ASSESSMENT OF BUSINESS PERFORMANCE TOWARDS FINANCIAL RATIO ANALYSIS IN THE HOSPITALITY MANAGEMENT AND TOURISM OPERATIONS

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Abstract
It has been observed that managers in the hospitality and tourism industry assess the performance of their business based on operational activities rather than scientific analysis of financial figures. The implication of such approach is shallow understanding of the strengths and weaknesses of the enterprise which could easily culminate into naïve as against pragmatic decisions. This paper examines the types of financial ratios and their relevance for objective assessment of business operations and decision making for sustainability in the face of competition. It is recommended that tourism services providers should employ ratio analysis as tools for measuring trends and relationships in trade.

Keywords: *Financial ratios, Business performance, Sustainability, Tourism industry*

Introduction
Often times, the managers in the hospitality and tourism industry assess the performance of their organizations based on volume of trade or the number of customers they record within a certain period. How many customers and guests ate in the restaurant? How many guests lodged in the rooms or how many rooms were occupied? How many tourists were received? How many units or covers were ordered? Some other times, they look at the financial statements prepared at the end of a trading period to judge the contribution by various departments. Are there more profits this year than last year? Is the profit from housekeeping

greater than that from Food and Beverage departments? Hence, they emphasize triviality over pragmatism thereby undermining true indicators of business success. One objective way of assessing the performance of a business is to subject operating statements and financial reports to critical analysis. Economic decisions are better made with the aid of analytical tools that are able to provide insight into the present status and future potentials of the business. Financial ratios are very useful tools for assessing business performance and determining direction and the chances of success or otherwise.

Financial ratios are guides that are useful in evaluating the financial position and the operations of a company from scientific facts. It helps in comparison of changes in static data from previous years to current year and with the comparison of other companies as well. Ratios are actually regarded as the real test of earning capacity, financial soundness and operating efficiency of business concern (Bragg 2012).

Financial Ratio Analysis is the calculation and comparison of main indicators – statistics, which are derived from the information given in a company's financial statements, including income statement and balance sheet. It involves methods of calculating and interpreting financial ratios in order to assess a firm's performance and status. Financial analysis is primarily designed to meet informational needs of investors, creditors and management through comparative measurement of financial data to facilitate wise investment, credit and managerial decisions (Brealey, Meyers and Allen 2013). Depending on the manager's information needs, this analysis may be based on a year- to- year comparisons, common size analysis or cross-sectional (inter-firm) comparisons where industrial averages and benchmarks play vital roles.

Types of Financial Ratios

The most common and attractive categories of financial ratios proposed in literature which are useful to the hospitality and tourism industry include the profitability ratios, activity or efficiency ratios, liquidity ratios and investment ratios(Brigham & Ehrhardt 2013, Higgins 2012, Adejoh & Dauda 2015) .

The profitability ratios are calculated to determine the financial performance for a given period, showing how well capital is utilized to yield returns and sales are made at profits. They provide indications of how profitable a firm has been

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over a period of time. Profit is the ultimate objective of a company and a company will have no future if it fails to make sufficient profit. These ratios include gross profit ratio (gross profit to sales), operating profit ratio (net profit to sales) and return on capital employed or return on equity (PBIT or Net income to capital)

The efficiency ratios are activity- based ratios which measure the operating performance of the business, usually over a short term period of time (Higgins 2012). They describe how well the firm is using its investment in assets to produce sales. These ratios include

- Inventory Turnover Ratio (Cost of sales/ Average stock) – i.e. no. of times.
- Account Receivable Turnover Ratio (total revenue / average debtors)). Average debtors = debtors at beginning + debtors at end / 2. – no of times
- Average Collection Period (Debtors / credit sales x 365days) – no of days
- Fixed Asset Turnover Ratio (Sales / Fixed assets) – i.e. no of times
- Total Asset Turnover Ratio (Sales / capital employed or Av. Total assets) – no of times
- Paid Room Occupancy (Paid rooms occupied / Available Rooms X 100). It measures the management's success in selling its rooms. It is a measure of facilities utilization.
- Seat Occupancy or Turnover (No of Guests Served / No of Seats Available X 100).It is calculated by meal session. The higher the ratio the higher the facilities utilization

The liquidity ratios describe the ability of a firm to meets its current obligations, i.e. the ability to pay short term bills as they fall due (Adejoh and Dauda 2015). Among them are Current Ratio (Current asset : current liability), Quick Ratio (Current asset less stock : current liability) and Cash Ratio (Cash + Cash equivalent : Current liability)

The investment ratios describe the potentials of a company to attract financing (Lee, Lee & Lee 2009). The ability of a business to survive depends on its capability to attract additional equity capital when required. This capacity is measured in the relationships between the earnings available for ordinary shareholders and the other attributes of the ordinary shares. These ratios include

(a) Earnings per share (EPS): This is of considerable importance in estimating the value of a share. It is arrived at as Net income / Number of ordinary shares

(b) Price/Earnings (P/E) Ratio: This is the comparison of the market price of an ordinary share with the earnings per share; calculated as: Market Price per Share / Earnings Per Share. All things being equal, this ratio indicates the number of years within which the investors' capital outlay will, at the present level of earnings, be recouped either in the form of dividend received or capital growth or by virtue of retained earnings.

(c) Earnings Yield: This is the reciprocal of the price earnings ratio which compares the Earning per Share with Market Price per Share. It gives the capitalization rate, which is the rate at which the stock market is apparently capitalizing the value of the current earnings.

(d) Dividend per Share: This is that part of earnings per share which is received by the shareholders as dividend. It is computed as: Ordinary share dividend divided by the Number of ordinary shares

(e) Dividend Yield: This, also known as the yield ratio, is based on dividend declared during the year in respect of any type of share. It is calculated as: Annual Dividend Per Share / Market Price Per Share. The dividend yield indicates how the capital employed is being efficiently utilized in comparison with the past years or with alternative investments or returns from other companies in the same industry.

(f) Dividend Cover: Indicating the relationship between earnings and dividend per share, dividend cover shows how many times dividend per share is covered by earnings per share. A higher dividend cover indicates that only a small portion of the earnings has been distributed as dividends while a substantial portion has been ploughed back into the business. A lower dividend cover will indicate the reverse situation. It is calculated as: Earnings Per Share divided by Dividend Per Share

Shim & Siegel (2008) describe investment ratios as the tripod stand on which the fate of a firm hangs. Constant review of these ratios will help managers and their organizations stay alert and keep secure in the market.

Ratio Analysis as Indicator of Business Performance

Ratios are useful guides for evaluating the financial performance and position of a tourism enterprise from scientific points of view .For the purpose of accounting and financial management, as observed by Adejoh and Dauda (2015), ratios are regarded as the real test of earning capacity, financial soundness and operating efficiency of business concern.

The importance of ratio analysis to hospitality and tourism operations can be appreciated in the following dimensions:

- **Clear Understanding of Accounting Figures**: Simply preparing income statement and balance sheet is not adequate to understand the direction of an operation. Ratios help to reduce figures to simple statistical indices that point to the direction and state of affairs (Shim & Siegel 2007, Shim,, Siegel & Shim 2011). Considering the fact that most operators of hospitality and tourism outfits are not accountants, ratio analysis simplifies the accounting figures in much easier way by which anyone can easily understand.
- **Determination of Operational Efficiency:** Ratios are useful tools in the hands of management for evaluating the firm's performance over a period of time by comparing the present ratios with the past ratios. Such ratios as stock turn over, account receivable turn over and other activity ratios are very useful for measuring the operational efficiency of the firm by investors, suppliers and financers (Temnent 2008, Subramanyam & Wild 2013).
- **Measure of Profitability:** Both the management and owners of a firm are primarily concerned with the overall profitability of the business. Profit and loss account merely reveals the profit earned or loss incurred during a period, but does not convey the capacity of the firm to earn in terms of sales, investment or assets. Such profitability ratios as net profit ratio, return on capital employed, return on investment and return on fixed assets are the best measures of earning capacity and profitability (Wahlen., Baginski & Bradshaw 2010). Most lodging companies that failed were mistakenly measuring their successes on raw figures of profits obtained from financial statements.

- **Measure of Liquidity Position:** Profit figures and bank balance do not convey adequate information about the liquidity of a business. Liquidity position of a firm is said to be the capacity of the firm to meet its current maturing obligations, spanning over a period of one year (Adejoh and Dauda 2015). A firm's liquidity position is said to be satisfactory only, if it has sufficient liquid funds to pay its short- term obligations. Liquidity is measured by the amount of cash and cash equivalents available to the business. The business creditors are particularly interested in the liquidity position of the business.
- **Evaluation of Long-term Solvency:** Ratio analysis is equally important in evaluating the long- term solvency of the firm. The firm's capital structure actually provides the basis for this analysis. The capital gearing or leverage ratios are helpful to long-term creditors, security analysts and present and prospective investors, as they reveal the financial soundness or weakness of the firm (Axson 2010). For instance, a ratio of debt to equity capital of 2:1 is considered too high to give interest parties the confidence of long term survival and chances of dividends.
- **Trend Analysis:** One reasonable way of assessing a firm's performance as asserted by Albrecht., Stice, Stice & Swain (2010) is to compare results over successive periods. Ratios allow for trend analysis. It is possible for trend analysis of ratios to reveal whether financial position of an enterprise is improving or deteriorating over years because it enables the firm to take the time dimension into account.
- **Inter-firm and Intra-firm comparisons:** Ratio analysis makes it possible for various companies in the hospitality and tourism industry to compare their operational efficiency with one another, even as it is possible for a firm to assess its efficiency at various divisions of the firm (Walker 2009). Absolute figures are not suitable for this purpose, but accounting ratios are the best tools. Hence, ratio analysis is the best measure of comparison among operators or owners which is capable of provoking healthy competition.

Points to Consider when Using Ratios

The application of ratios is subject to some limiting factors of which managers must take note (Stringer & Shantapriyan, 2011, Weil, Schipper & Francis 2012, Zimmerman 2010).

One ratio is not adequate for economic decision; it must be used in combination with other ratios. Since ratios are based on past or historic data, they do not reflect the future perspectives of a firm. The ability of the manager to use ratios as predictive indices for the future depends on the relative stability of the business environment.

Also, managers must watch out for any likelihood of window dressing in accounting figures that may distort the relevance of interpretation of ratios.

Inflation and other seasonal factors may distort comparisons and lead to inappropriate conclusions. Therefore, the analyst must make provision for this variation when ratios are used for financial analysis.

It must also be borne in mind that different accounting and operating practices can distort comparisons. Companies that share common characteristics are capable of being compared when using ratios. Therefore, it will be a misplacement to compare a small sole trade with limited liability company in terms of revenue and cost statistics.

Conclusion

The role of financial ratio analysis in assessing business performance in the tourism industry cannot be overemphasized. If appropriately applied, ratios can be used as a tool to assist financial analysis. They help to focus attention systematically on important areas and summarize information in an understandable manner and assist in identifying trends and relationships. Rational interpretation of ratios leads to objective forecasting and control which can help strengthen the business.

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