The Private Club Advisor™
A Letter to the Directors, Officers, Owners and Managers of Private Clubs

September 2011

Important Follow-Up: Profitability and Payroll

Our August issue included an item on a joint research project conducted by Ray Schmidgall of Michigan State University and Agnes DeFranco of the University of Houston. A number of readers contacted us to ask how the researchers had defined the terms "payroll costs" and "total revenue" for the purpose of this study. We reached out to Dr. Schmidgall for clarification and he explained that "payroll costs include salaries and wages, payroll taxes, and employee benefits. Total revenue includes all revenue according to the uniform system of financial reporting for clubs. This includes dues, initiation fees, food, beverage, etc."

The item also attracted the attention of club industry consultant Damon DeVito, managing director of Affinity Management, a professional club management firm frequently called upon to help turn around struggling clubs. DeVito believes the research supports the idea that clubs should be focusing less on cost cutting and more on revenue growth.

"The Schmidgall/DeFranco study results pointing to substantially higher labor costs as a percentage of revenue in struggling clubs versus healthy clubs (51.7% vs. 39.1%) is an interesting data point and should be the basis for club turnaround planning, " DeVito said. "We understand that cost cutting in tough economic times is common and necessary - but only to a point. Beyond that point, we have found it to be counterproductive and inconsistent with the core economic drivers of the club industry." DeVito said cost savings can be a bridge over troubled waters, but warned that clubs cannot save their way to prosperity.

"As written, the study comments suggest that the higher labor load is due to choices the struggling clubs are making to maintain unnecessary services." DeVito asserts that clubs are fixed overhead businesses. Maintaining a golf course at a certain quality level costs virtually the same regardless of the amount of use - within reason. "The restaurant should not be staffed for peak season every day, but closing on unprofitable nights can lead to member attrition that negates saving and triggers a multi-year death spiral, "he said.

"On the positive side, once a club passes the break-even threshold, it is common to see 70% of incremental revenue (excluding a la carte F&B) contribute to debt reduction and capital projects. This continues until about 25% EBITDA (earnings before interest, taxes, depreciation and amortization) in most cases."

DeVito said the opportunity for clubs - actually the necessity as he sees it - is revenue growth in the right areas. “Taking an 80/20 rule approach helps focus turnaround efforts. Typically only three revenue metrics drive incremental contribution in a golf club: membership, banquets and golf outings.” He explained that all other revenue lines either derive from these three or are relatively immaterial from a contribution perspective despite their critical value in keeping members happy. For example, he offered, a la carte food and beverage gets an overwhelming amount of attention in struggling clubs, but incremental gains in those areas can never produce a meaningful contribution.

“Alarmingly, the clubs with the greatest need for revenue growth rarely have anyone dedicating 100% of their time to growing the membership banquet or outing business. They often have no real marketing plan and are simply cutting fees and prices in a way that damages their brand, irritates members and sabotages future revenue.” DeVito acknowledges that quality growth in these areas may not be easy at the moment, but he believes it is achievable with focus, planning and experience.