MEASURING FINANCIAL SUSTAINABILITY

Mainstream business practices provide needed perspective for the private club industry

By Teri Finan and Russ Conde

Armies of people study the dynamics of industries across the world. Bankers, investors, competitors, consultants — searching for clarity and insight on the factors that separate market winners from losers. Analysis of industry dynamics in every market is unceasing and those with the best information are poised to win.

Financial models are a central element of understanding both industry dynamics and the performance of an individual business within the market. Such models exist to unearth and convey the key drivers of financial success. Investors, consultants and companies spend significant money developing financial models so they can understand how revenue, costs, margins, overhead, leverage and other financial metrics impact profitability and growth. The quest for fact-based insight is a direct and necessary response to unyielding competition and business challenges. The private club industry can’t escape this reality.

What’s the Big Deal?

Do clubs really need an accepted and benchmarked model for measuring their financial health? For perspective on that question, consider this quick (but common) example: We recently worked with leadership of

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a 100+ year old club experiencing financial duress. For several years, the board had been firmly convinced that two specific issues were the source of their stress:
- “We spend too much on labor.”
- “Making money in food and beverage will make us healthy.”

By applying financial modeling, we were able to identify what was (and was not) driving this club’s challenges. Our analysis contradicted the board’s theories, showing near breakeven food and beverage and typical labor expense overall. It also revealed a large operational deficit and insufficient capital. The data provided insight into both cause and effect. This small club was relying on a relatively weak dues revenue stream to fund the operation. A decision to add 9 holes to the existing 18 produced greater maintenance expense than the club could afford. Additionally, a decision to eliminate the club’s initiation fee triggered both capital starvation and high member turnover.

We developed the Financial Insight Model as a way for the business and financial dynamics of the private club industry to be studied and understood. In this limited space, we’ll introduce just a few of the model’s most critical measures correlated to financial sustainability.

Financial Sustainability
What does “financial sustainability” mean for a club? Think of it this way: If your current operational results and capital generation were continued for the foreseeable future, would the club be able to adequately fund all amenities and member experience, and be able to reinvest back in the club every year to replace depreciating assets and facilities per a documented capital reserve study? As you consider the question, remember to maintain a clear separation of funds: No stealing of capital to patch up operational deficits and no consumption of cash reserves that were not part of a capital plan.

If the goal is to measure and even predict financial sustainability, our model must be comprised of indicators that are:
1. Correlated to operational results and capital generation,
2. Relatively easy to measure,
3. Impacted by choices and decisions made by management and board,
4. Able to be benchmarked.

Financial Insight Model for Clubs
For measures that correlate to operational results, we can refer to any Business Management 101 course or the Yahoo Finance page, with a bit of customization for the club industry. Historically clubs have eschewed measuring themselves like a business, but like any business, clubs have revenue, direct costs of revenue (COGS), resulting gross profit/gross margin, etc. Just as these measures are critical to industries such as automobile manufacturing or software, they are also critical to the club industry. We call our club model the Financial Insight Model (FIM). Please note that while data shown in this article is for clubs with golf, the model applies equally to city, athletic, yacht, etc. clubs with only minor variation.

The core concepts of the Financial Insight Model include:
1. Separation of operating and capital monies and accounting for separate bottom line operating and capital results is a necessity.
2. All clubs raise and spend money on common activities and items regardless of geographic location, size or level of service. This “law of commonality” has been proven by the data collected by Club Benchmarking.
3. Recognizing a set of common departments present in every club leads to identification of direct costs (expenses directly tied to producing revenue), variable costs (expenses directly tied to sales volume), and fixed and independent costs (essentially overhead expenses independent of sales volume or department).

To understand how a club uses its gross profit, we present the information in a pie chart which can be used to answer several key questions: How is our spending divided between overhead and amenities? What is our spending split across amenities? What do these distributions tell us about the club’s culture and priorities?

AUTHOR’S NOTE: The Financial Insight Model does not displace the Uniform System of Financial Reporting for Clubs (USFRC) which is the accounting standard in the club industry. Our model leverages the USFRC. We are presenting a business analysis and financial model, not an accounting standard.
The goal of the FIM is to view clubs as businesses. Visit Yahoo Finance, Google Finance or any financial website and type in any stock ticker symbol (regardless of company or industry) and you will get a very simple, common view of an income statement like that shown in the table below.

This common view, at a glance, reports on the operational health of a particular company or business. Understanding the financial model of clubs requires a similar common view. Each club inventing their own fluid view that changes over time to suit the preferences of the current board defies all business logic and common practice. The premise behind the presentation of a common income statement on financial websites is simple: Identify the revenue, identify and calculate the direct costs of producing the given revenue, identify the fixed expenses necessary to run the business, identify the costs of financing the business (interest) and finally, identify and calculate the money the business drops to the bottom line. In a given industry, companies produce and sell a common product or service in a basically similar manner. As a result, there tends to be convergence of gross margin and operating margin across a given industry. Convergence on a common set of measures and ratios delivers long overdue club industry insight and actionable information that can be used to predict a club’s financial sustainability or lack thereof.

The FIM considers the following specific measures:

**OPERATING LEDGER**
- Operating Revenue
- Gross Profit
- Gross Margin
- Fixed Expenses
- Operating Result
- Operating Margin

**CAPITAL LEDGER**
- Carryover Operating Result (can be + or -)
- Capital Income
- Net Available Capital (net of operating result and lease payments)
- Net Available Capital Ratio (to revenue)

Additionally, the FIM includes two key operational measures:
- Dues Ratio (dues revenue as a percentage of operating revenue)
- Net F&B Ratio (net F&B result as a percentage of gross profit)

While we can’t go into deep analysis in the space we have in this article (the complete FIM document covers 30 pages) we will present two of the key measures, explain why they are important, and identify the values at which the industry converges on those measures.

**Gross Profit – Sources and Uses**
Gross profit, a critical measure in any business, indicates the ability and level to which fixed expenses can be funded. As expected, our data clearly shows that clubs with lower gross margins are much more likely to have an operating deficit and clubs with higher gross margins are much more likely to have an operating surplus. Knowing your own club’s gross profit and its sources is fundamental to understanding the private club financial model.

### Example of a Standard Income Statement

<table>
<thead>
<tr>
<th>Applies to ALL Businesses</th>
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**Revenue**

<table>
<thead>
<tr>
<th>Sales</th>
</tr>
</thead>
</table>

**Cost of Goods Sold** Includes cost of goods sold and all labor directly related to producing the given product and/or service.

**Gross Profit**

**Operating Expenses**

<table>
<thead>
<tr>
<th>R&amp;D</th>
</tr>
</thead>
<tbody>
<tr>
<td>These are fixed, “overhead” expenses.</td>
</tr>
</tbody>
</table>

| Selling, General Administrative |
| Other Expenses |
| Total Operating Expenses |

**Operating Income or Loss**

**Non-operating Expenses**

<table>
<thead>
<tr>
<th>Interest Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
</tr>
</tbody>
</table>

**Net Income**

Source: Yahoo Finance

### Gross Profit Sources

**Average Club**

- **Membership Dues,** 76%
- **Golf Operations,** 13%
- **Sports & Rec,** 5%
- **Rooms Net,** 3%
- **Other Net,** 3%
- **Yacht Net,** 1%
Three important considerations come to light in the chart on page 24:
• 76 percent of gross profit at the average club emanates from dues,
• The average club shows an absence of gross profit from F&B. This is because the average club loses money in F&B,
• 89 percent of the gross profit emanates from only two line items

With these results in mind, one sees that gross margin is affected by two main items, dues and golf operations. Clubs with low gross margins most often have weak dues revenue as the source of the issue. Note that clubs with unusually high proportions of revenue from food and beverage can also exhibit low gross margins despite generating typical amounts of dues revenue.

The table at right shows the relationship between gross margin and operating result. The correlations between dues as a driver of gross margin, and gross margin as a driver of operating result are both intuitive and evident. Higher dues ratio drives higher gross margin which in turn drives higher operating result. Note that F&B revenue has the opposite correlation. This is also intuitive as we know F&B is a low/no margin revenue stream and therefore pulls down the club’s overall gross margin. Balance is the key.

Regarding the uses of gross profit, the FIM presents fixed operating expenses in six common club departments:
• General & Administrative
• Buildings Maintenance & Operation
• Fixed Charges
• Sports, Recreation and Youth
• Course Maintenance
• Golf Operations Labor

Analysis of a club’s fixed operating expenses is a crucial component of the FIM. The pie chart at right presents a graphical map of fixed expenses for the industry viewed as an aggregate.
The table below illustrates the commonality of how clubs proportionately allocate gross profit within the industry.

In looking at this table, you’ll notice some slight variations. No industry is completely uniform. The message of this table is the remarkable consistency among the proportion of fixed expenses, particularly in an industry where many clubs cling to the belief that they are “not like other clubs.” Recognizing the natural relationships between fixed expenses and departments within a club, one starts to have a deeper understanding of the financial model of a private club. Opportunities to impact the budget process, board education and strategic focus are broad and significant.

### Proportionate Share of Department Fixed Expense by Geography and Size

<table>
<thead>
<tr>
<th>Department Share of Club’s Overall Fixed Expense</th>
<th>Services and Amenities</th>
</tr>
</thead>
<tbody>
<tr>
<td>G&amp;A</td>
<td>Building Maintenance &amp; Operation</td>
</tr>
<tr>
<td>United States</td>
<td>21%</td>
</tr>
<tr>
<td>By Region</td>
<td></td>
</tr>
<tr>
<td>Northeast</td>
<td>21%</td>
</tr>
<tr>
<td>Southeast</td>
<td>22%</td>
</tr>
<tr>
<td>Midwest</td>
<td>23%</td>
</tr>
<tr>
<td>Southwest</td>
<td>20%</td>
</tr>
<tr>
<td>West</td>
<td>20%</td>
</tr>
</tbody>
</table>

| By Size                                        |      |      |      |       |      |      |      |       |
| < $4.25 Million                                | 21%  | 15%  | 10%  | 46%   | 38%  | 5%   | 11%  | 54%   |
| $4.25 to $6.5 Million                          | 21%  | 17%  | 10%  | 48%   | 35%  | 6%   | 11%  | 52%   |
| $6.5 to $9.5 Million                           | 21%  | 19%  | 10%  | 50%   | 31%  | 9%   | 10%  | 50%   |
| > $9.5 Million                                 | 20%  | 21%  | 9%   | 50%   | 27%  | 13%  | 10%  | 50%   |

| Hole Count                                     |      |      |      |       |      |      |      |       |
| 18 Hole Clubs                                  | 22%  | 18%  | 9%   | 49%   | 29%  | 11%  | 11%  | 51%   |
| 36 – 108 Hole Clubs                            | 20%  | 20%  | 8%   | 48%   | 31%  | 11%  | 10%  | 52%   |

*Per USFRC – Real Estate Tax, Property & Liability Insurance, Interest on Debt