

# Key Performance Indicators



## A guide to help you understand the key financial drivers in your business

Running any business effectively requires good decision making which is based on good and timely management information. All businesses need to monitor profitability and cash-flow carefully and they use management accounts for this purpose. But to boost profitability and cash-flow, you also need to understand the key 'drivers' of your business. A driver is something which has a major impact on business performance.

Key Performance Indicators (KPIs) or ratios are based on the key drivers of your business and they reflect the performance and the progress of your business. KPIs give a mathematical expression to a relationship between two figures.

It is good practice within the hotel industry especially, and the hospitality and tourism industry generally, to use a series of standard Key Performance Indicators to monitor and to benchmark performance.

# Key Performance Indicators

The following table outlines the primary KPIs in use in the industry:

<b>Accommodation</b>	<b>Food</b>	<b>Beverage</b>
Average Room Rate;	Cost of Sales Ratio;	Cost of Sales Ratio;
Bedroom Occupancy Rate;	Gross Profit Ratio;	Gross Profit Ratio;
Revenue per Available Room;	Average Spend per customer;	Average Spend per customer;
Cost per Occupied Room;	Labour Cost Ratio.	Labour Cost Ratio.
Labour Cost Ratio.		

<b>Profitability</b>	<b>Liquidity</b>
Operating Profit Ratio;	Current Ratio;
Net Profit Ratio.	Average payment period.
	Average collection period.



# Key performance indicators

## 1. Accommodation

### Average room rate

Although room rates may vary depending on market segment, many lodging property managers calculate an average room rate ("ARR"). The average room rate reveals the average rate charged per paid room occupied and is calculated by dividing rooms revenue by the number of paid rooms occupied, as follows:

$$\text{Average Room Rate ("ARR")} = \text{€} \frac{\text{rooms revenue (net of VAT)}}{\text{number of rooms sold}}$$

### Bedroom occupancy rate

This operating ratio compares the number of rooms sold to the number of rooms available. Managers rely on this ratio in determining whether, or not, the premises are being utilised efficiently and whether expansion is possible. Bedroom occupancy rate is calculated by dividing the number of rooms sold by the number of rooms available, as follows:

$$\text{Bedroom occupancy rate} = \% \frac{\text{number of rooms sold}}{\text{number of rooms available}} \times 100$$

### Revenue per available room

This operating ratio compares rooms revenue to the number of rooms available. Revenue per available room ("REVPAR") is calculated as follows:

$$\text{Revenue per available room} = \text{€} \frac{\text{rooms revenue (net of VAT)}}{\text{number of rooms available}}$$

or ARR x rooms occupancy rate

### Cost per occupied room

This operating ratio compares the cost of the rooms department to the number of rooms sold. Managers rely on this ratio to determine whether, or not, room costs are reasonable. Occupied room cost is calculated by dividing the cost of the rooms department by the number of rooms sold, as follows:

$$\text{Cost per occupied room} = \text{€} \frac{\text{total rooms department cost}}{\text{number of rooms sold}}$$

## 2. Food and Beverage

### Food cost of sales ratio

This operating ratio compares the cost of food sales to food revenue. Food service managers rely on this ratio to determine whether, or not, food costs are reasonable. The Food cost percentage is calculated by dividing the cost of food sales by food revenue, as follows:

$$\text{Food cost of sales ratio} = \% \frac{\text{cost of food sales} \times 100}{\text{food revenue (net of VAT)}}$$

### Beverage cost of sales

This operating ratio compares the cost of beverage sales to beverage revenue. Beverage service managers rely on this ratio to determine whether, or not, beverage costs are reasonable. The Beverage cost percentage is calculated by dividing the cost of beverage sales by beverage revenue, as follows:

$$\text{Beverage cost of sales} = \% \frac{\text{cost of beverage sales} \times 100}{\text{beverage revenue (net of VAT)}}$$

### Food average spend

This operating ratio identifies the amount of the average food spend per cover and is calculated by dividing total food revenue by the number of covers. Covers refers to guests served in the food operation during the period. The average food spend can be calculated as follows:

$$\text{Food average spend} = \text{€} \frac{\text{food revenue (net of VAT)}}{\text{number of covers}}$$

### Beverage average spend

This operating ratio identifies the amount of the average beverage spend per cover and is calculated by dividing total beverage revenue by the number of covers. Covers refers to guests served in the beverage operation during the period. The average beverage spend can be calculated as follows:

$$\text{Beverage average spend} = \text{€} \frac{\text{beverage revenue (net of VAT)}}{\text{number of covers}}$$

### 3. Labour costs

The largest expense for most lodging properties is labour. Labour expense includes total payroll and related expenses for all departments and operational areas of the property.

#### Food and beverage labour cost

The food and beverage labour cost percentage is calculated by dividing food & beverage payroll and related expenses by total food and beverage revenue, as follows:

$$\text{Food and beverage labour cost} = \% \frac{\text{food and bev payroll \& related exps}}{\text{total food and beverage revenue}} \times 100$$

#### Rooms labour cost

The rooms labour cost percentage is calculated by dividing room payroll and related expenses by total room revenue, as follows:

$$\text{Rooms labour cost} = \% \frac{\text{rooms payroll \& related exps}}{\text{room revenue (net of VAT)}} \times 100$$

#### Total labour cost

The total labour cost percentage is calculated by dividing total payroll and related expenses by total revenue. This general labour cost percentage is simply a benchmark for making broad comparisons. For control purposes, labour cost percentages should be calculated and analysed for each department and operational area of the property. The total labour cost percentage can be calculated as follows:

$$\text{Total labour cost} = \% \frac{\text{total payroll costs \& related exps}}{\text{total revenue}} \times 100$$

## 4. Profitability ratios

*Ratios (based on extracts from the profit and loss account and balance sheet)*

### Gross Operating Profit margin ratio

This ratio measures management's overall ability to realise profits by generating sales and controlling the expenses for which it has direct responsibility (all departmental and undistributed expenses). This is a key industry benchmark. The profit margin ratio can be calculated as follows:

$$\text{Profit margin ratio} = \% \frac{\text{gross operating profit}}{\text{total revenue}} \times 100$$

### Net Profit ratio

This ratio measures the profitability of the business after the deduction of tax. Typically, the profit corresponds to the Gross Operating Profit less any fixed expenses of the business over which management have no, or limited, control (e.g. loan interest, depreciation, rent, insurance and tax). The ratio can be calculated as follows:

$$\text{Net Profit ratio} = \% \frac{\text{profit after tax}}{\text{total revenue}} \times 100$$

### Activity ratios

These ratios measure the number of times stock turns over during the period (the number of times that total stock needs replaced). Generally, the greater the number of times that stock is 'turned over' the better since stocks can be expensive to maintain. Stock turnovers are usually calculated separately for food and beverage items.

### Food stock turnover ratio

To calculate food stock turnover it is necessary to determine the average stock. This is accomplished by adding inventory at the beginning and end of a period and then dividing that figure by two. The food stock turnover can be calculated as follows:

$$\text{Food stock turnover ratio} = \frac{\text{food cost of sales}}{\text{average food stock-holding}}$$

### Beverage stock turnover

To calculate beverage stock turnover it is necessary to determine the average stock. This is accomplished by adding inventory at the beginning and end of a period and then dividing that figure by two. The beverage stock turnover can be calculated as follows:

$$\text{Beverage stock turnover ratio} = \frac{\text{beverage cost of sales}}{\text{average beverage stock holding}}$$

## 5. Liquidity ratios

### Current ratio

The most common liquidity ratio is the current ratio, which is the ratio of total current assets to total current liabilities. It reveals the amount of current assets for every Euro of current liabilities. It reflects the ability of the business to manage its working capital and its day to day operations (ideally the ratio should be between 150% and 200%). The current ratio can be calculated as follows:

$$\text{Current ratio} = \frac{\text{current assets}}{\text{current liabilities}} \times 100\%$$

### Acid-test ratio

The acid-test ratio measures a property's liquidity by considering "quick assets" – current assets minus stocks and prepaid expenses. This is often a more stringent measure of a property's liquidity because it may take several months for many properties to convert their stocks to cash. It reflects the ability of the business to pay its debts by comparing cash, or near cash, assets with short-term liabilities (ideally the ratio should be 100% or above). The acid-test ratio can be calculated as follows:

$$\text{Acid test ratio} = \frac{\text{current assets} - \text{stock}}{\text{current liabilities}} \times 100\%$$

Trade debtors can be the largest current asset of lodging properties because credit is often extended to clients. Therefore, any examination of a property's liquidity must consider how quickly trade debtors are converted to cash.

### Average Collection Period

This ratio reveals the average number of days taken by the company to collect trade debts, or the average number of days' credit allowed to debtors by the company. The average collection period is calculated by dividing the trade debtors by the sales in the year. The result is multiplied by 365 days. The Average collection period can be calculated as follows:

$$\text{Average collection period (or 'Debtor's Days')} = \frac{\text{trade debtors}}{\text{sales (inc VAT)}} \times 365$$

## 6. Solvency ratios

### Interest cover ratio

This ratio expresses the number of times interest charges can be covered from profits. The greater the number of times interest is earned, the greater the safety afforded creditors and lenders. The interest cover ratio can be calculated as follows:

$$\text{Interest cover ratio} = (\text{x times}) \quad \frac{\text{profit before interest and tax}}{\text{interest charges}}$$







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