Introduction

There are three key areas hospitality managers need to understand to ensure the profitability of the business: forecasting, pricing and revenue management. This guide provides both managers and students of hospitality with an overview of these important areas and explains some of the methods used in each to improve control over the business’s finances, to plan for and reduce costs and to achieve increased revenue.

Forecasting

Every business needs to plan ahead, otherwise there may be too many or too few resources – whether staff, food or rooms to sell – which results in wastage, affects guest service and costs the business money. In hospitality, ‘forecasting’ generally means short-term planning, ‘budgeting’ is for a formal, detailed plan for the next financial year and ‘strategic planning’ is for the longer term.

If an accommodation business doesn’t forecast how many rooms it will sell on a Saturday night, then it won’t be able to:

- sell the empty rooms (thereby losing revenue);
- buy the correct amount of supplies, such as eggs or bread;
- schedule the right number of staff on Sunday morning to clean rooms and serve breakfast.

The same is true of any hospitality or tourism business. If a theme park’s management doesn’t forecast accurately, keeping food outlets and attractions open could result in overstaffing and wastage with a loss of money as a result.

What’s the Process?

For a hotel restaurant, the forecasting process for breakfast would involve reviewing the:

Rooms occupied → People staying → Number eating breakfast → Staffing → Croissant order → and so on.

So when we forecast we look at:

- The number of bookings already made and the number of bookings we expect to get – and then take into account any seasonal variances.
- What actions we need to take to maximise occupancy & rate (whether for rooms, seats, conference space or golf rounds) such as offering discounts or marketing special offers.
- Staffing (the ratio of fixed headcount and part-time employees scheduled including the use of employee holiday time) and purchasing (particularly of perishable products).
- Cash flow.

Forecasting is done on a daily (perhaps by meal period), weekly or monthly basis, particularly where business volumes are very changeable. If demand is stable and constant (in residential care, for instance) then you still need to predict likes and dislikes for ordering and production.
Who Does the Forecast?

If you are a manager of a unit or department then you are the best person to estimate on a short-term basis. You may need information from other areas, but you should be able to estimate realistically what the volumes are going to be. By adjusting volumes you can review the impact on profits of, for example, a 20% rise or fall in volume - the total variable costs will change, but not the fixed costs. What if the costs rise by 5% or rates are discounted by 10%? Forecasting helps you see what might happen then you can identify the causes and take appropriate action.

The best sources for forecasting in small businesses are those that are practical. There are also some complex forecasting methods covered in accounting textbooks, which can be important for revenue management.

Pricing

Managers need to understand how to price a product in order to attract customers and to achieve a profit (or at least cover all the costs). There are two different approaches to pricing: the ‘accountant’s method’ and the ‘marketer’s method’. For optimum results in your business you should try to fit both methods together.

The Accountant’s Method

These are usually called ‘cost-plus’ as you add the identifiable product costs to a margin, or ‘mark-up’ that covers all other costs and profit to arrive at the selling price (excluding VAT).

The gross profit method is most commonly used for food and beverage products, but is very simplistic in its approach. It uses only the cost of the raw materials and the margin that is added covers all other costs (variable and fixed) and the profit required.

<table>
<thead>
<tr>
<th>Cost base</th>
<th>Mark-up or margin</th>
<th>= Selling price*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Materials (cost of sales)</td>
<td>All other costs</td>
<td>Profit</td>
</tr>
</tbody>
</table>

*add VAT to reach the ‘menu price’ or ‘price charged to the customer’

A more accurate method is to use all of the variable costs. This is called the contribution pricing method (‘contribution’ is selling price less variable costs). The margin covers the fixed costs and the profit required.

The problem with both these methods is that they assume that the costs don’t change, but they do, so the gross profit or contribution achieved is only an average and not totally accurate.

The Marketer’s Method

The ‘accountant’s methods’ don’t take into account any market conditions. The price may generate a profit, but will the customer pay it?

Market-based pricing recognises that the customer decides the price, depending on the availability of the product, the local economy, competition and so on. Most of the time the pricing is fairly realistic and does cover the costs, but this may not always be the case. Your restaurant might offer a heavily discounted main course, but then customers will pay a high price for drinks. Providing you cover your variable costs then any contribution is worthwhile – it's called loss leadership.

In general, if there is less competition in the market then the price will be higher. Market-based pricing depends on the season, the location and the product. It is also used where there is no immediate obvious competitor - perhaps simply to attract customers. Five-star and first-class services are not price sensitive as these customers are unlikely to object to minor price rises. However, high-street fast food chains are very price sensitive because customers react instantly and may change to another provider if the price is increased more than they consider reasonable.
Discounting

Discounting means offering a lower price for a short period of time: the price is not reduced permanently. This means that the price can go back to normal at the end of the promotion period without customers getting upset.

The accounting side of pricing would say that you must always charge a price to cover variable costs, so you can’t discount below the cost price. In this case, you may want to change your method of service or portion size to ensure that costs are reduced too. Marketing people say that as long as sales in other areas will compensate, you can go as low as you wish, but by how much can you really discount?

- If your business has high variable costs (if your selling price is £10 and your variable costs £6) then you can discount by £4 and still cover all variable costs.
- If your business has low variable costs (if your selling price is £10 and your variable costs £4) then you can discount by £6.

To learn more about pricing, check accounting books for cost-based methods and, for market-based approaches, review marketing titles and resources.

Managing Revenues

Maximising revenues in a hospitality business is as important as minimising costs to achieve profits. There are two key approaches in the industry for maximising revenue: revenue management (which involves managing prices and availability to match demand) and revenue control (which is about ensuring that everything that is consumed is actually paid for).

Some hospitality businesses are very simple, but others are much more complex with a single purchase having several different elements – for instance, a weekend break may include accommodation, meals and a golf round. Hospitality businesses may also have distinct peaks and troughs due to the season, different days of the week and different market segments using the facilities. For example, some restaurants offer a prix fixe menu at lunchtime to attract office workers but in the evening change to an à la carte menu to attract a different type of customer who will stay longer and spend more money. Hotels often serve different markets during the week (business travellers) than at weekends and subsequently apply different pricing strategies.

Identifying Areas for Action

As a manager or supervisor you can’t see everything, however much you ‘walk the job’. To help identify areas that are not showing a profit, you can use ratios. An example of a ratio is calculating the variance (or difference) between the actual result (what you achieved) compared to the budget (what you planned) for, say, Lunch Food. This shows whether the business did better or worse than planned. Then you can identify what went well, or badly, and take action to remedy the problem and improve future revenue in that department.

Performance of revenue areas is measured by:

- **Variance analysis** – where the variances between actual and budget are examined and causes of the variance are identified (i.e. more or fewer customers, different purchases)
- **Daily, weekly and monthly sales**
- **Occupancy** - the percentage usage of the space available (i.e. rooms, seats, conference space, parking slots)
- **Yield** - how well the room occupancy and rate (or other space, such as restaurant seats) combined perform against optimum levels (the maximum rate and occupancy)
- **Average spend** per customer, by market segment, meal time, etc.
- **Sales mix** – the ratio of one type of sales to another - for instance the proportion of food to beverage sales
- **RevPAR** – Revenue per Available room and GOPPAR (GOP per Available room)
- **Profitability percentages** - the profit gained expressed as a percentage of sales whether in total or by department
Improving Controls

For effective food and beverage (F&B) control, management attitudes and policies are critical. If, for example, employees are allowed to give away food or drink for free, then sales - and profits - will suffer. Electronic Point of Sale (EPOS) systems can limit this problem if they are pre-programmed with menu items and prices and can order and track items from the kitchen to ensure that nothing is served without receipt of payment. EPOS can also show stock usage compared to the stock held.

For functions and events, managers should agree detailed function event orders with clients in advance. Rooms controls ensure that all rates are correct and payment is received for all rooms sold. Housekeeping reports should be checked against rooms reports to ensure that all rooms occupied have been paid for by guests or used for staff.

Optimising Sales

Use ratios, such as percentages and average spends, to locate sales opportunities and then:

- **Diversify products** - sell more to your existing customers
- **Increase rates, up-sell to a higher grade, diversify spends** (persuade them to buy extra items)
- **Offer discounts** - to stimulate demand in a quiet period
- **Diversify markets** - find new customers

Revenue management (RM) has expanded from its initial use for airline ticketing to all areas where capacity can be managed including conference space, car hire, holiday lettings and even golf and beauty sessions. RM is a very technical topic, but the basic concept is to persuade people to stay at, or use the facility, during the times when it is quieter, or to pay more - and perhaps stay longer at higher rates - when the facility is busier. Revenue management is a dynamic and rapidly changing discipline therefore up-to-date books and current industry articles will provide the best information and guidance.

To obtain in-depth information and to see how to calculate the ratios that would suit your own hospitality business, please refer to the books listed in Further Resources below.
How to Forecast Cash

From where and when does the business’s cash come and where does it go? The following chart gives examples of incoming and outgoing cash.

<table>
<thead>
<tr>
<th>Cash Comes In</th>
<th>Daily</th>
<th>Monthly</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash, cheques, credit cards (MasterCard or Visa, for example). debit cards</td>
<td>Interest from banks &amp; building societies, other investment income, rents and so on</td>
</tr>
<tr>
<td>Cash Goes Out</td>
<td>Monthly</td>
<td>Quarterly</td>
</tr>
<tr>
<td></td>
<td>Payroll, cheques or BACS to suppliers, payroll taxes, business rates</td>
<td>Value Added Tax</td>
</tr>
<tr>
<td></td>
<td>Anually</td>
<td>Maintenance contracts</td>
</tr>
</tbody>
</table>

Each month there are days of high cash outgoings so, to avoid bank overdrafts, try to plan when people pay the business and when the business must pay its bills.

How to Calculate Cash

(Receipts - Payments = Surplus or Deficit for the month)
+ or - Opening Cash Balance = Closing Cash Balance

What can you do to improve cash flow in the business?

- How quickly do people pay you? Can you increase the use of debit and credit cards?
- Can you take more advance deposits for future bookings?
- Do you really have so many fixed costs or could some be converted to semi-variable?
- What about your stock levels? Money tied up in stock could be in the bank. Would it be better to buy smaller quantities (even if more expensive) to improve cash flow and minimise wastage?
- Talk to the bank manager about favourable terms for an overdraft.

The Institute of Hospitality provides members with free access to a number of ebooks on all aspects of budgeting, finance and revenue management in its Online Catalogue and e-Resources Collection, both of which are located on the Institute’s website under ‘Information Services’.

Further Resources


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