 2.
Types of Clubs

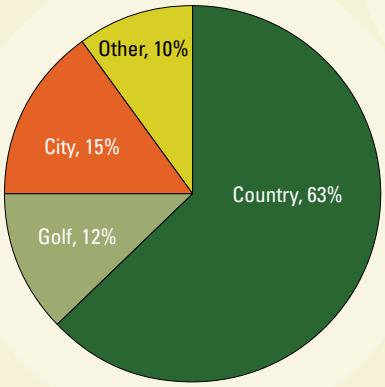
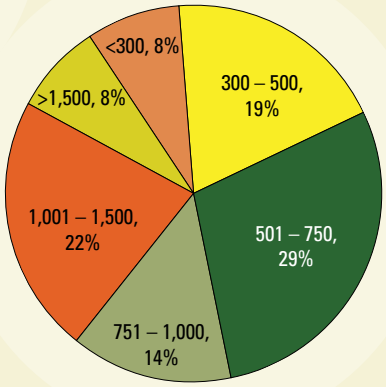


Figure 2.
Size by Membership



Profile of the Clubs in 2011

The demographics of the respondents are quite similar to previous studies. Controllers still is the top contributing group at 77 percent, followed by the chief financial officers at 13 percent, and the directors of finance at 4 percent. Assistant controllers, general managers and others were each at 2 percent, totaling 100 percent (see Figure 1). For the profile of the performing clubs, all contributors for low performing clubs are controllers, and in the top performing clubs, 86 percent are controllers, and the other 14 percent were split evenly between the chief financial officers and the assistant controllers.

Figure 2 indicates that 63 percent of respondents were from country clubs, with the remainder distributed fairly evenly in city clubs (15 percent), golf clubs (12 percent), and others (10 percent). The distribution of the types of clubs in the low and top performing groups is quite similar with the low performers having 61 percent country clubs and 13 percent each in golf, city and others. For the top performers, 62 percent were country clubs and, 19 percent were city clubs, 13 percent golf clubs and 6 percent others.

When the size of the clubs by membership is compiled, the 501–750 member clubs was the largest group, making up 29 percent of this study. The 1,001–1,500 group ranked second at 22 percent, and then the smaller ones of 300–500 members ranked third at 19 percent. On the extreme ends, 8 percent were the very small clubs with less than 300 members and another 8 percent were the very large clubs of over 1,500 members. Figure 3 above summarizes the details. However, the low performing group had most of their respondents in the smaller categories (37 percent with 300–500 members, another 19 percent each in the less than 300 category and the 501–700 category), while the top performing group has a very evenly distributed pattern (21 percent in each of the 501–750, 751–1,000, and 1,001–1,500 member groups, and 15 percent each in the over 1,500 members and less than 300 members).

In terms of location, 54 percent were from the East, 25 percent from the Central region and 21 percent from the West. The geographical distribution of low performers is similar to the entire group with 50 percent West, 31 percent Central and 19 percent West while the top performers also had the highest concentration from the East (67 percent) and the least from the Central region (13 percent) and West at 20 percent. As for the profit orientation of the clubs, one would posit that the top performers might be more in the "for profit" category. However, this is the exact opposite. The respondents as a whole are 85 percent nonprofit, 13 percent for profit and 2 percent others. The low performers had 25 percent for profit and 75 percent nonprofit while there were no for profit clubs in the top performing group at all (94 percent nonprofit, 6 percent other).

Financial Ratio Benchmarks

Twenty-four ratios were used in this study and three numbers are reported for each ratio: the median, the top 20 percent group as ranked by their return on assets and the bottom 20 percent group also ranked by their return on assets. These 24 ratios were divided into five categories: liquidity, solvency, activity, profitability and operating. Table 1 on page 29 offers the summary of all these statistics.

1. LIQUIDITY RATIOS

In general liquidity ratios reflect a club's ability to pay its bills as they come due. Three liquidity ratios are discussed.

Current ratio = current assets / current liabilities. The median current ratio was 2 for 2011. Since a 1 current ratio shows a club has the exact amount of current assets to cover and pay off its current debts, the median club is able to pay off its current debt twice with its current assets. This is good news. The top performers were at 2.10 while the low performers reported at 1.43. Thus, the clubs appeared to be able to manage their short-term obligations well.

Accounts receivable turnover = total revenues / average accounts receivable (times and days). A median of 10.38 times or 35 days was reported for 2011. This means clubs took a few days over a month to collect money owed to them. The top performers showed a 11.33 ratio or 32 days, three days shorter than the median; the low performers extended credit to their members for 39 days at a ratio of 9.45. For clubs that are not profitable to extend credit for almost 40 days is not a good strategy. This low turnover will hurt the clubs' cash position, creditors do not view this positively, and these clubs miss investment opportunities.

Operating cash flows to current liabilities = operating cash flow / average current liabilities. The median club showed a ratio of 0.28, signifying that the clubs earned 28 cents of cash flow from operations to pay off each $1 of current debt. The top performers were at a higher number at 42 cents while the low performers only reported a level of 11 cents.

These three ratios reveal the top performing clubs have a major advantage over the low performers in regards to liquidity.

2. Solvency Ratios

Solvency ratios suggest a clubs' ability to pay their long-term debt as it comes due. Five solvency ratios are presented.

Operating cash flows to long-term debt = operating cash flows / long-term debt. This first solvency ratio also measures operating cash flow and looks at how much cash flow is generated from the operation to pay the long-term obligations. The median of 0.10 means only 10 cents of cash flow is generated from the operations to cover long-term debt. While 0.25 were reported by the top performers, the low performers only reported a 0.05 ratio, meaning they only have 5 cents of operating cash flow to cover each $1 of long-term debt. This appears to be inadequate.

Long term debt to total capitalization = long term liabilities / (total long-term liabilities + total members' equity). This solvency ratio measures a club's long-term debt level to its capitalization. The capitalization of a club includes its long-term debt plus its members' equity. Thus, a smaller number will indicate less debt borne by the club. A 0.25 median translates to mean that for every $1 of total capitalization a club has, 25 cents were financed by long-term debt. The top performing clubs reported a 0.20 ratio meaning only 20 percent of the capitalization was financed by long-term debt, while the low performing clubs had a higher long-term debt ratio at 23 percent. Thus, the difference between the top and low performing clubs is fairly minor.

Debt-equity ratio = total long-term liabilities / total members' equity. This next solvency ratio measures the amount of debt against members' equity. As with the previous ratio, a smaller number is preferred. The median club reported a ratio of 0.32, showing that the club had 32 cents of long-term debt to each $1 of equity. The top performers were better with less debt at 0.25 and the low performers were at 0.30. Both groups were better than the median and the difference between the two groups is not significant.

Times interest earned (TIE) = (increase in net assets + interest expense) / interest expense or = EBIT/interest expense. This ratio measures the number of times a club can cover its interest payment obligation with its earnings before interest and tax. In 2011, a 1.41 ratio was reported for the median club meaning that the club had only $1.41 of earnings before interest and tax to cover every $1 of interest payment obligation. The top performers reported a high TIE of 64.06 times. This is not a surprise as they carried less debt. However, the lower performers had a negative TIE at -3.74. With operating losses, their interest obligations were not covered. Since the two prior ratios suggested the differences in their long-term debt was minor, the major difference is due to the profitability of the two sets of clubs. We speculate that the difference in the interest rates paid by the top performing clubs is probably considerably lower than low performers.

Fixed charge coverage = (increase in net assets + interest expense + rent expense) / (interest expense + rent expense). This next solvency ratio of fixed charge coverage is like the TIE but includes rent expense in the calculation. When rent expense is included, a 1.15 ratio was reported for the median, while the top performers' ratio was at 7.83 times. The low performers still reported a negative number of -0.24. Again in regards to this ratio there is a substantial difference in the two groups of clubs.

The biggest differences in regards to the solvency ratios are in cash flows and income flows rather than the relative amounts of long-term debt.

3. ACTIVITY RATIOS

Activity ratios measure the performance of managers in using the club's resources. Eight ratios are reported in this area with three in inventory turnovers measured in times and day, together with two asset turnover ratios.

Food inventory turnover = cost of food used / average food inventory (times and day). A 17.86 times food inventory turnover was reported as the median in 2011. When 365 days are divided into the 17.86 times, food was held for 20 days in the median club as inventory before it was sold to members. The top performers were only slightly better at 19.54 times or 19 days. The low performers, however, were at 13.74 times or 27 days. The seven days or one week more that the median of 20 days means food remained in the club generally a week longer in the low performers. It is not a good sign as food needs to be fresh and it does not make sense to tie up valuable cash in inventory. Therefore, if a club has a food inventory turnover of more than 20 days, perhaps it needs to review and potentially revise its food management policies.

Beverage inventory turnover = cost of beverage sold / average beverage inventory (times and day). A 3.29 times of beverage turnover was reported in 2011, which also meant beverage inventory stayed in the club for 111 days. This number did not change much over the previous years *(DeFranco and Schmidgall, 2007; DeFranco and Schmidgall, 2009b)*. However, only a 1.43 ratio was reported for the top performers. This means beverages stayed in the club for 255 days which is not expected. Past research has revealed that many clubs carry an extensive inventory of wine which is the major reason for such an overall low turnover. Even the low performers reported a 2.12 times or 172 days, outperforming the top performers.

Golf inventory turnover = cost of golf merchandise sold / average golf merchandise inventory (times and day). Normally, this ratio is lower than the others since golf merchandise is non-perishable. Yet, golf clothing will be out of season in a year or sooner and new and "improved" golf clubs are always coming on the market. Thus, it is good for clubs to turn this inventory over as soon as possible. For 2011, the median was at 1.91 times or 191 days. The top performers reported in at 2.88 (127 days), and even the low performing group beat the median at 2.38 times or 153 days.

Property and equipment turnover = total revenues / average net fixed assets. This ratio shows how club executives manage their fixed assets to generate revenues; thus, a higher ratio means better management. In 2011, the median ratio was 0.68. Therefore, the median club was able to generate 68 cents in revenue for every $1 of net property and equipment. The top performers were able to generate a bit more at 77 cents, and the low performers were only able to generate 63 cents.

Total asset turnover = total revenues / average total assets. Total asset turnover measures how well management uses the club's total assets to generate revenues. Again, as with the previous ratio, the higher the ratio indicates that management is more effective. The median of 0.50 in 2011 means the median club was able to generate 50 cents in revenue for each dollar of assets. The top performers reported a result of 60 cents while the low performers were at 49 cents, just one cent shy of the median club. There are only two ways to make more money: generating more revenues or controlling costs. Thus, if management can improve revenue generation, they can then increase the profitability of the clubs.

Clearly, the top performing clubs have better activity ratios than the low performers. This is to be expected, yet the differences were not as great as we expected.

4. PROFITABILITY RATIOS

Profitability ratios reveal how profitable an organization has been. Three profitability ratios are discussed.

Profit margin = net income / total revenues. The profit margin is the first of the three ratios reported for profitability. The median club in 2011 was able to net half a percentage point in profit (0.5 percent) whereas the top performers were at a high of 12.6 percent. The low performers, however, were not able to maintain a gain, and reported a loss at -8.8 percent. Indeed, 2011 was a tough year for the club industry.

Return on assets = net income / average totals assets. This ratio is a stricter measurement of profitability as total assets is generally much higher than revenues. Indeed, the median return on assets was at 0.2 percent, or only two cents of net income were netted to a dollar of assets. The top performers were at 7.6 percent and the low performers were again at a loss at -4.3 percent. In the activity ratios discussed previously, it was evident that the low performers group was not able to generate revenues from its long-term assets and total assets. The low performers also appeared to have a very difficult time in making a profit.

Operating efficiency ratio = income before fixed charges / total revenues. The last of the three profitability ratios measures income before fixed charges, rather than net income and divide the amount by total revenues. This is a better measurement of management's effectiveness as it only considers income before fixed charges. Fixed charges relate to capacity and financing and include expenses such as interest, property taxes, depreciation and rent. These expenses relate to decisions normally made by the board of directors. Thus, management does not have control in this regard. The median response of 18 percent in 2011 showed management was quite effective. The top performers logged in a high percentage of 32.2 percent, and even the low performers were able to report 16.9 percent. This shows the amount of fixed charges in clubs affect the profitability significantly.

As expected, top performing clubs clearly out performed the low performers in each ratio measurement of profitability.

Comparison of Key Financial Ratios of Top and Lower Performers in 2011

	Low Performers	Median	Top Performers
Liquidity Ratios			
Current Ratio	1.43	2.00	2.10
Accounts Receivable Turnover	9.45	10.38	11.33
Average Collection Period	39 days	35 days	32 days
Operating Cash Flows to Current Liabilities	0.11	0.28	0.42
Solvency Ratios			
Operating Cash Flows to Long-term Debt	0.05	0.10	0.25
Long-term Debt to Total Capitalization	0.23	0.25	0.20
Debt-equity Ratio	0.30	0.32	0.25
Times Interest Earned	-3.74	1.41	64.06
Fixed Charge Coverage	-0.24	1.15	7.83
Activity Ratios			
Food Inventory Turnover			
a. Times	13.74	17.86	19.54
b. Days	27 days	20 days	19 days
Beverage Inventory Turnover			
a. Times	2.12	3.29	1.43
b. Days	172 days	111 days	255 days
Golf Merchandise Inventory Turnover			
a. Times	2.38	1.91	2.88
b. Days	153 days	191 days	127 days
Property & Equipment Turnover	0.63	0.68	0.77
Total Asset Turnover	0.49	0.50	0.60
Profitability Ratios			
Profit Margin	-8.8%	0.5%	12.6%
Return on Assets	-4.3%	0.2%	7.6%
Operating Efficiency	16.90%	18.0%	32.2%
Operating Ratios			
Food Cost Percentage	38.4%	39.1%	33.0%
Beverage Cost Percentage	28.3%	31.8%	29.1%
Golf Merchandise Cost Percentage	60.9%	37.8%	50.2%
Labor Cost Percentage	48.1%	46.6%	41.1%

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